

# Private Client Services



## New legislation to change taxation of trusts

### At a glance

- ▶ Welcome certainty on streaming capital gains and franked dividends
- ▶ Significant new complexity and adverse outcomes for some
- ▶ Terms of the trust deed and trustee resolutions critical
- ▶ Not all issues fixed
- ▶ How Ernst & Young can help you

A new tax law amendment Bill, introduced to Parliament on 2 June 2011, will affect who pays tax on the income of many trusts.

The new rules will impact all trusts that have capital gains or franked dividend income or that make distributions to tax exempt entities. The rules apply for the current year ending 30 June 2011 and subsequent years. Managed investment trusts (MITs) can elect in to the rules, especially if they stream income among different beneficiaries.

The Bill provides a new method for allocating tax liabilities among the beneficiaries/trustee(s) of these trusts. This method provides some welcome certainty for trustees seeking to 'stream' capital gains/franked dividends between beneficiaries to achieve tax effective outcomes.

However, the rules add significant new complexity which will mean increased compliance costs and adverse outcomes in some circumstances.

The rules will need action by many trustees before 30 June.

### Who will be most affected?

All trusts that have capital gains/franked dividends or that distribute to tax exempt entities will be impacted to some extent (other than MITs which do not stream income). Particular issues will arise, for example, where a trustee:

- ▶ is seeking to 'stream' franked dividends and/or capital gains to specific beneficiaries
- ▶ wishes to retain concessional CGT amounts in the trust
- ▶ holds a leveraged Australian share portfolio
- ▶ has revalued capital assets at any time in the past and made distributions to beneficiaries in respect to that revaluation
- ▶ distributes to a religious organisation or charity and the amount paid is less than that entity's share of the trust's taxable income

## Terms of trust deeds/trustee resolutions are critical

The Bill reinforces the importance of the terms of each trust's deed, and also of the resolutions of the trustee regarding the distribution of income, on the tax outcomes. For example:

- ▶ The new legislation will not give trustees the power to stream capital gains and franked dividends to specific beneficiaries - these powers must be contained in the deed
- ▶ The new method of allocating tax liabilities for capital gains and franked dividends requires a determination of which beneficiaries are 'specifically entitled' to those amounts - the terms of the trustee resolutions and deed will be critical to this determination

Some trustees may need to consider trust deed amendments before 30 June 2011 to enable tax effective outcomes.

## Does this Bill clarify all outstanding issues?

Unfortunately the Bill only addresses some of the areas of uncertainty that exist in respect of the taxation of trust income. Examples of remaining uncertainties include:

- ▶ Whether different components of trust income, other than capital gains and franked dividends, can be 'streamed' to specific beneficiaries - there has been no further announcement by the Government on this
- ▶ Whether 'notional tax amounts' can be included in the 'distributable income' of the trust - in some circumstances this issue is critical in determining who pays tax on the trust income

These issues are expected to be addressed in the Government's future rewrite of all the trust tax rules following the review by the Board of Taxation (there is no date set for this at present).

## Action required and how we can help

These tax changes, together with other recent developments related to the taxation of trusts, mean that the year-end trustee resolution process is more important than ever to achieving tax effective outcomes. This process requires trustees to understand the tax profile of potential beneficiaries, the distribution powers contained in the deed, the level of trust income and taxable income and to carefully draft resolutions in this regard before 30 June. As mentioned, in some cases trustees might need to consider trust deed amendments.

Please contact your Ernst & Young tax advisor or our Private Client Services team for assistance with this process or for advice on how these new tax changes will impact your trust.

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