TaxFlash

PKF Chartered Accountants & Business Advisers

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Trusts – must do items for 2012

Recent tax law changes, court cases and Tax Office rulings have dramatically affected the tax treatment of trusts and beneficiaries. Below are some of the important issues many trustees, beneficiaries and their advisers should consider for the year ending 30 June 2012.

TRUST DISTRIBUTIONS AND RESOLUTIONS

Trust distributions must be recorded by the end of the tax year. This year, the Tax Office is looking closely to ensure the trustee income distribution determinations and resolutions for discretionary trusts are correctly made and recorded by the required times.

Trustee determinations by 30 June 2012

Most trust deeds for discretionary trusts require trustees to make their income distribution determinations on or before 30 June, sometimes 28 June or 29 June. Some trust deeds have an automatic distribution to a default beneficiary if the trustee does not make a determination of the income distribution by 30 June.

Even if the trust deed does not specify a final date for the trustee determination or does not have a default beneficiary, there are a number of court cases that indicate the trustee must make the distribution determination before 30 June.

Withdrawal of tax ruling

In previous years the Tax Office has not strictly applied these requirements and, until recently, there was a Tax Office ruling that allowed trustees until 31 August to make their income distribution determination. However, following recent court cases that held this practice was not effective, the Tax Office has withdrawn this ruling.

Tax Office reviews of trustee determinations

The Tax Office has issued statements that it expects trustees to make determinations in accordance with their trust deeds and trust law this year. This includes making definitive determinations by the date required by the trust deed, which in most cases is by 30 June 2012. .

The Tax Office has also announced it intends to review a number of trusts to determine whether the distribution determination has been correctly made by the trustee. The Tax Office will also be looking for evidence of when that determination had been made. This is required to ensure the trustee (or default beneficiary, if there is one) is not taxed on the taxable income of the trust.

Written evidence by 30 June 2012

We suggest written evidence of the trustee's determination of income of the trust for the year ending 30 June 2012 be prepared by 30 June 2012. This can be either by a formal trustee resolution, or at least a note signed and dated by the trustee, or if it is a trustee company, by its director/s.

The resolution or note must include the names of the beneficiaries and the amount or proportion of the income each is to receive.

In most cases, the trustees will not know (at 30 June) the exact income of the trust for the year. In these cases, we suggest the distribution resolution or note show the distributions to each beneficiary as:

- a percentage or fraction of the trust income; or
- exact amounts for certain beneficiaries with the balance going to a balance beneficiary; or
- up to a certain amount to certain beneficiaries, and any balance to a balance beneficiary.

Distributions of franked dividends and capital gains

Where there are franked dividends or capital gains that the trustee wishes to distribute to specific beneficiaries, the resolution or note also needs to identify the beneficiaries and the amount or proportion of the franked dividend or capital gain they are specifically entitled to in accordance with the new trust streaming requirements, as discussed below.

TRUST STREAMING

Under the new trust streaming provisions, trustees are permitted to stream franked dividends and capital gains to specific beneficiaries, rather than distributing amounts as part of the general distribution to beneficiaries. This allows certain beneficiaries to have the benefit of franking credits and/or capital gain concessions to the exclusion of other beneficiaries.

Review trust deed

To be able to stream franked dividends and/or capital gains, the trust deed must not prevent these amounts being streamed to specific beneficiaries. The trust deed should be reviewed to ensure there are no such restrictions.

Trust accounts and records

The trust accounts must also be prepared to separately show the streaming of the capital gains and/or franked dividends. The amounts of the specific entitlement for each beneficiary to the franked dividends and/or capital gains must be recorded in the accounts or records of the trust.

The beneficiaries' specific entitlement to franked dividends must be recorded by 30 June 2012. The trustee's distribution resolution in favour of the specifically entitled beneficiary would generally be sufficient for this purpose.

The specific entitlement to capital gains must be recorded by 31 August 2012. However, some trust deeds include capital gains as part of the income of the trust. In these cases the recording of the specific entitlement to the capital gains would generally have to be at the same date as the trustee's determination of the income distribution, which would generally be by 30 June 2012.

Capital distributions

Where the capital gains are only partially taxed (e.g. Capital Gains Tax (CGT) discount and/or small business CGT concessions) the beneficiaries must be specifically entitled to all the capital gain to ensure the full CGT concessional treatment is passed on to the beneficiaries.

For example, if the trust has a capital gain of $1,000 that is eligible for the 50% CGT discount so that only $500 is assessable, the beneficiaries have to be made specifically entitled to the full $1,000 capital gain to ensure they receive the benefit of the full 50% discount.

In some cases, it may be necessary for the trustee to make a separate capital distribution to beneficiaries. This will be where the whole or part of the capital gain is not included in the income of the trust.

For example, where the trust deed only includes the taxable portion of the capital gain in the income of the trust, the trustee may have to make a separate capital distribution of the non-taxable portion of the capital gain. In these cases, the recording of the specific entitlement to the capital distribution can be made by 31 August 2012.

UNPAID TRUST DISTRIBUTIONS

Trust distributions to private companies after 16 December 2009 that remain as Unpaid Present Entitlements (UPE) at the due date for lodgement of the trust's tax return for the income year for the trust distribution, may be deemed to be a loan from the company to the trust and deemed to be a dividend under Division 7A.

Action to avoid deemed dividend

To avoid the UPE being treated as a deemed dividend, the trustee must do one of the following:

- place the UPE in a sub-trust for the exclusive benefit of the company by the lodgement day for the trust's tax return for the income year for the trust distribution; or
- turn the UPE into a Division 7A complying loan by the lodgement day for the private company's tax return for the next income year after the trust distribution; or
- pay the UPE to the private company by the lodgement day for the private company's tax return for the next income year after the trust distribution.

Sub trust options

The Tax Office has indicated three acceptable investment methods for the sub trust as follows.

1. Loan the UPE funds to the main trust for a maximum term of seven years with interest payable on the loan at least equal to the Division 7A benchmark rate of return (7.8% for the 2012 income year).
2. Loan the UPE funds to the main trust for a maximum term of 10 years with interest payable on the loan at least equal to the Reserve Bank's indicator lending rate for small business variable overdraft (10.65% for the 2012 income year).

3. Invest the funds in a specific income producing asset or investment that provides arm's length rate of return on the investment e.g. a depreciating asset that is leased to the trust or a third party at an arm's length lease fee.

Sub trust accounts and tax return?

If options one or two are used, the sub trust does not generally need separate accounts or tax return as long as:

- the sub trust's loan is separately identified in the main trust's accounts;
- the interest on the loan is recorded in a journal entry at the end of the income year; and
- that interest is included in the private company's income tax return for the income year.

If option three is used the sub trust would need separate accounts and tax return.

Binding investment agreement

Under all three options the sub trust investment needs to be subject to a binding agreement but this does not have to be a formal agreement and can be evidenced by tax return working papers.

Interest or investment return must be paid

Also, under all three options the Tax Office requires the interest/return on investment be paid to the private company by the lodgement day of the main trust's tax return for the income year in which the interest/return on the investment was derived.

However, for option one or two, the Tax Office will allow an extra year for the interest on the sub trust loan to the main trust to be paid to the private company for UPEs that arose between 16 December 2009 and 30 June 2010. This means that it has to be paid by the lodgement day of the main trust's 2012 tax return.

Example

The trustee for the ABC Trust makes a private company presently entitled to $2,000 trust income for the 2011 income year. The trustee puts the UPE under sub trust using a seven year loan on 15 May 2012 (the due date for lodgement of the trust's 2011 tax return). The interest on the loan from 15 May 2012 until 30 June 2012 must be included in the private company's 2012 tax return, and that amount must be paid by the trustee to the private company by the lodgement date of the trust's 2012 tax return (usually 15 May 2013).

The full year's interest on the $2,000 loan for the 2013 income year must be included in the private company's 2013 tax return and be paid to the private company by the due day for lodgement of the 2013 trust tax return (usually 15 May 2014). The same treatment for each of the following years will apply up until the end of the seven year term at 14 May 2019, when the full $2,000 loan principal and accrued interest to 14 May 2019 must be paid to the private company.

Trustee loans or payments to shareholders

It is also important to note that where there is a UPE from a trust to a private company and the trustee provided loans to, or payments on behalf of, shareholders of the private company (or to the shareholder's associates), these amounts may also be deemed to be a dividend under Division 7A. This applies even where the UPE is held under a sub-trust.

TFN TRUST REPORTING

Trustees of resident family trusts, discretionary trusts and other closely held trusts are reminded that since 1 July 2010, trustees are required to report most of the beneficiaries' Tax File Numbers (TFNs) and certain personal information to the Tax Office. This is in addition to the beneficiaries' TFNs included in the trust's tax return's distribution schedule (subject to the transitional rules mentioned below).

TFN withholding tax

If the beneficiary does not provide their TFN to the trustee, the trustee will have to withhold tax from the distribution at 46.5% (the beneficiary will be entitled to claim a credit on the tax when they lodge their income tax return).

TFN reports to the Tax Office

The report of the beneficiaries' TFNs to the Tax Office must be made by the end of the month after the end of the quarter in which the trustee received the TFN. For example, if the TFN was received by the trustee on 25 June 2012, the report to the Tax Office would have to be by 31 July 2012.

However, there were transitional rules for the 2010 and 2011 tax years that accepted the TFN and beneficiary information in the 2010 and 2011 trust tax returns prepared by tax agents as satisfying these reporting requirements for TFNs to be reported in the 2010 and 2011 years.

Report each TFN only once

The trustee only has to report the beneficiary's TFN once. Therefore, trustees only have to report the TFN for new beneficiaries that have not previously been reported to the Tax Office.

2012 beneficiaries TFN reports

For the 2012 year, the trustee must report any new beneficiaries that are entitled to distributions of the 2012 trust income where their TFNs have not previously been reported by the trustee to the Tax Office.

Affected beneficiaries

Affected beneficiaries include individuals, companies, partnerships and other trusts. There is an exclusion for non-residents and beneficiaries under a legal disability (such as minors). These beneficiaries are excluded because the trustee has separate requirements to pay the tax on the distributions to these beneficiaries

Should you require assistance or additional information, please contact your PKF Tax Adviser

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