

Tax Consequences of Using Dual-Trust Structures

Dual-trust structures are commonly used for their ability to make tax-effective distributions to unit holders. However, the advantage of using dual-trust structures is in doubt following a recent Court decision.

In this particular Court case, the taxpayer was ConnectEast, the builder and operator of the EastLink toll road. ConnectEast used two listed operating trusts to hold an investment trust that had substantial carry forward losses. In general, trust carry forward losses are subject to stringent trust loss rules. However, if the trust has a status of "Listed Widely Held Trust", concessional trust loss rules may apply.

Carry Forward Losses Denied

ConnectEast sought to access the concessional trust loss rules by obtaining the Listed Widely Held Trust status through its two listed operating unit trusts. However, the Court disallowed such status and as such, ConnectEast was unable to carry forward tax losses accrued before 1 July 2007 to offset against future income.

Time to Revisit the Dual-Trust Structure

The Court's decision implied that if ConnectEast had used a single listed unit trust as an operating vehicle it would have been able to carry forward the tax losses. Consequently, some of the tax effectiveness of using the dual-trust structure is now questionable.

Reference: ConnectEast Management Limited V FCT

Return of Capital or Capital Streaming

Streaming of Capital Benefits

Companies from time to time make distributions out of their capital accounts (e.g. returns of capital) instead of profits. In most cases, there are legitimate reasons to do so. However, on some occasions, companies have been found to use returns of capital as a strategy to stream capital benefits (which are more concessional taxed) to their shareholders in substitution for fully taxable dividends.

Penalties may be Hefty

To deter companies from streaming capital benefits to their shareholders, a network of complex anti-avoidance provisions have been written into the *Tax Act*. The Tax Office, in order to provide guidance for the operation of the anti-avoidance provisions, has recently released a practice statement. Principally, if a company is found to have entered into a scheme for the purpose of enabling a shareholder to obtain a capital benefit, the amount of the capital benefit obtained by the shareholder will be deemed an unfranked dividend. Further, in some circumstances the Commissioner may also determine a franking debit in the company's franking account.

Stay out of Trouble

As the penalties are severe and the provisions are complex, it seems a private/class ruling is inevitable to ensure that a return of capital will not be construed by the Tax Office as a scheme to provide a capital benefit.

Reference: PS LA 2008/10

Should you require assistance additional information, **contact your PKF tax adviser** or:

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