



Smart decisions. Lasting value

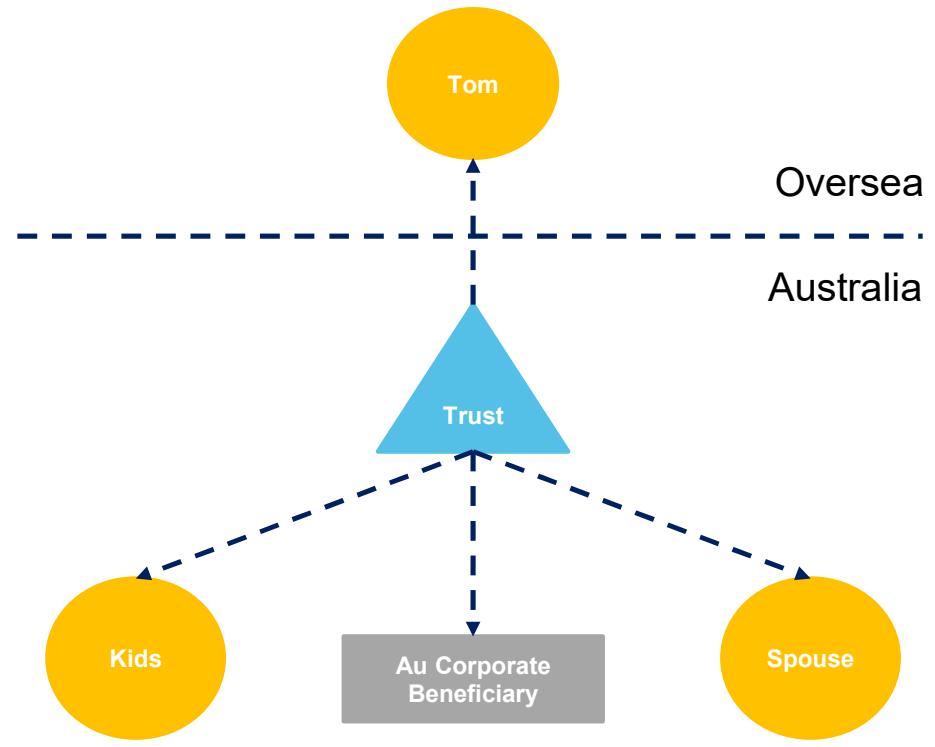
Training - Trust Distribution

Family Office Session



Agenda

- Trust Income Definition
- Streaming of Income
- Eligible beneficiary
- UPE and Div 7A
- Repayment of Div 7A loan



Trust Asset	Value	Annual Income
NSW Residential Property	\$3,000,000	\$150,000
Portfolio Investment	\$5,000,000	\$250,000

Trust Income Definition – s95 of ITAA1936

What happens when there is no definition in the Deed?

- Determined according to ordinary concepts
- Capital gains cannot be distributed unless as a capital distribution if permitted under the deed.

Many Deeds define Trust income = s95(1) net income

"net income", in relation to a trust estate, means the total assessable income of the trust estate calculated under this Act as if the trustee were a taxpayer in respect of that income and were a resident, less all allowable deductions, except deductions under Division 393 of the Income Tax Assessment Act 1997 (Farm management deposits) and except also, in respect of any beneficiary who has no beneficial interest in the corpus of the trust estate, or in respect of any life tenant, the deductions allowable under Division 36 of the Income Tax Assessment Act 1997 in respect of such of the tax losses of previous years as are required to be met out of corpus.

Option commonly used in Practice: Aligning to accounting profits.

Trust income Definition – Bamford Case

The decision in Bamford confirmed:

- *The income of the trust is determined with reference to the relevant trust deed.*
- *Subject to the wording in the trust deed, a discretionary trust can classify capital gains as income.*
- *If trust income is not defined in the trust deed, it will be taken to have its ordinary meaning, and capital gains may only be distributed to beneficiaries as capital distribution (if allowed under the Trust Deed).*
- *The proportionate approach is to be used in the allocation of trust income.*

Key Take Way:

- *Understanding the Trust Deed is essential.*
- *Beneficiaries are taxable on a pro-rata share of the taxable income of the trust (i.e., on a proportionate basis).*
- *The decision did not address streaming – the ATO is arguing that streaming is no longer allowed.*

Streaming of Income – Special Entitlement

Trust can distribute income in three categories (if Deed allows):

- Franked dividend – Streaming is available, or proportionate (Sub207 – B)
- Capital gains – Streaming is available, or proportionate (Sub115-c)
- Other Income (i.e. Interest income, rental income, foreign income or unfranked dividend) – Proportionate only

When the Family trusts have large capital gains / large amount of franked dividend flowing through a trust then it becomes essential to consider it and get it right.

Trust Derives \$280,000 fully franked dividend (Franking credit is \$120,000, taxable franked dividend is \$400,000)

Situation	Potential Tax Liability
Australia Beneficiary entitled to franked dividend	\$68,000 ($\$400,000 \times 47\% - \$120,000$)
Au Corporate Beneficiary entitled to franked dividend	\$0 ($\$400,000 \times 30\% - \$120,000$)
Foreign Beneficiary entitles to franked dividend	\$0 (<i>majority situation no withholding tax on fully franked dividend</i>)

Streaming of Income – Special Entitlement

Trust Derives \$300,000 other income with 150,000 interest income and 150,000 rental income.

Can you stream \$150,000 interest income to foreign beneficiary and 150,000 rental income to corporate beneficiary?

Situation	Potential Tax Liability
Au Corporate Beneficiary entitles to 300,000 income	\$90,000 ($\$300,000 \times 30\%$)
150,000 interest income to Foreign beneficiary 150,000 rental income to Au corporate beneficiary	\$60,000 ($150,000 \times 10\% + 150,000 \times 30\%$) X

Key Risk to consider:

The Trustee may separately record the following categories of income or capital in the accounts of the Trust which under the Acts:

- **Family Trust Election?** (a) are dividends:
 - (i) which are fully franked;
 - (ii) which are unfranked;
 - **Categories of income ?** (iii) to which a foreign tax credit attaches; or
 - **Trust Deed Clauses allow?** (iv) to which another separately identifiable taxation consequence or benefit may attach (b) is income or capital:
 - (i) which has an Australian source;
 - (ii) which has an ex-Australian source;
 - (iii) to which a foreign tax or other credit attaches;
 - (iv) which is exempt from tax or subject to differing rates of tax or tax treatment; or
 - (v) which has or gives rise to any other separately identifiable taxation consequence or benefit.
 - **Appropriate minutes in place?**
- Worst outcome:** client may end up with unexpected tax outcomes (Invalid Distribution and subject to 47% top marginal rate)



Beneficiary – Eligible?

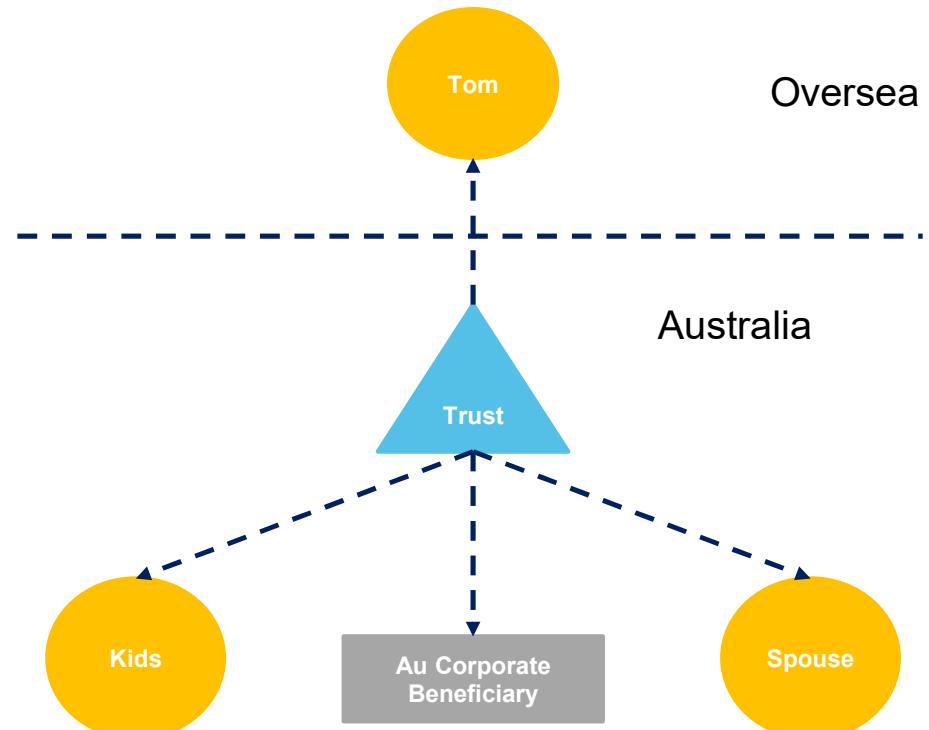
NSW Residential Property – Foreign Person Exclusion Clause?

In Practice:

- Very common to see the clause in a Trust with Residential land holding in NSW. (i.e. 5% annual land tax surcharge in NSW and 9% Surcharge Purchase Duty in NSW)
- Effective Clause is **irrevocable!**
- Once this clause put in place, no way foreign beneficiary can receive any distribution of capital and income from the trust.

Planning Tips:

- Check asset holding in the trust
- Check the Trust Deed. (under which states' definition?)



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NSW Residential Property	\$3,000,000	\$150,000
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UPE and Div 7A

Div 7A Provision:

Integrity provision to minimise shareholders (and their associates) of private companies (within and outside Australia) taking out profits taxed at corporate tax rate (25% to 40%) in the form of payments, loans or debt forgiveness.

Consequences of distributing income to corporate beneficiary:

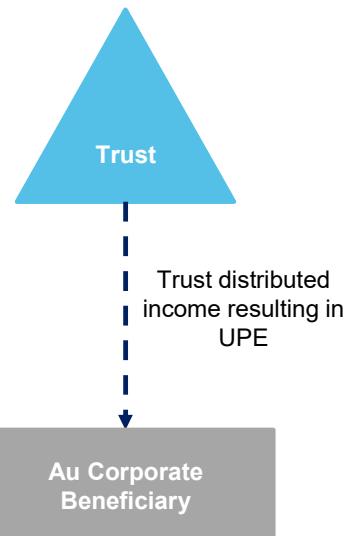
TD2022/11:

Where a private company beneficiary is made presently entitled to trust income and that entitlement is not satisfied, there is a **UPE**.

A private company beneficiary with a UPE, by arrangement, understanding or acquiescence, consents to the trustee retaining that amount to continue using it for trust purposes if the company:

- has knowledge of an amount that it can demand immediate payment of from the trustee, and
- does not demand payment.

This constitutes the provision of financial accommodation to the trustee under paragraph 109D(3)(b). As a result, the private company beneficiary makes a loan to the trustee under the extended definition of a 'loan' in subsection 109D(3).



UPE and Div 7A

Timing: (Trust Distribution happened at 30 June 2024)

UPE amount likely to be unknown on 30 June 2023 and accordingly, should remain in place and actioned in subsequent financial year.

1. **30 June 2023:** Company received trust distribution
2. **30 June 2024:** UPE is settled by way of cash, asset transfer, declaration of dividend, or convert UPE into Div 7A loan before trust 2023 lodgment due date. (i.e 15 May 2024)
3. **30 June 2025:** Trust Repays Division 7A loan or put a complying loan agreement before lodgment date of trust tax return (i.e 15 May 2025)

First Principal and Payment repayment due by 15 May 2025

30/6/2023	Private company beneficiary becomes presently entitled to 100% of trust income.
1/8/2023*	The income of the trust is determined. The private company beneficiary provides financial accommodation to the trustee.
15/5/2025**	The private company beneficiary and the trustee enter into a complying loan agreement in respect of the financial accommodation before this date.
30/6/2025	The first minimum yearly repayment under the complying loan agreement is due by this date.

Repayment of Div 7A loan

The minimum payments for the year could be made in the following ways:

1. Cash transfer to the Company's bank account
2. Transfer of an asset to the Company
3. Declaration of a dividend by the Company, with the dividend payable offsetting the amount due. (**Commonly Used**)

Recent Benchmark interest rate 8.77%					
Year	Loan Opening Balance	Minimum Repayment	Interest	Principal	Loan Closing Balance
2026	700,000	138,012	61,390	76,622	623,378
2027	623,378	138,012	54,670	83,342	540,037
2028	540,037	138,012	47,361	90,651	449,386
2029	449,386	138,012	39,411	98,601	350,785
2030	350,785	138,012	30,764	107,248	243,538
2031	243,538	138,012	21,358	116,654	126,884
2032	126,884	138,012	11,128	126,884	0
Total		966,083	266,083	700,000	

