

Topdocs Discretionary and Unit Trust Updates (Bamford Updates)



BACKGROUND TO THE BAMFORD CASE

The ATO previously considered that the “income of the trust estate” referred to ordinary income derived in the hands of the trustee, and that neither the provisions of a trust deed nor a determination by a trustee acting under authority of a trust deed could alter the character of receipts or outgoings in the hands of the trustee.

However, in *FCT v Bamford & Ors, Bamford & Anor v FCT* [2010] HCA 10 (**Bamford**) the High Court held that a trustee resolution, made pursuant to a power in the trust instrument, to treat a capital receipt as income was effective in treating the capital receipt as part of the “income of the trust estate” for the purposes of section 97 of the *Income Tax Assessment Act 1936* (**ITAA 1936**).

The decision relates to sections 95 and 97 ITAA 1936. Section 95 of the ITAA 1936 defines the concept of “net income” of a trust estate as assessable income, less allowable deductions, of the trust estate in respect of a year of income. Thus, net income is similar to the concept of taxable income.

Then there is the concept of “present entitlement”, where section 97 of the ITAA 1936 provides that a beneficiary of a trust estate, who is not under any legal disability, is presently entitled to a share of the income of the trust estate so long as the assessable income of the beneficiary includes that share of the net income of the trust estate.

The Bamford decision of the High Court supports the view that:

- the income of the trust is whatever the trust deed determines it to be. So trustee(s) and their advisors need to be aware of which definition (if any) the trust deed contains, and whether the trustee has the power to adopt a different definition in respect of a particular year of income; and
- if the beneficiaries of the relevant trust are made presently entitled to a 100% share of the "income" of the trust, then they will be required to include in their assessable income, 100% of their share of the taxable income of the trust.

ATO Decision Impact Statement

- As a result of the High Court decision Tax Office has released a Decision Impact Statement and Practice Statement (PS LA 2010/1) on 2 June 2010. These deal with the ATO’s interpretation of the decision and how the ATO will apply the decision.
- This Decision Impact Statement sets out a number of general propositions, as understood by the Tax Office, which have emerged from the High Court’s decision. It covers the Tax Office’s administrative treatment of tax returns for the 2009/10 and earlier income years. It also identifies a number of issues in relation to tax laws dealing with trust income which the Tax Office considers to remain unresolved.

TRUST REVIEWS FOLLOWING BAMFORD

In order to benefit from the outcomes of the Bamford case, trustees and their advisors need to be aware of the definitions that their trust deeds contain. Many older trust deeds do not have the necessary provisions to enable them to take advantage of the Bamford principles.

As a result, it is now timely to consider the review of your trust deeds, to ensure that they effectively define “net income” of the trust and provide the ability to redefine capital gains as “income of the trust estate”.

TOPDOCS TRUST REVIEWS

Topdocs (in conjunction with Topdocs Legal Pty Ltd and also SBN Lawyers Pty Ltd) provides a trust deed review service with amendments if necessary to:

- Ensure the trust deed has a definition of trust income that allows the inclusion of capital gains and also ensure the trustee has the discretion to adopt a different concept of income to provide maximum flexibility.
- Ensure the income definition excludes “notional amounts” such as franking credits as it is not possible for a beneficiary to be presently entitled to these notional amounts. This is an issue highlighted by the Commissioner in the DIS.
- Insert provisions to give the trustee a discretion to apply outgoings against income or capital and make distributions out of gross income (which may allow distributions out of gross income to preserve franking credits etc).
- Remove any requirements that the trustee must resolve to distribute income or determine what concept of income applies by 30 June in any year. The Commissioner has indicated that, where the deed stipulates that income distributions must be made by 30 June, he will insist on strict compliance.

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	Price
First of type and version	\$600
Subsequent of the same type and version	\$530
More than 10 of the same type and version	\$410