TOPDOCS' DISCRETIONARY TRUST AND UNIT TRUST UPDATES (BAMFORD UPDATES)

The Bamford decision relates to the treatment of income of a trust estate. This article reviews the background and consequences of this ruling.

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.

> *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.*

Current as at 29 May 2013.
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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) provides a trust deed review service with amendments if necessary:

- To ensure the current 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;
- To ensure the income definition of trust income may exclude 'notional amounts' such as franking credits as it is not possible for a beneficiary to be presently entitled to these and the ability for the trustee to make distributions out of gross income (to preserve franking credits etc);
- To include an adequate "attribution" provision to give the trustee a discretion to categorise receipts as income or capital and apply expenses and outgoings against income or capital and to distribute these categories to beneficiaries in disproportionate shares; and
- To allow flexibility in the requirement stipulated by the Commissioner in Tax Ruling 2012/D1 that the trustee must resolve to distribute income or determine what concept of income applies to the Trust by 30 June in any year, should proposed legislation be introduced otherwise.

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More information

Should you have any queries or require more information, please contact the team at Topdocs on 1300 659 242.

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