[1821] One remedy where trust distributions prove problematic

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Article

by Matthew Burgess, Partner and Liam Polkinghorne, Lawyer, McCullough Robertson

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A recent article in this Bulletin focused on the critical need to "read the deed" whenever making trust distributions (see 2013 WTB 38 [1642]).

Even where distributions are made validly to a potential beneficiary, they can prove extremely problematic from an asset protection perspective.

One scenario that seems to arise regularly in this regard is the distribution by a trust to a corporate beneficiary, the shares in which are owned personally by an at-risk individual.

Often, the difficulties with this ownership structure are not identified until after many years of distributions have been made to the bucket company, and anecdotally, the issue is often first identified at a point which is too late, for example, just before litigation proceedings are to commence against the relevant shareholder.

Where this ownership structure is identified and assessed to be inappropriate, the first critical step is to ensure that any future distributions to a corporate beneficiary are directed to a newly established company, the shares in which are owned by a non-risk entity (eg a passive family trust).

However, resolving the historical distributions is generally not as simple.

Depending on the circumstances, some form of dividend access share or discretionary dividend share may provide a pathway to remedy the historic distributions, although it will be important to consider the ATO's recent guidance in Draft Taxation Determination TD 2013/D5 (see 2013 WTB 24 [1092]) and Taxpayer Alert TA 2012/4 (see 2012 WTB 30 [1194]) which warned taxpayers of arrangements where accumulated profits of a private company are distributed substantially tax-free to an entity associated with the ordinary shareholders of the private company.

Similarly, since the introduction of the Personal Property Securities Act 2009 (PPSA), steps can often be taken to grant a security interest over the at-risk shares to a low risk related entity.

Broadly, this solution can be achieved by a "gift and loan back" style arrangement, whereby:

1. the at-risk individual gifts a cash amount equal to the gross value of the shares to a protected environment (eg a passive family trust);
2. the family trust subsequently lends the gifted amount back to the at-risk individual; and
3. the family trust simultaneously registers a security interest over the shares on the PPS register to secure repayment of the loan. Subject to certain conditions (such as the family trust establishing "control" over the shares) the family trust's interest in the shares should be protected under the PPSA.

The advantages of utilising a gift and loan back, compared to a straight transfer of the shares in the corporate beneficiary can include:

- the arrangement achieves broadly equivalent protection for the asset compared with a straight transfer; and
- as there is no change in the legal ownership of the shares, transfer duty (where applicable) and CGT will generally not apply. The only transaction cost should be the PPSR registration fee.

The disadvantages of utilising a gift and loan back approach, compared to a straight transfer of the shares can include:

• the arrangement is more complex than a simple transfer, and involves the preparation of additional documentation (including a deed of gift, loan agreement and security documentation);

• it only protects the amount of net equity in the asset at the time of the gifting, however as mentioned above, there should not be any further distributions made to the inappropriately structured corporate beneficiary; and

• the arrangement is subject to the bankruptcy clawback rules and specialist advice should be obtained in relation to the operation of these provisions.

Organisations Mentioned: ATO; PSA; environment; tax; port; Act; security; litigation
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