THOMSON REUTERS WEEKLY TAX BULLETIN
Issue 27, 20 JUNE 2014

[942] Trust distributions – 3 reminders for 30 June 2014
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As regularly addressed in this *Bulletin*, a methodical approach is needed when preparing trust distribution resolutions to ensure the intended outcomes are achieved.
With another 30 June fast approaching, it is timely to consider 3 key issues often overlooked, namely:

1. ensuring that the intended recipient of a distribution is in fact a valid beneficiary of the trust;
2. avoiding distributions to beneficiaries who appear to be validly appointed under a trust deed, however are in a practical sense excluded; and
3. complying with any timing requirements under a trust deed, regardless of what the position at law may otherwise be.

Further comments on each of these issues are set out in turn below.

Is the intended recipient a beneficiary?

A beneficiary is a person or entity who has an equitable interest in the trust fund. A beneficiary has enforceable rights against a trustee who fails to comply with their duties, regardless of whether they have ever received distributions of income or capital from the trust. The range of eligible beneficiaries will generally be defined in the trust deed and the first step in any proposed distribution should be to ensure that the intended recipient falls within that defined range.

Once the range of eligible beneficiaries has been determined, the next step is to identify classes of specifically excluded beneficiaries.

These exclusions will usually override the provisions in a trust deed which create the class of potential beneficiaries and some common examples include:

- persons who have either renounced their beneficial interest or have been removed as a beneficiary of the trust fund;
- the settlor and other members of the settlor's family;
- any "notional settler"; and
- the trustee.

A comprehensive review of a trust deed must include an analysis of every variation or resolution of a trustee or other person (such as an appointor) that may impact on the interpretation of the document.

The range of documents that could impact on the potential beneficiaries of a trust at any particular point in time is almost limitless. Some examples include:

- resolutions of the trustee to add or remove beneficiaries pursuant to a power in the trust deed;
- nominations or decisions of persons nominated in roles such as a principal, appointor or nominator; and
- consequential changes triggered by the way in which the trust deed is drafted (eg beneficiaries who are only potential beneficiaries while other named persons are living).

Does the intended recipient appear to be a beneficiary, yet practically is excluded?

It is important to remember that the unilateral actions of a potential beneficiary may impact on whether they can validly receive a distribution. For example, a named beneficiary may disclaim their entitlement to a distribution in any particular year, or may in fact renounce all interests under the trust.

There are also a number of potential issues that can arise in relation to beneficiaries that appear to have been nominated as beneficiaries, as to whether the nomination is effective. These issues can include:

- whether the appointment needs to be made in writing;
- whether the appointor has been validly appointed to their role;
- at what point the nomination needs to take place in the context of the timeframe within which a distribution must be made; and
- are there any consequential ramifications of the nomination, eg stamp duty, resettlement for tax purposes or asset protection.

Family trust election

In addition to the traditional trust law related restrictions on the potential beneficiaries of a trust, it is important to keep in mind the consequences of a trustee making a family trust election or interposed entity election.

Where such an election has been made, despite what might otherwise be provided for in the trust instrument, the election will effectively limit the range of potential beneficiaries who can receive a distribution without triggering a penal tax consequence (being the family trust distribution tax).

A family trust election will generally be made by a trustee for one or more of the following reasons:

- access to franking credits;
- ability to utilise prior year losses and bad debt deductions;
- simplifying the continuity of ownership test; and
- eliminating the need to comply with the trustee beneficiary reporting rules.

While a full analysis of the impact of family trust elections and interposed entity elections is outside the scope of this article, it is critical to consider the potential implications of any such election on what might otherwise appear to be a permissible distribution in accordance with the trust deed.

Complying with any timing requirements under the trust deed

Historically, the Commissioner permitted resolutions to be made after 30 June each year via longstanding ITs 328 and 329, however as practitioners will recall, these were withdrawn in 2011.

The current law does allow resolutions in relation to capital gains to be made no later than 2 months after the end of the relevant income year. Any other distributions, including in particular franked distributions, must be made by 30 June in the relevant income year. Notwithstanding the general position above, the ATO has regularly confirmed its view that regardless of any timing concessions available under the tax legislation or ATO practice, ***these concessions are subject always to the provisions of the relevant trust instrument***.

In recent times, we have reviewed a number of trust deeds by different providers that require all resolutions to be made by a date earlier than 30 June, eg no later than 12pm on 28 June in the relevant financial year. Unfortunately, in every situation we have seen, all distributions for previous income years were dated 30 June, meaning each resolution was in fact invalid under the deed, regardless of the fact that the resolution otherwise complied with the law.

In these situations, arguably the only practical solution is to proceed with lodgment of amended returns, relying on the default provisions under the trust deed – assuming there are adequate default provisions.