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TAX matters

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TAX

BAMFORD DIS AND PSLA – MORE QUESTIONS THAN ANSWERS

On 2 June 2010 the Commissioner issued his much anticipated Decision Impact Statement (the DIS) and practice statement, PSLA 2010/1(the PSLA) regarding the High Court decision in Bamford.

The DIS and PSLA give an insight into what the Commissioner thinks, and doesn't think, about the High Court's decision in Bamford and also on the minefield of issues that is currently plaguing the area of taxation of trusts.

Much of the commentary in the two publications is uncontroversial. However the Commissioner does drop an unforeseen bombshell for tax professionals, with what appears to be the complete reversal of his previous view of the ability of a trust to stream income to different beneficiaries.

Broadly, it seems that the Commissioner concludes that the character of allocated income does not flow through a trust (subject to the effect of specific statutory provisions outside Division 6 of the 1936 Act). An amount of tax net income that is included in a beneficiary's assessable income under section 97 comprises an "undissected or unallocated proportionate share of the entirety of the (tax) net income" returned by the trust. This appears to be a view that a beneficiary can only be entitled to a proportionate share of the entire bundle of the trust's tax net income, even though the trust deed may specifically allow the trustee to distribute different types of income to different beneficiaries. The correctness of this view may be subject to considerable doubt. The Commissioner does note that the tax Acts have specific provisions dealing with the flow through effect of income to beneficiaries.

What makes these comments surprising is that the issue of

income streaming was not dealt with by the High Court in the Bamford decision, nor was it asked to deal with the issue. Therefore it is curious that the Commissioner has taken this opportunity to comment on it. We do note that the Commissioner states that he intends to consult with the tax profession on the manner in which the statutory flow through provisions such as Subdivision 115-C (capital gains) and Subdivision 207-B of the 1997 Act (franking credits) will interact with Division 6 of the 1936 Act. Further it appears that the Commissioner will not generally disturb income streaming in respect of the 2010 income year.

Another practical point that arises from the Commissioner's comments in the DIS and PSLA is that the terms of the trust deed (together with trust law principles) are almost always paramount when administering a trust. We cannot stress enough that accountants should read each and every trust deed for trusts for which they prepare distribution minutes and

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accounts, to comply with the procedure outlined in the trust deed for the effective distribution of income to the beneficiaries.

Subtle differences in trust deeds can dramatically affect the validity of distributions; for example: certain trust deeds require the guardian's consent for distributions of income to beneficiaries. Therefore, if the consent is not obtained by the trustee for the distribution of income for a given financial year the distribution may be invalid and therefore taxed in the hands of the trustee or in the hands of a default beneficiary according to a default distribution clause contained in the deed (if any).

The traditional view that "one size fits all" in relation to trusts is not (and never was) the case. Careful attention has to be given to specific terms of the trust, for example trust clauses enabling the trustee to re-characterise a receipt or outgoing cannot contradict other requirements of the trust instrument (refer to the Commissioner's DIS in relation to Forrest v FCT [2010] FCAFC 6).

What does this mean for 2010 returns and beyond?

The Commissioner has directed ATO staff to take a non-active approach to retrospective application of the Bamford decision. As stated above, it also appears that the new views on "streaming" will not generally apply for 2010. In relation to the 2009/2010 tax year, the PSLA directs ATO staff not to select cases for

active compliance solely to correct errors in tax returns or trust administration which the Bamford decision has brought to light. This leniency does not extend to circumstances of deliberate exploitation of Division 6 of the 1936 Act.

While this does not mean that cases will be chosen solely on the basis of such error, disputes on other grounds may lead to review of the basis upon which trust distributions have been made. If there are disputes on other grounds ATO officers are directed to apply the law as expounded in Bamford. More than ever practitioners need to show great care in this area, and will need to consider any practical implications of triggering unrelated disputes which might cause ATO investigation of the treatment of trust distributions.

Amending Deeds

We still see many deeds with vague or no definitions of income or net income and no income streaming provisions. Such deeds should be amended to provide clarity for the drafting of trustee resolutions.

Where distributions to corporate beneficiaries are contemplated, consideration should also be given to the ATO views on Division 7A loans as recently expressed in Ruling TR 2010/3.

Contact: Richard Norton, Chris Smailes, Daniel Fry or Reagan Gruenthal.

Norton & Smailes

We advise on:

- the small business CGT concession;
- income tax, GST and FBT
- employee share schemes
- wills, estate planning and business succession planning
- superannuation and superannuation deeds
- transfer duty, land tax, payroll tax and other State taxes
- trusts and trust deeds
- objections and appeals
- tax and commercial litigation
- commercial law

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