


# ***TD 2012/22EC - Compendium***

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## **Ruling Compendium – TD 2012/22**

This is a compendium of responses to the issues raised by external parties to draft Taxation Determination TR 2012/D5 Income tax: for the purposes of paragraph 97(1)(a) of the *Income Tax Assessment Act 1936* (ITAA 1936) is a beneficiary's share of net income worked out by reference to the proportion of the income of the trust estate to which the beneficiary is presently entitled?

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

### **Summary of issues raised and responses**

| <b>Issue No.</b> | <b>Issue raised</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | <b>ATO Response/Action taken</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1                | <p>How would the Commissioner apply the proportionate approach to the following example, both before and after amending the net income of the trust? In the example, the trustee attempts to distribute trust income by reference to the tax impact of the distribution on the particular beneficiary.</p> <p><i>Example</i></p> <p>The trust deed of the ABC Trust equates the income of the trust with its net income as calculated under section 95 of the ITAA 1936 unless the trustee determines it to be a different amount.</p> <p>The trustee makes a written determination that trust income for the 2012 income year will be the same as the net income of the trust, excluding any capital gains made during the year. The trust has a non-discount capital gain of \$30,000 in the year. This results in [the trustee thinking that] the income of the trust is \$90,000 while the net income of the trust</p> | <p><i>Income equalisation clauses generally</i></p> <p>The effect of an income equalisation clause is open to doubt. As Slater* observes</p> <p>On one view, (the clause) would fail by reason of uncertainty as to its meaning and operation. On another view it would operate in some cases and in some years, but would fail, so that entitlements under it would abate, in other years, creating an unpredictable outcome for the relationship between trustee and beneficiaries.</p> <p>This may be because, for example, the precise calculation of net income may depend on the trustee making certain choices (such as which depreciation or valuation methodologies to use, which capital gains to apply capital losses against, etcetera), which perhaps have not in fact been made by the time of making the resolution. It may also be because as defined under section 95, net income may in fact be calculated differently in respect of different beneficiaries.</p> <p>Subject to the views expressed in draft Taxation Ruling TR 2012/D1</p> |

\* Slater, Tony; *Taxing Trust Income after Bamford's Case*, paper presented at The Tax Institute 26<sup>th</sup> National Convention

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| Issue No. | Issue raised                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | ATO Response/Action taken                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
|-----------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|           | <p>under section 95 is \$120,000.</p> <p>On 30 June 2012 the trustee resolved to distribute the income of the trust as follows in the order stated below:</p> <p>An amount of trust income (to the maximum extent it is available) that would ensure that Harry's share of the net income of the trust as determined under section 97 of the ITAA 1936 does not exceed \$30,000;</p> <p>An amount of trust income (to the maximum extent it is available) that would ensure that Eva's share of the net income of the trust as determined under section 97 of the ITAA 1936 does not exceed \$20,000; and</p> <p>The balance (if any) to Chris.</p> <p>Following lodgement of the tax returns for the trust and beneficiaries the Commissioner disallows some tax deductions and increases the net income of the trust by \$10,000 [so that the net income is instead \$130,000 and the trust income is instead \$100,000].</p> | <p>about the meaning of income of a trust estate for Division 6 purposes, the Commissioner will seek as far as possible to give effect to an equalisation clause. This means that where the Commissioner is of the view that the net income of the trust differs from that originally calculated by the trustee (for example because the Commissioner or the trustee determines that the net income as originally calculated by the trustee was incorrect), the Commissioner's broad approach will be to treat the income of the trust as always having had been that revised amount.</p> <p>Where the calculation of the net income depends on the exercise of a choice by the trustee, the Commissioner's approach, unless there is evidence to the contrary, will be to assume that the trustee had determined how it would be made prior to 30 June, and that the calculation of the net income of the trust does not vary as between different beneficiaries. In that way, beneficiaries will be treated as having a vested and indefeasible interest in the trust income by 30 June wherever possible.</p> <p>Where the amount assessed to a beneficiary under section 97 is to be determined on the assumptions set out in Division 6E, some of the factors relevant to application of section 97 may not be known until after the end of the income year (because the trustee has until 31 August to make a beneficiary specifically entitled to capital gains). This may mean that a resolution of this type will not be effective to create a present entitlement in any beneficiary by 30 June.</p> <p><i>Effect of resolution</i></p> <p>We assume in the example given that the trustee did not determine trust income to actually be the \$90,000 it calculated, but rather simply determined that it would be the net income of the trust estate less the</p> |

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| Issue No. | Issue raised | ATO Response/Action taken                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
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|           |              | <p>net capital gain of the trust estate for the relevant year, and then assumed this was \$90,000. We have further assumed that by 30 June the trustee was able to effectively exclude the possibility of it making any beneficiary entitled to the financial benefits representing the capital gain (such that it was able to be known with certainty at 30 June that no beneficiary was or would be specifically entitled to the capital gain).</p> <p>On this basis (and assuming this is possible), and in light of the above, the Commissioner's approach to the particular resolution would be to assess the beneficiaries under section 97 as follows:</p> <p>Amounts returned as the relevant shares of net income<br/>           Harry - \$30,000<br/>           Eva - \$20,000<br/>           Chris - \$70,000</p> <p>As later amended, the Commissioner's opinion as to the relevant shares of income:<br/>           Harry - \$30,000<br/>           Eva - \$20,000<br/>           Chris - \$80,000</p> <p>However, the motivation and desired effect of such resolutions may need to be considered. The ATO advised members of the NTLG Trust Consultation Sub-group at a meeting in April 2012 that appropriately worded resolutions of this type may have the intended effect of creating a present entitlement to income by 30 June. However we also advised that we do not consider it appropriate to include, as a general example in a Taxation Determination, an arrangement where taxation considerations explicitly are driving trust distributions.</p> |

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| Issue No. | Issue raised                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | ATO Response/Action taken                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
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| 2         | <p>How would the Commissioner apply the proportionate approach to the following example, both before and after amending the net income of the trust? In the example the trustee attempts to distribute trust income by reference to the overall taxable income of the beneficiary (that is, a factor that is external to the trust itself)</p> <p>The trust deed of the XYZ Trust equates the income of the trust with its net income as calculated under section 95 of the ITAA 1936 unless the trustee determines it to be a different amount.</p> <p>The trustee makes a written determination that trust income for the 2012 income year will be the same as the net income of the trust, excluding any capital gains made during the year. The trust has a non-discount capital gain of \$30,000 in the year. This results in the income of the trust being \$90,000 while the net income of the trust under section 95 is \$120,000.</p> <p>On 30 June 2012 the trustee resolved to distribute the income of the trust as follows in the order stated below:</p> <ul style="list-style-type: none"> <li>• an amount of trust income (to the maximum extent it is available) that would ensure that Zac's total taxable income for the 2012 income year does not exceed \$80,000;</li> <li>• an amount of trust income (to the maximum extent it is available) that would ensure that</li> </ul> | <p>There are many matters which may happen after 30 June which could affect the calculation of the beneficiaries' taxable income. For example, each may have various choices to make under the tax law. Also, it is difficult to see how a resolution of this type would operate in respect of an entity that is beneficiary of two trusts where the trustees of both trusts had made similar resolutions.</p> <p>Without knowledge of all relevant facts and circumstances, the Commissioner is not able to indicate how the proportionate approach would apply in the context of this example.</p> |

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| <b>Issue No.</b> | <b>Issue raised</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | <b>ATO Response/Action taken</b>                                                                                                                                      |
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|                  | <p>Sam's total taxable income for the 2012 income year does not exceed \$180,000; and</p> <ul style="list-style-type: none"> <li>• the balance (if any) to Diane.</li> </ul> <p>Zac's taxable income for the 2012 income year excluding the distribution to be received from the XYZ Trust is \$60,000. Sam's taxable income for the 2012 income year excluding the distribution to be received from the XYZ Trust is \$120,000.</p> <p>Following lodgement of the tax returns for the trust and beneficiaries the Commissioner disallows some tax deductions and increases the net income of the trust by \$10,000.</p>                                                                                                                                                                                                                                                          |                                                                                                                                                                       |
| 3                | <p>We strongly contend that the technical reasoning underpinning the operation of the proportionate approach, including how the 'income of the trust' for section 97 purposes is determined, should be elaborated upon in each of the examples and in the related explanatory material. For example, looking at Example 10, Russ includes \$50,000 in his assessable income after the trust's taxable income is amended. We would like to understand how the amount equal to the non-deductible expenses (for example \$10,000 of entertainment and political contributions) can form part of the distributable income, given that the trust has spent the \$10,000 and, therefore, it would no longer be available for distribution. Is this because the \$10,000 is met from the capital of the trust? We would like the conclusions reached by the ATO in this and each of</p> | <p>The Explanation in the final Determination has been expanded to indicate how the particular facts in the examples are relevant in arriving at the conclusions.</p> |

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| Issue No. | Issue raised                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | ATO Response/Action taken                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
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|           | <p>the other examples to be explained fully.</p> <p>We note that, in particular, many practitioners will find it extremely difficult to reconcile the differing outcomes in Examples 1 and 4 of the draft Determination</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| 4         | <p>We believe that it would also be helpful if the final Taxation Determination included an example where the trust's taxable income has increased due to the application of Part IVA, particularly where the income of the trust is defined to be equal to the trust's taxable income.</p>                                                                                                                                                                                                                                                                                                                                                                                                  | <p>As far as possible, we would prefer this Determination and TR 2012/D1 to be standalone documents. We have not included an example of the type suggested in the final Determination.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| 5         | <p>We note that all of the examples in the draft Determination involve situations where the trust's taxable income has increased. Examples of how the proportionate view would apply where the trust's taxable income decreases would also be of practical use.</p>                                                                                                                                                                                                                                                                                                                                                                                                                          | <p>An example of how the proportionate approach applies where taxable income decreases has been added to the final Determination.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| 6         | <p>In our view it has been a common long standing practice of many practitioners to allocate all of the income of a trust to beneficiaries on a percentage basis which is denominated in dollar terms rather than as a percentage rate. That is, a trustee may resolve to distribute a third of trust income of \$120,000 in the form of a \$40,000 distribution to three beneficiaries rather than resolve to distribute a one third percentage of such income to three beneficiaries. In the context of Example 1, it is submitted that it is readily apparent that all the \$120,000 income is being distributed on a one third basis albeit expressed in dollar terms rather than as</p> | <p>The way in which a trustee words a resolution to distribute income is critical in determining its effect.</p> <p>While the effect of the resolution in Example 1 is that each beneficiary was entitled to one third of the income of the trust as calculated by the trustee, we do not consider that, in the absence of other evidence, the beneficiaries have an entitlement to any more than \$40,000. As demonstrated by the example, we do not consider that the resolution has the effect that each of the beneficiaries had an entitlement to \$43,000.</p> <p>The result may be different if, for example, the trustee resolution indicated that each beneficiary was entitled to \$40,000 'being one third</p> |

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| <b>Issue No.</b> | <b>Issue raised</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | <b>ATO Response/Action taken</b>                                                                                                                                                                                                                                                                                                                                                                                                               |
|------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|                  | <p>a percentage rate, and that such an approach should be accepted as a valid form of trustee resolution.</p> <p>We submit that if a trustee cannot distribute a percentage of trust income expressed in dollar terms then a clear technical rationale as to why this approach is not acceptable should be detailed in the Draft Determination as many practitioners would regard such an approach as a marked change in practice. Given the abundance of complex recent changes to the taxation of trust law and its administration it is vital that practitioners be provided with clarity on this matter.</p> | <p>of the income of the trust estate’.</p> <p>Advice that we have received in the past, for example from members of the Trust Consultation Sub-group, is that it is not common for trustees to make a resolution in this form. That is, because it would be unusual for the trustee to know the precise amount of the trust income by 30 June, it would be unusual for the trustee to specify beneficiary entitlements as a dollar amount.</p> |
| 7                | <p>We note that paragraph 51 of the draft Determination states that the Determination when finalised will apply on both a prospective and retrospective basis.</p> <p>We submit that should the view be reached that a share of trust income can only be expressed on a percentage rate basis in a trustee resolution then such an approach should only apply on a fully prospective basis. This is required to avoid inequitable outcomes for practitioners and their trustee clients who would have regarded their past practice as technically appropriate.</p>                                               | <p>Having regard to the factors in paragraph 36(a) of Law Administration Practice Statement PS LA 2011/27, we do not think that the ATO has facilitated or contributed to any different views from those expressed in the Determination.</p> <p>Accordingly, the date of effect of the final Determination has not been changed.</p>                                                                                                           |