Drafting effective trustee resolutions has always been part science, part art. Indeed, in the past it was possible to get away with a resolution on advice from a practitioner who was not particularly skilled in either trust or tax law. This was because unless you ended up contesting civil proceedings, for instance as a result of a family breakdown, there was no government authority enforcing the requirements of trust law.

Moreover, the Tax Office’s previously underdemanding attitude to the tax law as it applied to trust administration meant that it was possible to craft resolutions that did not meet all the requirements of the tax law yet had the same effect as a resolution that observed all the requirements of the law and the deed itself.

The Tax Office Changes Tack
The Tax Office’s decision to change its attitude towards the administration of trusts has been building for some time. Following several court decisions that concerned tax matters and where trust law was held to be pre-eminent, such as the Full Federal Court’s decision in Cakhusic’s case (2006) 155 FCR 430 and the High Court’s decision in Barnford’s case [2010] HCA 10, it was apparent that the Tax Office needed to observe the trust law implications in more detail.

Secondly, on 29 June 2011 the Tax Laws Amendment (2011 Measures No 5) Bill 2011 received Royal Assent. This legislation spelt out in greater detail than ever before the requirements to ensure that a beneficiary of a trust was “entitled” to receive income, thereby requiring the Tax Office to administer the legislation with due care and consideration.

Response to the New Legislation
Many in the accounting community have interpreted the legislative change as “business as usual” as it provides a legal framework for what has been done by many trusts for years – that is ‘streaming’ different classes of income to beneficiaries.

Moreover, some practitioners have interpreted the legislation as codification of IT Rulings 328 and 329. Yet, this is far from the case. When the Tax Office withdrew IT 328 and 329, the “administrative concession”, which provided a two month extension for the creation of present entitlement in trust income, went with it.

Many practitioners relied on this concession for years, even though there was debate in the professional community as to whether the Commissioner was actually entitled to provide it under the law. The concession in IT 328 and 329 allowed resolutions to be made after the accounts of the trust had been formulated. This enabled a precise allocation of the trust income (and tax income) to each beneficiary.

The new legislation does allow “capital gains” to be recorded “in their character” within two months after the end of the income year. However, this only applies to capital gains and not to any other form of income (including franked dividends). It appears that this may have been drafted merely to allow for the settlement period that can take place after a contract has been entered into to dispose of a capital gains tax asset.

In any case, the recording of amounts “in their character” as capital gains in the accounts or records of the trust is not the same as the requirement to create a present entitlement trust income. Consequently, it is still as vital as ever to create a present entitlement by 30 June. Failure to do so will result in the Tax Office determining that income in which no valid present entitlement has been created will be assessed to the trustee at penalty rates.
It is our understanding through the Trusts National Tax Liaison Group that the Tax Office intends to do a compliance review that will focus on this specific area. So in many ways, far from being "business as usual", trustees face increased scrutiny compared to what was the case before.

What Needs to be Done in 2012?

For a start, there must be some recording of the state of mind of the trustee as at 30 June 2012 in relation to distributions of income derived during the 2012 income year. This should reference the trust deed and the classes of income derived during the year.

Also, because of these timing requirements and the practical impossibility of knowing precise amounts of trust income derived as at 30 June, there is likely to be a move away from drafting resolutions which provide a precise amount being distributed to a specific beneficiary. This is because even if the trust operates under an income "equalisation clause", most trusts will not know for sure that they have that precise amount of trust income available until they have their accounts done, which will be after 30 June.

On this basis, the wording of the resolution is much more likely to be in terms of fixed proportions of trust income. Trustees that are committed to distributing fixed dollar amounts may still do so. However, the resolution is likely to state, for example, “first $416 to beneficiary xx” and then provide a “balance” to a beneficiary that can absorb a variable distribution and tax impost.

For those wishing to stream capital gains or franked distributions, heed must be paid to the requirements of the new provisions. Trusts that have crystalised capital gains and derived franked dividends will need to ensure that their resolutions identify at least three classes of income:

- Capital gains
- Franked dividends
- Other income

It is also important, as always, that the resolution references the trust deed. For example, although it is possible to stream capital gains under the new legislation without an income clause, this will need to be done as a capital distribution. Also, trusts that still have income equalisation clauses will need to distribute part of a discount capital gain as income and part as a capital distribution. For many, this may involve two separate resolutions.

In a Nutshell

Trustees need to be aware that the Tax Office’s previous laissez-faire attitude to the administration of trusts is over. Far from simplifying the law, the new streaming measures makes the law much more complicated than ever before. To ensure you get the right advice on these important new measures, speak to a Crowe Horwath representative today.
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