

Bucket companies - What must be done by 30 June 2010? - Chris G Wallis FTIA ~ Victorian Bar (Greens List)

When a trustee makes a distribution resolution in favour of a corporate beneficiary any time after 16 December 2009 for an Accounting Period it is critical that the trustee (and for trustee read accountant) does not simply copy what was done a year ago.

A confluence of trust and division 7A developments in the period leading up to 30 June has created a perfect storm for tax agents dealing with trusts and division 7A issues. The bad news is that the Commissioner will take unpaid present entitlements created after 16 December to be loans at the end of the year after the UPE arises unless they are held as separate trusts. The good news is that the trust deed determines the income of the trust estate. Mum and dad generally require the cash.

Mum and dad's usual requirement for "all the cash" might be met more easily this year by a combination of capital advancements and income distributions - subject to meeting the both the technical requirements of the SBE and small business CGT concessions and the needs of individual beneficiaries.

In a draft practice statement (PS LA 3362) the Commissioner sets out, for his auditors, what he currently considers to be appropriate rates of return for any separate trusts established for bucket companies. The acceptable rates of return can (must) be determined in accordance with one of three methodologies. The so called appropriate rates of return may change.

The big questions

The questions on the lips of most tax agents are the following:

- ◆ what do we need to do by 30 June?
- ◆ do we need to get trust deeds amended?
- ◆ will our existing unpaid present entitlements to corporate beneficiaries become loans?
- ◆ can we keep using bucket companies?

Don't worry about spilt milk

What the trustee did before 16 December 2009 can be left well enough alone until well after 30 June 2010.

Tax agents have enough to do in the run up to 30 June without concerning themselves with addressing the things the trustee did prior to 16 December 2009. If what was done pre 16 December 2009 created a UPE then the Commissioner will not take it to be a loan. Sloppy ledgers and financials might benefit from some legitimate clarification after 30 June. The Commissioner accepts that can occur.

A small distinction needs to be made in relation to the date 16 December 2009. If in the period since 16 December 2009:

- ◆ your firm has prepared journals, written forms of resolutions or written forms of minutes relating to trustee's actions that occurred prior to 16 December 2009 you treat those trustee's actions as having occurred prior to 16 December 2009 (on the date on which the actions occurred rather than the date of documentation);
- ◆ a trustee has had meetings or made decisions or passed resolutions you should treat those things as having occurred since 16 December 2009.

What needs to be done by 30 June 2010?

The trustee of every trust needs to make a distribution before the end of each Accounting Period, usually 30 June.

Unless a trustee is willing to fight the Commissioner's view as set out in TR 2010/3, as to when in relation to the 2010 year of income, an unpaid present entitlement of a corporate beneficiary becomes a loan, then **before 30 June 2010** (or the end of the Accounting Period as appropriate) the trustee must:

- ◆ ascertain whether the deed contains a provision that deems an unpaid present entitlement to be a loan – a small but significant number of older deeds contain such a deeming provision and these amendments will be required by 30 June;
- ◆ ascertain what the deed determines is either the "income of the trust estate" or the mechanism for determining the "income of the trust estate";
- ◆ ascertain whether the deed empowers the trustee to "pay apply or set aside" a proportion of the income of the trust estate – a significant number of deeds contain such a deeming provision;
- ◆ ascertain whether a valid distribution empowers the trustee to make a distribution by a "**resolution made in writing before the end of the Accounting Period**" – a significant number of deeds require this nuisance provision;
- ◆ to avoid a section 99A assessment, resolve to distribute in the required manner and by the specified time, the entirety of the "income of the trust estate";
- ◆ use a form of distribution resolution:
 - ~ which sets out how the income of the trust estate is to be determined;

- ~ which employs the words “set aside” proportions of the “income of the trust estate” rather than the words “pay, apply or set aside”.

Given the impact of UPE’s being taken to be loans and the Bamford decision it is prudent to draw all resolutions this year in terms of a % of the distributable amount rather using the long favoured first \$XX etc. This will focus attention on whether a choice should be made between distributions to minors and distributions to bucket beneficiaries. Where adjustments to returned taxable income are likely a limiting resolution might be tried – but seek advice as to its form.

If there is little or no possibility of the Commissioner adjusting the returned taxable income of the trust a compromise approach, at or before the end of the accounting period, would be to direct the first \$XX to be share equally between the specified minors with the balance of the trust income to be shared in the following proportions. **Any adjustment will be made on a proportionate basis.**

Accounting Periods (and the date by which a distribution must be made) can end on a variety of dates, including the following:

- ◆ 30 June;
- ◆ a day prior to the last day of the financial year;
- ◆ at sunset on the last Friday of the financial year; etc etc

NOTE If a deed has any mechanism whereby the income of the trust estate can be made determined to be equivalent to section 95 income there may be no need to amend the deed at any time.

What is to be done after the end of the accounting period but before lodging the tax return?

Before the “income of the trust estate” for any accounting period concluding after 16 December 2009 is quantified so as to give meaning to the earlier resolution, the trustee (read accountant):

- ◆ must ascertain whether the deed requires an unpaid present entitlement to be held on a separate trust, a requirement which is not consistent with the financial accounts for the trust reflecting the unpaid present entitlement as a liability or loan account;
- ◆ should employ journals in the financial records of both the trust and the corporate beneficiary that accurately reflect the trustee’s resolution and the requirements of the trust deed, so as to reflect with certainty, an unpaid present entitlement of the corporate beneficiary:

Date	Account	Sub account	Description	Dr	Cr
			P&L Appropriation account OR Distribution Account	100,000	
			Unpaid entitlement – ABC Pty Ltd (use a sub account as was done with pre 97 loan ac to quarantine the entitlement away from other pre existing Entitlements)		100,000

Typically ledgers which record unpaid present entitlements have been established as liability accounts, or beneficiary loan accounts and little care has been taken with the headings to those ledgers or their type or character. This comment applies equally to the ledger that clients maintain.

Journals which accurately reflect both the requirements of the trust deed and the trustee’s resolution may necessitate the trustee (read accountant):

- ◆ to amend the Headers within the ledger account of the trust in the accountant’s software (Solution 6, Handisoft, Handitax, APS etc);
- ◆ if the software allows - to re-characterise the liability account as an equity account and to use appropriate memos recording the reasons for the change;
- ◆ to make corresponding amendments in the client’s accounting software;

In the books of the corporate beneficiary:

Date	Account	Sub account	Description	Dr	Cr
			distribution entitlement (use a sub account as was done with pre 97 loan ac to quarantine the entitlement away from other pre existing Entitlements)	100,000	
			distribution entitlement receivable		100,000