

One of two questions that most accountants are asking lawyers - right now

by Chris Wallis, Director, Tax Matrix Pty Ltd*

The Abstract

This article:

- ◆ examines the four broad types of distributable income mechanisms commonly found within deeds;
- ◆ explains how to identify and classify the distributable income mechanisms within a deed;
- ◆ identifies circumstances in which each of the four distributable income mechanisms are suitable or circumstances in which they are unsuitable;
- ◆ observes that the accountant must have a thorough understanding of the deed's distributable income mechanisms, the characteristics of trust receipts and the client before considering an amendment to the client's deed;

The question

In a period when accountants are being bombarded with literature promoting deed amendments most accountants, perhaps all, have questioned whether they “*need to have trust deeds amended*”.

Their question has historically reflected the fostering and or exploitation, perhaps subliminally, of two beliefs:

- ◆ trusts could be dealt with more simply, and therefore more profitably, within a practice by making all deeds within the practice the same;
- ◆ the practice of regularly amending all superannuation deeds within a practice to produce identical deeds is extendable to discretionary trusts.

If a deed requires amendment it seems likely that the deed must have a deficiency. What is that deficiency? How does that deficiency play out? Can the deficiency be eradicated without introducing other deficiencies? In the headlong rush to amend these questions are not often addressed.

More recently the promise of amendments to the tax law to clarify the results of streaming, and perhaps even a rewrite of Division 6, have forced consideration of the extent to which a deed permits streaming.

The promotional literature

The typical promotional material, which often promises reduced prices for job lots of deeds, neither explains the type of amendment that will be made, nor addresses the reasons for making the amendment. Almost without exception the literature fails to address the need for the trustee's consent or the need to consider and advise the trustee about:

- ◆ the two distribution mechanisms used in the relevant deeds and the relationship between those mechanisms;
- ◆ the assets comprising the relevant funds;
- ◆ the type of receipts being generated by the relevant funds.

The shortcomings in the promotional material merely underline the importance of the accountant having knowledge of the deed, the trust fund, the character of its receipts, and the tax status of the beneficiaries before attempting to justify, to the client, the reasons for the

deed to be amended, a justification that may involve the accountant engaging in legal practice.

What is the correct response?

The correct response is simple:

- ◆ a deed may serve the client's purposes best if it is left as it is; or
- ◆ the deed might serve that client's purposes better if it is amended.

The distribution mechanisms within deeds

Almost all deeds bear some similarities, they provide for a settlor, a settled sum, a vesting date, some distribution mechanisms and some beneficiaries. Beyond that there is not much that can be assumed to be similar notwithstanding that many firms, in the chase for profitability, use template distribution minutes which, for their efficacy, assume that deeds are identical.

Most deeds provide two separate distribution mechanisms:

- ◆ the **first distribution mechanism** provides the trustee with the power to appoint the income of the trust;
- ◆ the **second distribution mechanism** provides the trustee with a power to advance the corpus.

The two distribution mechanisms are linked by default in most, but not all trusts:

- ◆ in some trusts what is not distributed as income in an accounting period will be accumulated to become corpus;
- ◆ in many trusts what is not distributed as income will be accumulated and retained as income for distribution as income in a subsequent accounting period.

A deed may or may not provide a streaming mechanism.

The discretions within the first distribution mechanism

The first distribution mechanism will provide the trustee with either one or two separate discretions:

- ◆ some discretionary trusts (and many unit trusts) provide the trustee with a discretion to determine the amount of income that will be distributable in each accounting period;

- ◆ by definition in every discretionary trust the trustee has discretion to appoint the income that is distributable for the accounting period amongst the beneficiaries.

The time for exercising the discretions

If the deed provides the trustee with both discretions:

- ◆ the trustee must exercise the discretion to determine the income that will be distributable in an accounting period prior to appointing any income for the accounting period amongst the beneficiaries;
- ◆ the trustee should make an appropriate resolution or resolutions in relation to the exercise of each of the discretions.

A commonly used provision within a deed requires the trustee to appoint the income of the trust **prior to the end of** the accounting period.

Many deeds vary the time by which the trustee must appoint the income, some deeds bring it forward to 26 June, some to 29 June and a few deeds delay it until 31 October.

To protect against a section 99A assessment of income not distributed by the end of the accounting period many deeds contain a default distribution mechanism such as “If the trustee has not appointed the whole or any part of the income of the trust by 30 June (the trigger time) then that amount is ...[appointed in a particular manner].”

A provision of this type will be triggered at the conclusion of 29 June, although the triggering time can be any time, so that, on the evidence of the resolution, the entirety of the income will have been appointed in accordance with the protective default mechanism by the time recorded in the resolution.

Evidencing the exercise of a discretion

Most deeds require the trustee to evidence the exercise of any discretion in writing. A resolution will generally suffice, a minute may suffice.

Too often, template distribution minutes masquerading as evidence, lazily and less than credibly, record any discretion as having been exercised at 10:00 in the accountant’s office on 30 June. In many cases the accountant’s time sheet will bear annotations recording the actual location, date, time and manner of any meeting at which the resolution was made. This evidence should be reflected in the resolution.

A lazily documented resolution may result in:

- ◆ a distribution made in accordance with a protective default mechanism rather than as the trustee intended;
- ◆ a section 99A assessment if the deed does not contain a protective default mechanism.

Elaborating on what constitutes the amount the trustee can appoint

If the trustee does not have discretion to determine the amount of income that will be distributable in an accounting period the deed will specify the amount of

income that is distributable by describing that amount generically.

Irrespective of whether a deed provides for the trustee to determine the amount of income that can be distributed in an accounting period, or, specifies that amount in by the use of an alternative label, the deed generally contains a clause (the “income distribution clause”) resembling the following:

*‘The trustee may at any time prior to the end of the Accounting Period pay apply or set aside the **income**’ of the trust [or any part of the income of the trust] for any one or more of the beneficiaries ...’*

The word “**income**” specifies what can be distributed. Some income distribution clauses employ a phrase such as “**net income**” to specify the amount that is distributable.

The deed may or may not elaborate on the label employed. Draftspersons do not adopt a standard approach.¹ Where there is no elaboration of the description, of what constitutes the income that can be appointed, the expression takes its ordinary meaning even when that expression is “net income” (*simpliciter*). A reference to “**net income**” is not, without more, a reference to “**net income calculated in accordance with section 95**”.

It is the amounts that fall within the ambit of the description that determine the amount the trustee must distribute to avoid a section 99A assessment. Practitioners are increasingly referring to that amount as the “distributable income” following the High Court’s adoption of that terminology in endorsing² the proportional approach taken by Sundberg J in Zeta Force³.

The “**distributable income**” label, although not widely employed by draftspersons in deeds, is a useful label that reinforces the need to calculate, for every trust, both the distributable income and the taxable income even though, on some occasions, those two amounts might have identical numerical outcomes.

Distributable income mechanisms

A provision within a deed that elaborates (or fails to elaborate) on what constitutes, or might constitute, distributable income is the distributable income mechanism (“**DIM**”).

Over many years draftspersons have pursued one or other of two broad approaches to drafting **DIMs**:

¹ Any of the following expressions may be used by the draftspersons of the deed in lieu of the word “income”: Income, net income; Net Income, ordinary income; accounting income; income calculated in accordance with GAAP; income calculated in accordance with accounting standards.

² [Commissioner of Taxation v Bamford \[2010\] HCA 10 \(30 March 2010\)](#);

³ [Zeta Force Pty Ltd v Commissioner of Taxation \[1998\] FCA 728 \(29 June 1998\)](#).

- ◆ the first and longest lived of those broad approaches has been to draft a **DIM** that makes distributable income equal to ordinary income;
- ◆ the second and more recent of those broad approaches has been to draft a **DIM** that makes distributable income equal to the net income calculated in accordance with section 95.

Neither of these approaches provided the trustee discretion to determine the distributable income.

In recent years draftspersons have modified those broad approaches to drafting **DIMs** to provide the trustee with discretion to determine what receipts and outgoings will be taken into account in determining the distributable income.

The inclusion of those discretions followed the birth of franking credits and the proliferation of capital gains:

- ◆ capital gains that are fully assessable;
- ◆ capital gains that are partially assessable and partially disregarded;
- ◆ capital gains that are wholly disregarded.

There are now four types of **DIM**, two based on income and two based on assessable income:

- ◆ Type 1 **DIM** ~ generally the deed will not elaborate on the description “income” but some deeds elaborate by specifically including within that description, receipts, such as capital gains, that do not fall within the ordinary meaning of the description employed;
- ◆ Type 2 **DIM** ~ the deed will provide the trustee with a discretion to determine the distributable income to be whatever the trustee decides it is by a specified date and if the trustee does nothing by the specified date the distributable amount will be determined by a Type 1 **DIM**;

The income of the trust estate means the amount the Trustee determines before the end of the Accounting Period to be the income of the trust estate and in default of the Trustee making such a determination will be the ordinary income of the trust estate.

OR

The income of the trust estate will be the net income after taking account of the gross profits and gains of the trust estate and the expenses incurred in generating those profits and gains unless the trustee prior to 29 June in an accounting period determines the income of the trust estate to be some other amount.

- ◆ the Type 3 **DIM** ~ the deed will provide the trustee with a discretion to determine the distributable income to be whatever the trustee decides it is by a specified date and if the trustee does nothing by the specified date the distributable amount will be determined by a Type 4 **DIM**;

The income of the trust estate means the amount the Trustee determines before the end of the Accounting Period to be the income of the trust estate and in default of the Trustee making such a determination will be the amount determined in accordance with section 95

OR

The income of the trust estate will be the net income determined in accordance with section 95 ... unless the trustee prior to 29 June in an accounting period determines the income of the trust estate to be some other amount.

- ◆ the Type 4 **DIM** ~ generally the deed will not elaborate on the generic description “*the amount determined in accordance with section 95*” but some deeds do elaborate by specifically excluding receipts that would be assessable income, such as franking credits, or by specifically including disregarded capital gains or by including specific accounting rules.

Each type of **DIM** works well for receipts of a particular character. Type 2 **DIMs** and Type 3 **DIMs** provide the trustee with the flexibility to deal with receipts of all types. This can be seen in table 1 below.

Where is the DIM in a deed?

The lawyer’s version of a Treasure Hunt, the **DIM**, may be buried deep within in the deed, but is most commonly located:

- ◆ within the distribution clause through the incorporation of additional generic descriptions such as “ordinary income” or “assessable income” in lieu of the single word “*income*”; or
- ◆ within the Interpretation clause of the deed, sometimes the first clause, but it may be the last sub-clause; or
- ◆ at the tail end of the distribution clause; or
- ◆ deep within the accounting rules for the deed.

Where the **DIM** is not “front and centre” accountants have more difficulty in dealing with the deed and do so less profitably and with greater risk.

What are the consequences of the various DIMS?

The various **DIMs** result in different types of receipts being included in the distributable income of a trust. This can be seen by examining the outcome in each **DIM** for receipts of different character table 1 below in which the colour bars in column 1 identify receipts with similar character. The orange bar identifies capital gains and the vertically hatched Orange identifies non assessable components of capital gains.

Table 1.

Income distribution mechanism ("DIM")	Type 1 DIM	Type 2 DIM	Type 3 DIM	Type 4 DIM
	the income [#] of the trust estate	The trustee can determine the amount that will be distributable but the default distributable amount will be <i>the income[#]</i> of the trust estate	The trustee can determine the amount that will be distributable but the default distributable amount will be <i>net income calculated in accordance with s 95</i>	The net income calculated in accordance with s. 95 ⁺
Is this type of receipt included within the distributable income?				
Sales receipts / trading income	Yes	Yes unless trustee excludes	Yes unless trustee excludes	Yes
Management fees	Yes	Yes unless trustee excludes	Yes unless trustee excludes	Yes
Interest income	Yes	Yes unless trustee excludes	Yes unless trustee excludes	Yes
Rental income	Yes	Yes unless trustee excludes	Yes unless trustee excludes	Yes
Exempt Income	Yes	Yes unless trustee excludes	No unless trustee includes	No
Res Collective Investment Vehicle (CIV) distributions (other than capital gains or franked dividends)	Yes	Yes unless trustee excludes	Yes unless trustee excludes	Yes
Foreign Income (excl than capital gains)	Yes	Yes unless trustee excludes	May depend on treaties but trustee could exclude	May depend on treaties
Dividends (unfranked)	Yes	Yes unless trustee excludes	Yes unless trustee excludes	Yes
Dividends (fully franked excl franking credit)	Yes	Yes unless trustee excludes	Yes unless trustee excludes	Yes
Dividends (partially franked excluding franking credit)	Yes	Yes unless trustee excludes	Yes unless trustee excludes	Yes
Franking credits	No	^F No unless trustee includes	^F Yes unless trustee excludes	^F Yes
Statutory income under Division 40 – Capital losses	No	^F No unless trustee includes	^F Yes unless trustee excludes	^F Yes
Statutory income under Section 70-90 - Trading stock	No	^F No unless trustee includes	^F Yes unless trustee excludes	^F Yes
Deemed dividends	No	^F No unless trustee includes	^F Yes unless trustee excludes	^F Yes
Forex realization gains	No	^F No unless trustee includes	^F Yes unless trustee excludes	^F Yes
Res CIV distributions of capital gains	No	^F No unless trustee includes	^F Yes unless trustee excludes	^F Yes
Foreign capital gains	No	^F No unless trustee includes	^F May depend on treaties but trustee could exclude	^F May depend on treaties
Pre cap gains	No	^F No unless trustee includes	^F No unless trustee includes	No
100% Disregarded cap gains %	No	^F No unless trustee includes	^F No unless trustee includes	No
Non discount cap gains (asset held less than 12 months)	No	^F No unless trustee includes	^F Yes unless trustee excludes	^F Yes
Discount cap gain – taxable %	No	^F No unless trustee includes	^F Yes unless trustee excludes	^F Yes
Discount cap gain – non tax %	No	^F No unless trustee includes	^F No unless trustee includes	No
CGT small business concessions – 50% taxable	No	^F No unless trustee includes	^F Yes unless trustee excludes	^F Yes
CGT small business concessions – 50% disregarded portion	No	^F No unless trustee includes	^F No unless trustee includes	No
CGT small business concession – 25% taxable (after second 50% concession)	No	^F No unless trustee includes	^F Yes unless trustee excludes	^F Yes
CGT small business concession –after second 50% concession 75% non-taxable	No	No unless trustee includes	No unless trustee includes	No

N.B. [#] Some deeds arbitrarily modify what would be considered "income" - take care (see notes above).

N.B. ⁺ Some deeds arbitrarily modify s.95 income - take care (see notes above).

N.B. ^F Identifies receipts that might need to be considered in the context of the decision of the Full Court of the Federal Court in Forrest v Commissioner of Taxation [2010] FCFCA 6 (5 February) has passed largely un-remarked. The Forrest decision cannot be ignored in the context of deed amendments and is addressed at greater length in an Addendum to this article. (for further discussion see the addendum to this paper)

If a **DIM** doesn't include, or permit the inclusion of an amount, such as a non assessable capital gain, in the distributable income, and the beneficiaries have already taken that amount, it will be necessary to either record a loan or make a capital advance in addition to appointing the distributable income. This will generally require a further resolution.

Identifying which **DIM** drives each deed:

- ◆ is critical to identifying the style or resolution required for a trust in each accounting period;
- ◆ facilitates easier processing and greater profitability with less risk;
- ◆ makes checking of work easier.

A distribution of partnership income to the four trustee partners can result in each of the trusts having different distributable income because each of the four trusts has a different **DIM**.

What deeds does your practice deal with each year?

On the basis of each principal of an accounting practice having upwards of between 100 and 200 trust funds even moderately sized practices might deal with nearly 1000 trusts deeds each year.

Every practice will have deeds that have been sourced from anywhere between 10 and 100 deed providers over a thirty year period and several tax eras.

Our experience in recent years shows that even a firm with 1000 deeds would be exceptionally fortunate to have 100 identical deeds or 10% of its deeds from one provider.

One firm was surprised to find that their web based provider had used three different **DIMs** in deeds it provided within the last 18 months.

Another firm was surprised to find that one legal firm, that had provided 30% of its deeds, had used five different **DIMs**, albeit they only covered three of the four possible types of **DIM**, over an eight year period. What surprised the firm most was that these changes were made without any notice.

Many of the older deeds provide the trustee with discretions. Many newer needs provide no discretions. There is no hard and fast rule.

Unfortunately deeds are not provided with identifiers of either the type of **DIM** or its location within the deed.

Lifting the fog

A firm can easily undertake a successful **DIM** recognition exercise on its own. A **DIM** recognition exercise provides lasting benefits but requires organisation, commitment and resources to be successful. Some simple rules that can be applied for the purposes of the exercise are as follows:

- ◆ if there are no discretions in the **DIM** it will be Type 1 **DIM** or Type 4 **DIM**;
- ◆ if the **DIM** includes a reference to section 95 then it will be either Type 3 **DIM** or Type 4 **DIM**.

- ◆ if the **DIM** does not include a reference to section 95 then it is more likely to be Type 1 or Type 2.

With the correct approach and administrative support it is possible for 2 people to identify the type of **DIM** in more than 250 deeds in a day.

The results of any **DIM** recognition exercise undertaken using a firm's deeds have been excellent. The "Y genners" do get it, can do it and do take pride in identifying and characterizing the **DIM**. Unsolicited emails of appreciation in the days after a recognition exercise are ample proof of that.

The principals who participate in the recognition exercise also get it and almost without exception seek to use their own deed for the exercise.

However, the limitations of what is in essence formulaic exercise and people operating beyond their recognized skill set must be appreciated – the results of a well undertaken exercise will be useful to the practitioners and the practice but cannot be considered determinative.

One of the lasting benefits of the exercise is much greater awareness of the risks imported when a practice:

- ◆ takes on transferring clients;
- ◆ constantly changes its deed suppliers;
- ◆ orders deeds sight unseen in pursuit of the cheapest deed rather than the most appropriate deed;
- ◆ acquires deeds from suppliers that provide no of summaries of the deed characteristics, point of sale service or explanatory information.

Providing for the changes to allow for streaming

Without undertaking a detailed analysis of the proposed (at the time of writing) amendments to deal with the taxation of trust distributions, currently being considered by Treasury, it is sufficient to note that:

- ◆ the amendments deal with streaming of franking credits and streaming of capital gains;
- ◆ a client's trust will only be able to benefit from any proposed streaming provisions if the deed permits streaming and the method of keeping the books of account support streamed distributions.

The first question to be addressed in deciding whether a deed should be amended to provide for streaming is whether the client trust requires the benefit of the streaming provisions. The second question to be addressed is whether the books of account comply with both the requirements of the deed and also legislative requirements.

It is unlikely that a genuine trading trust will require the facility to stream income.

If the client requires the benefit of streaming the next task is to determine whether the deed provides for streaming.

Finding the streaming provision in the deed is comparatively simple, although the word streaming is rarely used. The usual indicators are phrases such as "income of a particular type" or income having particular "characteristics".

Does amending a deed solve a problem?

It is a trustee's discretion to determine the distributable income, and the accountant's keen appreciation of the difficulties of undertaking that task for a wide range of deeds before 30 June, that has many experienced accountants seeking a simpler solution.

That simpler solution is perceived by some accountants to lie in amending deeds to remove the discretion to determine distributable income and thus remove a 30 June compliance issue. The ability to uncritically use a single template distribution resolution for all trusts within a practice is often seen as the real benefit of the simpler solution. The folly if not the risks of such a formulaic approach should be plain to all.

Removing the trustee's discretion to determine the distributable income from a Type 2 **DIM** or a Type 3 **DIM**:

- ◆ will not solve the 30 June compliance issue in a discretionary trust as the trustee must still appoint the distributable income by the end of the accounting period to avoid a section 99A assessment;
- ◆ will result in the trust reverting to a Type 1 **DIM** or a Type 4 **DIM** respectively and potentially create further issues that need to be addressed.

If a deed contains a Type 2 **DIM** or a Type 3 **DIM** it is unlikely that amending the **DIM** is necessary, justified or even desirable.

Perversely Type 4 **DIM**'s provide the least satisfactory outcomes yet they were incorporated in deeds drafted in the early 90's to deal with capital gains, or in amendments made to Type 1 **DIM**s to deal with capital gains.

Amending the deed to provide for streaming may be justified. Whether the deed needs to be amended to provide for streaming will depend on whether it would be advantageous to the beneficiaries to be able to receive streamed distributions.

In summary

Arguably, and depending on the terms of the letter of engagement, an accountant may have a duty to advise the client to consider having their deed amended.

There will be compelling reasons to have some deeds amended.

Any decision to amend a deed requires knowledge of:

- ◆ the **DIM** currently within the deed;
- ◆ the **DIM** that will replace the current **DIM**;
- ◆ whether the trust receives franked dividends or capital gains and whether it would be advantageous to the beneficiaries to stream those receipts.

Amending deeds:

- ◆ creates risks, especially in relation to resettlement;
- ◆ is not the panacea for the difficulties of dealing with deeds and drafting resolutions within an accounting practice.

Risks associated with amendment must be identified and explained to the trustee before the trustee is asked to consider or agree to any amendment.

Any conclusion reached about the desirability of amending a deed for one trust cannot be extended to another deed for another trust, even an identical deed, unless the other trust has an identical asset, income and beneficiary profile, a situation that is unlikely to arise too often.

If the trust is likely to receive franked dividends or capital gains, including distributions from other trusts of franked dividends or capital gains or franked dividends recycled through a corporate beneficiary, the trustee must consider the potential benefit to the beneficiaries of having the deed amended to include streaming provisions.

If the deed provides the trustee with sufficient flexibility in determining and appointing the distributable income it probably doesn't need amendment. The deed may simply need an accountant who is willing to identify and use that flexibility and to adjust the practices within the firm accordingly. Clients wanting the benefit of a trust must be willing to pay fees that reflect their accountant's skill.

Accountants must identify and exploit the flexibility within a deed rather than persist with the belief that amendments will provide a one size fits all solution for an accounting practice to increase its profitability. While that approach might be possible for superannuation deeds it is not possible for discretionary trusts or unit trusts.

Given the cost of amending deeds, and the need for the accountant to identify, consider and explain the attendant risks to the trustee in the course of seeking the trustee's agreement a decision to advise the trustee to amend the deed should only be taken after careful consideration of:

- ◆ the extent to which the existing deed is "fit for purpose" (the client's purpose rather than the accounting firm's purposes);
- ◆ the likely costs of the deed of variation and the associated resolutions;
- ◆ the costs (stamp duty and CGT) that would be incurred if there was a resettlement;⁴
- ◆ the extent to which the lawyer retained to effect the amendment precludes the risk of resettlement.

In any discussion about deed amendments the usual follow up question is whether there is any point in amending a deed now or whether it would be better to wait until the rewrite of the trust legislation is finalised. Again the answer is simple – if the deed provides the trustee with sufficient flexibility it probably won't need amendment – at any time.

It is the trustee's risk, it is the trustee's decision to make. In making that decision the trustee must be properly informed.

⁴ The author is aware of one legal firm (Melbourne) that will give a warranty in relation to the resettlement issue – but an extra fees are charged for doing so.

Last but not least

Last but not least - not all deeds provide for a power of amendment in which case it might be necessary to rely on the relevant trustee legislation.

It would be embarrassing for all concerned to suggest that a trustee have their deed amended only to later find that the deed either did not provide for any amendments, or if it made provision for amendments, it only provided for limited amendments. Unfortunately there are many examples of amendments made without regard to the amending clause or procedures.

When preparing a deed of amendment a good lawyer will generally, but not always, recite the entirety of both the amendment clause. They will also recite in similar fashion any consents required from appointors or guardians. Finally they will list all previous amendments.

If the lawyer doesn't recite the entirety of the amendment clause they will identify the location of the clause within the deed.

Table 3 The situation can be summarised as follows:

	Type 1 DIM	Type 2 DIM	Type 3 DIM	Type 4 DIM
Deed contains a streaming provision	An amendment to the DIM may need to be considered if the trust is likely to generate capital gains. If an amendment is made consideration needs to be given to the unresolved tensions between a present entitlement and an absolute entitlement. Assessable capital gains can only be distributed by a capital advance.	Only in the rarest circumstances will an amendment to the DIM be required If an amendment is made consideration needs to be given to the unresolved tensions between a present entitlement and an absolute entitlement.	Only in the rarest circumstances will an amendment to the DIM be required. The trustee is in a position to eliminate the difficulties created by tax losses.	An amendment to the DIM may need to be considered if the trust is likely to generate franking credits or capital gains. Tax losses can create difficulties. Non assessable capital gains can only be distributed by a capital advance.
Deed does not contain a streaming provision	An amendment to the DIM may need to be considered and, a streaming provision inserted, if the trust is likely to generate capital gains. If an amendment is made consideration needs to be given to the unresolved tensions between a present entitlement and an absolute entitlement. Assessable capital gains can only be distributed by a capital advance.	An amendment to include a streaming provision should be considered if the trust fund generates or is likely to generate either dividends or capital gains. If an amendment is made consideration needs to be given to the unresolved tensions between a present entitlement and an absolute entitlement.	An amendment to include a streaming provision should be considered if the trust fund generates or is likely to generate either dividends or capital gains. The trustee is in a position to eliminate the difficulties created by tax losses.	An amendment to the DIM may need to be considered, a streaming provision inserted, if the trust is likely to generate franking credits or capital gains. Tax losses can create difficulties. Non assessable capital gains can only be distributed by a capital advance.

*Tax Matrix Pty Ltd is a registered tax agent 82933 000.
Chris Wallis is a registered tax agent 82443 003 and a member of Greens List - Victorian Bar

Annexure (included for the sake of completeness)

A problem that has been ignored - the impact of the decision in Forrest

In Forrest the Court considered the deductibility of interest incurred in relation to the acquisition of units in a trust. The beneficial interest in the trust fund was divided (at clause 3.2) into components:

- ◆ the Unit Component was held on trust for the Unit Holders (who held Ordinary Units) from time to time;
- ◆ the Discretionary Component generally held, at the trustee's discretion, for the discretionary beneficiaries.

A similar issue would arise in any trust in which one group of beneficiaries had entitlements in relation to the income of the trust and another group had entitlements in relation to the capital.

In Forrest the deed relevantly provided for the trustee to determine the Income of the trust:

12 DETERMINATION OF INCOME

12.1 The Trustee ...may at any time and from time to time determine whether:

- (a) (i) any amounts received or disbursed, or any amounts of income, profit or gain or loss;

- (ii) *any amounts derived accrued or incurred or deemed to have been derived accrued or incurred under [the Act] for or in respect of any Financial Year;*
- (iii) *any amounts that under the [Act] are capital gains or capital losses and any amounts that are assessable income or allowable deductions with respect to the net income (as that term is understood for the purposes of section 95 of the 1936 Act ...for any Financial Year,*

are on capital or income account or partly on capital and partly on income account and in what proportions and the decision of the Trustee whether made in writing or implied from the acts of the Trustee shall be conclusive and binding on all persons; and

- (b) *any taxes expenses outgoings losses debts or obligations due or accruing shall or ought to be paid or borne out of the capital or income of the Fund and the determination of the Trustee in this respect shall be conclusive and binding on all persons.*

At first instance the Tribunal held that by cl 12.1 and possibly 12.2(a) of the Trust Deed, the Trust was a discretionary trust of income.

On Appeal Forrest submitted that cl 12 was a power to classify receipts, and does not, and cannot, be used to vary the trusts created by cl 3 so that the trust was a fixed trust of income so that the interest expense was deductible. The Court summarised the argument at paragraphs 24 and 25 as follows:

[Forrest] argues that cl 3 creates the trust or trusts, and that cl 12 is a mere power to classify income ... because cl 3 is imperative in its terms, and cl 12 is permissive, the usual distinction between a trust and a power: see Heydon and Leeming Jacobs' Law of Trusts Australia (7th ed) at [246]

The appellant further submits that cl 12 is a power to classify receipts, and does not, and cannot, be used to vary the trusts created by cl 3.

The Full Court held that:

- 27 *In our opinion, the power conferred by cl 12 cannot be exercised by the trustee wrongly to classify a receipt as a capital gain, when the receipt is, in truth, income, and thus deprive [Forrest] of his interest in the unit component of the trust. Clause 12 is not an unlimited power to be exercised in the trustee's unconfined discretion.*
- 28 *... Clause 12.1 is a power to make an honest administrative determination whether receipts are on capital account or income account. It is not a power to determine, in the trustee's unconfined discretion, whether a receipt "represents realised or unrealised capital gains".*
- 29 *... The words used [in clause 12] can be given full force as a power honestly to classify income or distributions according to law, as [Forrest] contended to this Court. ...*
- 30. *In our judgment, cl 3.2, together with the definitions, and the rights expressly conferred on the Unit Holder by cl 4, demonstrate that the settlor's and trustee's objective intention was that income other than capital gains was to be held on a fixed trust for the Unit Holders, and capital gains were to be held on a discretionary trust.*

Following the Forrest decision a question that must be considered prior to making any amendment is whether the trustee's classification of a capital gain will enable the trustee to treat that capital gain as "income of the trust estate".

To the extent each of the Type 3 DIM and a Type 4 DIM empower the trustee to classify capital gains as income they will be ineffective in some deeds, but which deeds?

If the proposed amendment will result in the trust having a Type 3 or a Type 4 DIM the issue will be determined by ascertaining the Settlor's and Trustee's objective intention.

If a trust already has a Type 3 DIM or a Type 4 the problem already exists.

The problem will also exist in a trust with a Type 2 DIM if the trustee seeks to include capital gains as part of the income of the trust estate.