Trusts

- ‘Types of trusts:
    - Express – set up by a document (e.g. trust deed)
    - Constructive – set up by an action (e.g. *Zorbory case)*
    - Inter vivos – ‘living trust’ that can distribute assets within the trustor’s lifetime
    - Testamentary – goes into effect following death of the trustor; provides a vehicle for wealth preservation
    - Fixed – beneficiaries are entitled to fixed proportions (e.g. unit trusts)
    - Discretionary – entitlements of beneficiaries are at the discretion of the trustee

Charles v FCT (1954) 90 CLR 598
Provides an explanation of what it means to be a unit holder in a unit trust versus a shareholder in a company: shares hold no legal or equitable interest in the assets of the company, whereas units confer a proprietary interest in all of the property which for the time is subject to the trust deed.

Discretionary Trust
Beneficiaries are allocated trust income or capital by Trustee’s discretion
Ability to split income between beneficiaries taking into account the tax profiles of the beneficiaries (subject to anti-avoidance provisions)
Trust provides asset protection in the case of beneficiaries becoming bankrupt
CGT Event E4 does not apply, thus tax concessions at the trustee level flow through to the individual beneficiaries
‘Appointor’ determined by trust deed can revoke powers of Trustee and appoint a new Trustee
Trustee administers property ‘on behalf’ of beneficiaries
Settlor pays fee to Trustee for investment/operations
Trust wound up on vesting date or earlier by distributing all of the income and capital of the trust estate to beneficiaries

Capital Beneficiaries and Income Beneficiaries

Proportionate View
Presently entitled to 100% of net income of the trust, and thus taxed on capital amounts as well, despite not receiving them.

Quantum View
Fails to identify who should be the taxpayer for capital amounts – and thus, if the amount remains in the trust, it will be taxed at the top marginal rate + Medicare levy. Contradicts the reality of capital beneficiaries.

Bamford v FCT (2010) 240 CLR 481
FCT denied deductions for loan to pay superannuation charges and interest, increasing the assessable income (and thus tax payable) by the beneficiaries. After deducting the family's distributions, the remaining balance was meant to be distributed to the Church of Scientology. The Bamfords argued that any increases in assessable income should thus be allocated to the Church of Scientology. Thus, the Bamfords advocated a quantum approach. **The High Court confirmed that a proportional approach should be applied.**

Taxation of a Trust

1. Calculate net income of trust
    a. If there is a net loss: net losses trapped at trust level
2. If there is net income: are any of the beneficiaries presently entitled to the trust income?
    a. No: Trustee pays tax under s99 or 99A ITAA 1936
3. Yes: Is the beneficiary entitled to the trust income under legal disability?
    a. Yes: Trustee pays tax on behalf of the beneficiary under s98 ITAA 1936
4. No: Beneficiary pays tax under s97 ITAA 1936

- A beneficiary presently entitled to a share of the trust income is in general taxed under section 97 of ITAA1936. His or her assessable income will include that share of the net income of the trust.

- A beneficiary is taxed under section 98 ITAA1936 if he is under legal disability, which includes (1) minors; (2) lack of mental capacity and (3) bankruptcy.

- The prevailing approach to allocate the net income of a trust to its beneficiaries is the proportionate approach, instead of the quantum approach.

- A trust follows the trust law definition of income and derived rental income $200 and capital gain $100 in the current income year. Its trust income is $200 and its net income is $300.

- Accumulated income in a trust in general is taxed in the hands of the trustee at the top marginal rate (+ Medicare levy) pursuant to section 99A ITAA1936.

- A minor receiving passive income in general is taxed at the top marginal rate pursuant to Division 6AA ITAA1936.

Trusts – Legislation

Authority	Provision
S97 ITAA 1936 *Beneficiary Presently Entitled and Not Under a Legal Disability*	Where a beneficiary is presently entitled and not under a legal disability, the assessable income of the beneficiary shall include that share of the net income of the trust estate
S98 (1) ITAA 1936 *Beneficiary Presently Entitled and Under Legal Disability* S100 (2) ITAA 1936	For a beneficiary that is presently entitled and under a legal disability (a minor, insane or bankrupt), tax is payable on the distribution amount by the Trustee on behalf of the beneficiary Beneficiary is entitled to a deduction for the tax paid by the Trustee
S98 (2A) & (3) ITAA 1936 *Beneficiary Presently Entitled and Non-Resident*	Income is taxed in the hands of the Trustee at the rates applicable to non-residents
S102 ITAA 1936 Division 6AA ITAA 1936 *Beneficiary Presently Entitled and a Minor*	Children under 18 are taxed at the highest marginal rate + Medicare levy (Tax free threshold: $416 – not subtracted from higher amounts)
S99A ITAA 1936 *No Beneficiary is Presently Entitled*	Undistributed amounts are taxed at the highest marginal rate + Medicare levy (for this reason, trusts often have a ‘default beneficiary’ – often a corporate trust to cap tax liability at 30% – which the excess will be automatically distributed to at year end)
S95 (1) ITAA 1936 *Income of the Trust Estate vs. Net Income*	The net income is the total assessable income of the trust estate calculated under the tax law as if the trustee were a resident, less allowable deductions; capital gains are also included in assessable income Income of a trust estate is calculated as per regular standards, and thus, does not include capital amounts