Trust Deed Clauses to Look For

This brochure is designed to inform and assist Trustees in locating a few of the clauses in their Trust Deed that help ensure that income is taxed by the correct beneficiaries in the correct amounts - specifically those clauses that are impacted by recent court cases and ATO rulings.

Errors in the deed can lead to a multitude of problems, with (arguably) the worst being that the Trust is taxed on all of the income at 46.5% - a big penalty when one of the benefits of a trust is streaming income to low tax paying individuals.

To assist Trustees, some example clauses are contained in this brochure. These examples are provided to give Trustees a better indication of what they are looking for in their Deed to assess whether their Deed is suitable.

Disclaimer

We have provided this document to assist you in locating the Clauses of your Trust Deed that determine what "Net Income" is, how it is distributed, and how much flexibility the Trust has in making distributions.

The terms of your Trust Deed are legally binding on the Trustees and Beneficiaries - so understanding what is contained within is very important. It is therefore logical that ensuring that the terms of the Deed are appropriate is also very important.

This document is not to be taken as advice under any circumstances as the alteration of a Trust Deed is something that needs to be done by a Legal Professional. If you are considering acting based on anything written in this document, we suggest you seek legal advice first.

We will not accept liability for anyone relying on the contents of this document

No warranties are given in respect to any examples of Deed clauses provided in this document - we are not recommending that these clauses are used, they are mere examples of what some Deeds contain.

We are able to procure Trust Deeds that have been written by legal professionals for a small fee should you wish to have your Deed updated and not be comfortable doing so yourself.

Determination of Net Income or Trust Income

"Net income" or "trust income" is basically income based on ordinary accounting concepts. One deficiency this has is that items of "statutory income" (i.e. items that are taxable only because of specific Legislation) such as capital gains and franking credits are not classified as income under ordinary accounting concepts.

This can create a situation where "net income" is different to "taxable income" - and that can cause a multitude of problems.

To get around this, a good trust deed will give the Trustees the discretion as to what amounts are included in "net income".

Example Clause

The Trustee may treat any profit, gain or receipt which is assessable income for the purposes of the Tax Act as net income of the Trust.

The Trustee may treat any expenditure, payment or loss which is an allowable deduction for the purposes of the Tax Act as expenditure against the net income of the Trust.

Streaming Different Types of Income

Tax Law taxes different types of income differently depending on who earns that income.

Individuals can get a 50% discount on capital gains, whereas companies cannot; and minors lose the benefit of franking credits if they don't have a TFN to name a couple. When a Trust earns these types of income, unless an effective "streaming clause" is in the Deed, each beneficiary gets a proportion of all these different types of income.

An effective streaming clause would allow you to distribute all of the capital gains to an individual, all the franked dividends (and franking credits) to someone other than a minor, and the rest of the income to everyone else - which helps minimise tax.

Example Clause

The Trustee in its absolute discretion will have the power to classify any particular source of net income, including but not limited to capital profits or gains, dividend income with franking credits...and may pay or set aside any class of net income to particular beneficiaries and may exclude any beneficiaries from a certain class of net income.

Any distribution to a beneficiary will retain its character and be of the same nature and substance in the hands of the beneficiary as it was to the Trustee.

Required Resolution

A trust is basically a vehicle for earning income on behalf of the beneficiaries. Each year, the trust does a set of accounts, calculates a profit or loss, and then has to decide whether any profit is distributed to its beneficiaries or is accumulated in the trust.

From a tax point of view, any amounts not distributed are taxed at 46.5%. ("Distributed" here does not mean physically paid, but simply apportioned to or applied for the benefit of a beneficiary - which commonly results in the distribution being attributed to a loan account so the beneficiary can draw those funds out at a later date.)

The ATO's stance (which is backed up by the Courts) is that a Trust must actually make the decision to distribute - it is not just a default thing that occurs. If the trust doesn't make that decision, by default (as per Trust Law) any profits are accumulated and therefore taxed at 46.5%.

In addition, the ATO requires (which is also *somewhat* backed up by Trust Law) that this decision must be made by 30 June (i.e. the last day of the financial year in question), **unless your trust deed specifies an earlier date**.

While it would be uncommon for a trust to dictate an earlier date, it is possible.

It is important because if you create a minute stating that you decided on June 30 to distribute to "x" beneficiary all of the net income, but your deed states is must be done earlier - you are deemed not to have made the distribution and the Trust is taxed at 46.5%.

Example Clause

The Trustee must determine to set aside or pay to one or more beneficiaries the net income of the trust by ***May 30*** *(or any other date the Deed may specify).*

Default Beneficiary

The one possible exception (and we state possible as it hasn't been tested in Court) to the above rule that "should the Trustee not make the decision to distribute by June 30, the Trust pays 46.5% tax" is if the Deed has a "default beneficiary" that receives any un-allocated or un-distributed income.

Many deeds don't have a default beneficiary clause because it prevents the trust from being able to accumulate income (which has its place despite the 46.5% tax rate), but there are some Deeds that do.

Whether a default beneficiary clause is effective is another question, and unfortunately one we can't definitively answer. Many legal professionals say it is, the ATO says that it probably isn't.

Example Clause

> *Should the trust not distribute all of the net income of the trust before the expiration of the accounting period, any un-distributed amounts are deemed to be set aside for the benefit of [insert beneficiary] by way of crediting a loan account in their name.*