

THE BAMFORD DECISION – HOW DOES IT AFFECT YOUR CLIENTS' TRUSTS?

Since the High Court handed down its decision in the Bamford case on 30 March 2010, we have been looking carefully at the decision with our lawyers and tax advisers.

The decision of the High Court supports the view that:

- 1 The term “share” in section 97 of the Income Tax Assessment Act 1936 (the “Act”) means a “proportion” of the net income of the trust. The court rejected the notion that the term should refer to a quantum of income distributed to a beneficiary. In other words, a beneficiary might be liable for tax on amounts not received or distributed to it. This is particularly relevant where the Commissioner issues an amended assessment which increases the net income of the trust. The proportionate approach means that each beneficiary will bear tax on the increased amount in the proportion that their distribution bears to the net income of the trust determined before the increase in net income.
- 2 The trust deed for the trust can define what income is. This means that, provided the trust deed has an adequate definition of income and the trustee has the discretion to determine what is or is not income at any time, the trustee can include in income items that might not otherwise be income (e.g. capital gains).

There are 2 other issues that practitioners must also be aware of:

- 1 The Commissioner issued a Decision Impact Statement and Practice Statement (PS LA 2010/1) on 2 June 2010. These deal with the ATO’s interpretation of the decision and how the ATO will apply the decision. The statements released by the ATO are open for consultation. Practitioners should carefully consider each of these statements and how they will impact on trust deeds.
- 2 There are a number of issues that the High Court did not address and which are still open for discussion. The ATO has indicated in the Decision Impact Statement and Practice Statement PS LA 2010/1 its interpretation of some of these.

Our standard discretionary trust deed was amended in August 2009, shortly after the Full Federal Court handed down its decision in the Bamford case. At that time, provisions were inserted into our deeds to take advantage of that decision.

Many older trust deeds do not have the necessary provisions to enable them to take advantage of the Bamford principles. Without those provisions:

- the trustee may not be able to determine how income is to be defined in any financial year;
- the trustee may not be able to attribute particular expenses against income of a particular category;
- the trustee may not be able to distribute specific categories to particular beneficiaries;
- some beneficiaries may be required to pay tax on amounts they are not entitled to and have not received.

What to do?

Trustees of discretionary trusts should now review their trust deeds to determine if:

- the trust deed contains an adequate definition of income and if the trustee can determine at any time what definition the trustee will apply;
- the trust deed contains a discretion for the trustee to determine the nature of receipts and expenses and whether they are applied to the income account or to capital account;
- the trust deed contains a power for the trustee to distribute specific categories of income to particular beneficiaries.

Trustees and their financial advisers must also review the activities of their trusts and determine if the income definition is effective for those activities.

Where the trustee determines that changes to the trust deed are necessary or desirable, we can provide a deed of amendment to incorporate our post-Bamford changes.

Prompt action is now needed to avoid the consequences of not having the appropriate terms in your clients' trust deeds for the current financial year.

Important Note

Great care needs to be taken when amending trust deeds to incorporate these changes, as the trustee must exercise caution to ensure that the trust is not resettled. Resettlement may result in capital gains tax or stamp duty liabilities.

While we do not provide an opinion on possible resettlement issues, if such an issue is identified, we will refer it to you for instructions.

We are also aware that some suppliers do not sight trust deeds when making similar amendments. The dangers of resettlement are amplified with this practice as there is no way of knowing if these changes can be legally made or if a potential resettlement issue arises.

If you have any queries or require trust deed amendments, please call 1300 880 963