

february 2012

risk of trust resettlement

This article appeared in this month's edition of the Law Society Journal (NSW).

You receive a letter from the accountant for a client of yours enclosing a trust deed and asking you to amend the deed to "make it comply with the High Court's decision in *Bamford v The Commissioner of Taxation*".

Given the vagueness of the accountant's letter, you call to find out exactly what you are being asked to do. You are told to insert a definition of income and make sure the trustee can stream franked dividends and capital gains – it is explained that by "streaming" the trustee can, for example, give all the capital gains to one beneficiary, all the franked dividends to another and all other income (interest, rent and so on) to a third.

The accountant also tells you that the trust, which was established in 1989, owns a block of residential units in Sydney and a large share portfolio.

During the discussion you explain that you recently attended a seminar where they said in order to be able to stream all of a capital gain to a beneficiary, in most cases a trust deed needs to contain a clause giving the trustee the power to make capital distributions to beneficiaries.

You look at the deed and discover it has no definition of income, no income streaming cause and no capital distribution clause, but that it does have a clause giving the trustee the power to amend the deed in any way it chooses.

Reviewing the deed you also note that the trust vests when the settlor's youngest grandchild turns 30 and at that time the capital is to be distributed to the settlor's grandchildren equally.

You prepare the required deed of amendment, inserting a definition of income, an income streaming clause and, at the accountant's request, a clause giving the trustee the power to distribute capital to any beneficiary.

The sting

Based on the ATO's view in its Statement of Principles you have probably, in the eyes of the ATO, resettled the trust due to the addition of the capital distribution power.

Generally, the addition of a definition of income, would not result in a trust being resettled. In its Statement of Principles the ATO states: "Although inserting or varying an income definition may materially change the rights of beneficiaries, it may not in itself alter the essential nature and character of the trust relationship so as to result in a new trust estate. The ATO will accept that no new trust estate arises where, in the absence of other factors:

- it can be reasonably concluded that the purpose and effect of the new definition is to clarify rather than significantly redefine entitlements to income and capital;
- where there is a significant change in respective entitlements, it is between the rights of a single beneficiary or class of beneficiary, rather than between different beneficiaries or classes of beneficiaries."

Likewise, the addition of a power to stream income is unlikely to result in a trust being resettled as it is a procedural change which will not substantially alter the rights of beneficiaries in respect of trust property.

However, the addition of a power to distribute capital before the vesting date is likely to amount to a resettlement.

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The terms of the trust suggest that the settlor, by not including a power to distribute capital, intended that the trust capital would be preserved until the vesting date and then pass to his grandchildren.

By inserting a power to distribute capital you have, in the ATO's view probably changed the essential nature and character of the original trust relationship and therefore created a new trust.

As the trust is deemed to have disposed of all of its assets at market value the unrealised capital gains will become taxable.

It is always important to consider resettlement risks whenever you are amending a trust deed.

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