THINKING **BUSINESS, ESTATE PLANNING & TRUSTS**

Streaming provisions in the Tax Act have had a direct impact on Discretionary and Testamentary Trusts. As part of the process of considering proper business structures or as part of estate planning, it is common to establish a trust structure. Most family trusts are discretionary trusts. That means that the trustee has power to decide which of the beneficiaries will participate in any distributions of income or capital and amongst those participating beneficiaries what share, percentage or amount each will receive.

Many people as part of prudent estate planning have wills that create testamentary trusts which include discretionary powers given to the trustees.

Prior to the 2010 – 2011 tax year well drawn trust deeds and wills with testamentary trusts covered all the foreseeable possibilities and appropriately empowered the trustee to make discretionary distributions of both income (yearly) and capital. The Tax Laws Amendment (2011 Measures No5) Act 2011 significantly altered the procedural requirements as to the tax treatment of capital gains and the distribution of franked or partly franked dividends on shares and as to the allocation of franking credits attached to those dividends.

As a result of the enactment of that legislation, many wills and family trusts drafted before 2011 do not adequately empower trustees to allocate these capital gains and franking credits and the result can be substantial adverse tax liabilities for the family trust or the beneficiaries under wills.

What the tax law now requires is that:-

- the definition of income must include capital gains and franking credits;
- a particular beneficiary(s) is designated as "specifically entitled" to an amount of a specific capital gain after offsetting any capital losses. Only then will the net capital gain be attributed for tax purposes to that specific beneficiary;
- where the trustee holds shares in a company and receives a franked or partly franked dividend from that company, the assessable income of the trust includes the franking credit on that distribution (as well as the dividend itself). The trustee must then decide which beneficiary or beneficiaries is "specifically entitled" to receive the franked dividend. The franked distribution (dividend) and the franking credits are then "streamed" to that specific beneficiary/ beneficiaries). For this to occur, the Trust Deed must contain dividend streaming provisions that empower the trustee to stream franked distributions "to a specifically entitled" beneficiary, and,
- The Trustee must keep records that clearly detail all such allocations.

If your family trust does not contain adequate provisions that empower your trustee to decide which beneficiaries are specifically entitled to:-

- Capital gains;
- Franked dividends and franking credits; and,
- Keep the required records, there may be serious adverse tax consequences to your family trust or testamentary trust and also to the beneficiaries.

The keeping of proper records as to the allocation of capital gains and franked distributions are essential for the allocations to be effective. Your Trust Deed must provide for this.

If you have, as part of your business or estate planning arrangements a will that contains testamentary trusts, or if you receive income by way of franked dividends through a discretionary trust structure you should seek accounting, financial, legal and tax advice as to the legislative changes might affect you. By obtaining professional advice to review your discretionary trust and/or will you may have the opportunity to maximise the benefit to the beneficiaries.

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