FIRM LOGO

Our Ref: TD Letter 2023

To the Trustee

[ name of Trust]

Dear Trustees

**General Advice Letter – Making Trust Distributions**

I hope this letter finds you well. As we approach the end of the financial year, it is crucial to revisit the rules and regulations surrounding trust distributions to the beneficiaries. This letter aims to provide a summary of the requirements, highlight the parameters of Section 100A of the Income Tax Assessment Act 1936, discuss the implications of the Owies case where the Trustee of a discretionary trust did not take into account the needs of named beneficiaries, and offer some practical tips for your consideration.

1. **Trustee Requirements**

The trustees have a fiduciary duty to act in the best interests of the beneficiaries. When making distributions, you must adhere to the terms of the trust deed, which outlines the rights, duties, and obligations of the trustee and the beneficiaries. It is essential to ensure that the distributions are made in accordance with the trust deed and that proper records are maintained for each distribution.

1. **Streaming of Income for Tax Efficiency**

The trustee may be able to stream different forms of income to different beneficiaries to achieve tax efficiency. However, it's important to note that the trust deed must allow for income streaming, and the trustee must make a valid resolution to stream the income.

1. **Distributions made but not Paid**

Trust distributions made to beneficiaries, which may include family members, companies, and trusts, will require the beneficiary to include the distribution in their income tax return for the year ending in which the distribution is made. However, it is common practice for amounts left unpaid. These are called unpaid present entitlements (UPE) and after a period of time will become loans from the beneficiary to the Trust.

If the beneficiary is a company – often known as a bucket company, as it collects distributions from a trust at a lower tax rate than other beneficiaries, there may be a requirement for interest to be paid on the loan under Division 7A of the Income Tax Assessment Act 1936 (ITAA 1936).

We also advise that such loans in the names of beneficiaries are exposed in the event of litigation, including bankruptcy, insolvency, family law, and family provision claims. Any claim can not only tie up the beneficiary but also force the trust into liquidation or the forced sale of assets. We can discuss with you the ability to transfer UPEs to a special-purpose Family Protection Trust that, when properly created, shields against litigation.

1. **Section 100A**

Section 100A of the ITAA 1936 deals with reimbursement agreements in relation to trusts. This might be where a trustee distributes money to an adult child who does not get paid, and then the trustee uses the money personally. The Australian Taxation Office (ATO) has clarified that an 'arrangement or understanding' under this section must have been entered into consensually. However, the acceptance or adoption of such an arrangement can be tacit, and the arrangement itself can be both informal and unenforceable. There are exceptions where the arrangement is part of ordinary family or commercial dealings. However, it is something that the trustee must bear in mind when making a distribution that is not paid.

1. **Owies Case – removal of Trustee**

*Owies v JJE Nominees Pty Ltd [2022] VSCA 142* is a landmark decision that has significant implications for trust distributions. The case highlighted the need to consider the financial position of all named beneficiaries. We note that this is a Victorian decision and may not be followed in other States, but consideration should be taken.

Guidelines from the Owies decision that trustees should consider include:

1. **Trust Deed Provisions:** The trustee must follow the terms of the trust deed, which will often outline how and when distributions should be made. This can include specific instructions about distributing income or capital, or it may provide the trustee with discretion to decide.
2. **Beneficiary Needs and Circumstances:** The trustee should consider the current needs, circumstances, and future needs of the beneficiaries. This can include their financial situation, health, age, and other personal circumstances.
3. **Equitable Treatment:** While the trustee has discretion, they must act impartially and in the best interests of all beneficiaries. This doesn't necessarily mean distributions must be equal, but they should be fair and justifiable.
4. **Tax Implications:** The trustee should consider the tax implications of any distribution. Different types of distributions (income, capital, etc.) can have different tax consequences for both the trust an the beneficiaries.
5. **Legal Obligations:** The trustee must comply with all relevant laws and regulations. This can include laws related to trusts, taxation, and potentially others, depending on the nature of the trust and its assets.
6. **Long-term Sustainability of the Trust:** The trustee should consider the long-term sustainability of the trust when making distributions. They need to ensure that the trust can continue to meet its obligations and purposes into the future.
7. **Potential Conflicts of Interest:** If the trustee is also a beneficiary or has a close relationship with a beneficiary, they must be careful to manage any potential conflicts of interest. They should make decisions in the best interest of all beneficiaries, not just themselves or the person they have a relationship with.

We advise that if your trust has named beneficiaries that you do not want to distribute to or have them part of your financial consideration, please contact your accountant prior to making any distributions so that we can legally remove them from the Trust.

1. **Two Things to be Wary of**
2. **Avoid Reimbursement Agreements:** Avoid arrangements where a beneficiary is entitled to a distribution, but there is an understanding that the funds will be returned to the trust or used for the benefit of another person. Such arrangements may be caught by Section 100A.
3. **Don't Delay Resolutions:** Do not delay making resolutions to distribute the income of the trust. Failing to make a resolution before the end of the income year could result in the trustee being assessed on the trust income at the highest marginal rate.

In conclusion, it is crucial to ensure that trust distributions are made in accordance with the trust deed and the law. Contact our firm if you have any questions or need further clarification.

Yours sincerely,

[Your Name]

[Your Position]