May 2010

BANKS GROUP

Your Link to Business Success

Bamford Decision Provides Trusts with Greater Flexibility

by Tim Olynyk

On 30 March 2010, the High Court of Australia handed down its much awaited decision in the Bamford case.

In the Bamford case, in calculating Trust Income, the taxpayer sought to reclassify a capital profit from the sale of a capital asset as income rather than capital pursuant to the terms of the Trust Deed – the ATO objected to this course of action on the basis that the capital profit was on capital account and could not be re-characterised as income irrespective of what the terms of the Trust Deed said.

The High Court approved the decision of the Full Federal Court in that:

- A provision in a Trust Deed that allows the trustee to determine in their absolute discretion what amounts should be recognised as income and what amounts should be recognised as capital in calculating Trust Income was valid; and
- The amount each beneficiary must include in their assessable income (for tax purposes) is a proportion of the Trust Income distributed to them from the relevant trust.

The decision in Bamford represents a huge win for taxpayers as the ATO had previously been of the view that a Trust Deed could not dictate what Trust Income was – rather, the ATO was of the view that Trust Income was calculated in accordance with Generally Accepted Accounting Principles and could not be modified irrespective of what the Trust Deed purported to do.

In effect, the decision in Bamford confirms that provided the Trust Deed of the trust permits, Trust Income can be a very flexible concept and the terms of the Trust Deed itself can become a very useful tax planning tool.

For example:

- By allowing the Trustee of the trust to calculate Trust Income in accordance with tax principles (rather than Generally Accepted Accounting Principles), under the proportionate approach, the trust should never be in a scenario where it is unable to distribute its taxable income by reason of not having Trust Income.
- By providing the Trustee with flexibility in calculating Trust Income, a trust with liquidity issues could potentially calculate Trust Income in such a way that ensures that it is not required to distribute the full amount of what would ordinarily be considered “accounting profit” in accordance with Generally Accepted Accounting Principles. Under this scenario, and pursuant to the proportionate approach, all taxable income of the trust should still be assessed to beneficiaries rather than the trust on the basis that the trust has distributed out the full amount of its Trust Income.

In light of the Bamford decision, taxpayers are encouraged to review the terms of their Trust Deeds to ensure they are provided with maximum flexibility in calculating Trust Income.

If you have further queries, please contact us on (03) 9810 0700.