TR 2012/D1 - Income tax: meaning of 'income of the trust estate' in Division 6 of Part III of the Income Tax Assessment Act 1936 and related provisions

This cover sheet is provided for information only. It does not form part of *TR 2012/D1 - Income tax: meaning of 'income of the trust estate' in Division 6 of Part III of the Income Tax Assessment Act 1936 and related provisions*

There is an Addendum (1) notice for this document.

There is an Addendum (1) notice for this document.

Generated on: 19 September 2026, 12:16:16 AM

Draft Taxation Ruling

Income tax: meaning of 'income of the trust estate' in Division 6 of Part III of the *Income Tax Assessment Act 1936* and related provisions

Contents Para

PROPOSED LEGALLY BINDING SECTION:

What this Ruling is about 1

Ruling 7

Date of effect 59

NOT LEGALLY BINDING SECTION:

Appendix 1:

***Explanation* 60**

Appendix 2:

***Alternative views* 126**

Appendix 3:

***Your comments* 135**

Appendix 4:

***Detailed contents list* 137**

This publication provides you with the following level of protection:

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation provision applies, or would apply to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the following way. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

What this Ruling is about

1. This ruling is about the meaning of the expression 'income of the trust estate' as used in Division 6 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936)[1] and related provisions. Division 6 contains rules for assessing the net income of a trust calculated under section 95 (referred to in this ruling as the trust's 'net income').

2. Prior to the 2010-11 income year, a resident beneficiary of a trust estate who was presently entitled to a share of the income of the trust estate and not under a legal disability was assessed under section 97 on that same proportionate share of the entire net income of the trust estate. Section 98 operated in a similar manner to assess the trustee on behalf of certain beneficiaries who were presently entitled to income of the trust estate but were under a legal disability or were non-residents at the end of the income year; and certain beneficiaries who were deemed by subsection 95A(2) to be presently entitled to income of the trust estate. If there was some net income not assessed to or in respect of any beneficiary, then the trustee was generally assessed on that net income under section 99 or section 99A.[2]

[1] Unless otherwise indicated, all legislative references are to the ITAA 1936.
[2] The trustee was not assessed on that part of the net income which represented income to which a beneficiary was presently entitled that was attributable to a

3. For the 2010-11 and later income years, capital gains and franked distributions included in the net income of a trust are brought to tax in accordance with Subdivisions 115-C and 207-B of the *Income Tax Assessment Act 1997* (ITAA 1997) respectively.[3]

4. The balance of the net income (that is the net income excluding capital gains and franked distribution) of the trust is still assessed under Division 6 in the manner described in paragraph 2, but modified by Division 6E of Part III (Division 6E).

5. Division 6E adjusts the rules in Division 6 to ensure that capital gains and franked distributions are not taxed twice (that is, as a result of Subdivisions 115-C or 207-B of the ITAA 1997 and Division 6). In broad terms the effect of Division 6E is to apply Division 6 on the assumption that net capital gains and franked distributions are excluded from the trust's net income, and any amount relating to these things is excluded from the income of the trust estate.

Definitions

6. In this Ruling, unless context otherwise requires:

- **net income** means the net income of a trust estate calculated pursuant to subsection 95(1) as the total assessable income of the trust estate calculated as if the trustee were a resident taxpayer less all allowable deductions (*except for certain deductions identified in the provision*)
- **notional income** is an amount of assessable income taken into account in calculating the net income of a trust estate for an income year, that either does not represent any accretion (of either cash or value) to the trust estate in that year or that represents an accretion coupled with a corresponding depletion (in cash or value) of the fund.
- **notional expense** is an allowable deductible taken into account in calculating the net income of a trust estate for an income year, that either does not represent any depletion (in either cash or value) of the trust estate in that year or which represents a depletion of the trust estate that is coupled with a corresponding accretion to the fund.

period when the beneficiary was not a resident and was also attributable to foreign sources: subsections 99(2), (3), 99A(4A) and 99(4B).

[3] Note that franked distributions included in the net income of a trust are assessed directly under Subdivision 207-B. Capital gains reflected in the net income of a trust are taken into account in determining a beneficiary's own net capital gain under section 102-5 of the ITAA 1997

Ruling

7. There is no set or static meaning of the expression 'income of the trust estate' as used in Division 6. The meaning in the case of a particular trust will depend principally on the terms of that trust and the general law of trusts.

8. The statutory context in which the expression is used may also influence its meaning. In the context of Division 6 the 'income' must be:

- measured in respect of distinct years of income,
- a product 'of the trust estate', and
- an amount in respect of which a beneficiary can be made presently entitled.

Statutory context

Measured in respect of distinct income years

9. The 'income of the trust estate' is measured in respect of distinct income years (being the same years in respect of which the trust's net income is calculated).

A product of the trust estate

10. 'Income' and 'trust estate' are distinct concepts, income being the product of the trust estate.

11. It follows that something which formed part of the trust estate at the start of an income year cannot itself, for the purposes of Division 6, be treated by the trustee as income of the trust for that year.

Amount beneficiary can be made presently entitled to

12. In the context of Division 6, the 'income of the trust estate', is not a reference to the gross income of a trust estate, but rather a reference to the net amount of income to which a beneficiary could be made presently entitled or accumulated. That is, it is a reference to the income available for distribution to beneficiaries or accumulation by the trustee, commonly referred to as 'distributable income'.

13. Notwithstanding how a particular trust deed may define income, the 'income of the trust estate' for Division 6 purposes must therefore be represented by a net accretion to the trust estate for the relevant period. In effect, the statutory context places a cap on what the income of the trust estate may be for Division 6 purposes. Specifically, for these purposes, the income of a trust estate for an income year cannot be more than the sum of:

- the accretions to the trust estate (whether accretions of property, including cash, or value) for that year;
- *less* any accretions to the trust estate for that year which have not been allocated, pursuant to the general law of trusts (as that may be affected by the particular trust instrument), to income [and therefore cannot be distributed as income]; and
- *less* any depletions to the trust estate (whether depletions of property, including cash, or value) for that year which, pursuant to the general law of trusts (as that may be affected by the particular trust instrument), have been allocated as being chargeable against income.

Income equalisation clauses

14. Where the distributable income of a trust (as defined in the trust instrument or by the trustee acting in accordance with a power granted under the trust instrument) is equated to the trust's net income

- amounts received that would not ordinarily be considered income but which are assessable (for example, net capital gains) will form part of the trust's income. Likewise outgoings that may ordinarily be chargeable against capital will reduce the distributable income of such a trust if those outlays are deductible (for example, deductible outlays for capital acquisitions).
- amounts received that might ordinarily be considered income but which are not assessable (for example, ordinary income that is exempt) or outgoings that are not deductible (for example, entertainment expenses) will be treated for trust purposes as accretions to or depletions of trust capital.

15. If the trust's net income includes notional income amounts, those amounts cannot, except in the circumstances outlined in paragraph 16, be taken into account in calculating the 'income of the trust estate' for Division 6 purposes. Particular amounts that may be included in calculating a trust's net income but which may not form part of the income of the trust estate include:

- the amount of a franking credit included in the calculation of the trust's net income under subsection 207-35(1) of the ITAA 1997;
- so much of a share of the net income of one trust (the first trust) that is included under section 97 in the calculation of the net income of another trust, but which does not represent a distribution of income of the first trust;
- so much of a net capital gain that is attributable to an increase of what would have otherwise been a relevant amount of capital proceeds for a CGT event as a result of the market value substitution rule in section 116-30 of the ITAA 1997;
- so much of a net capital gain that is attributable to a reduction of what would have otherwise been a relevant cost base or reduced cost base of a CGT asset as a result of the market value substitution rule in section 112-20 of the ITAA 1997;
- an amount taken to be a dividend paid to the trustee of the trust pursuant to subsection 109D(1), and
- an amount of attributable income under an attribution/accruals regime such as Part X (about controlled foreign companies) or Division 6AAA of Part III (about non resident transferor trusts).

16. Where, for trust purposes, a trust's distributable income is equated with its net income, notional income amounts may form part of the distributable income of a trust estate only to the extent that they are matched by notional expense amounts, for example, deductions for depreciation which may exceed any depletion of the trust estate, a deduction for a LIC capital gain under section 115-280 of the ITAA 1997 or an additional deduction in respect of new business investment under Division 41 of the ITAA 1997.

17. The effect of a clause in the trust instrument (or the valid exercise of a power by the trustee) to equate the distributable income of the trust with its net income is that an amount of notional income is able to satisfy any notional expenses chargeable against trust income. However, to the extent that the total notional income amounts for an income year exceed notional expense amounts of the trust estate for that year, they cannot form part of the 'income of the trust estate' for Division 6 purposes (the trust estate's 'distributable income') for that year.

Examples

Example 1 – amounts that already form part of the trust estate cannot be income

18. During an income year, the trustee of the Hobart Family Trust received a $70,000 fully franked dividend and paid $75,000 in interest expenses. The trustee had no other relevant income or expenses for that income year – that is, the trustee had on the face of it a loss of $5,000.

19. However, for trust purposes, the Hobart Family Trust deed defines 'income' to mean such amount as is determined by the trustee.

20. Pursuant to that deed, the trustee resolved to treat as income an additional amount of $5,001 (which represented income from a prior year which had been accumulated or capitalised). This meant that the trustee of the Hobart Family Trust had $1 able to be distributed in respect of the relevant income year in accordance with its powers to distribute income.

21. However, for the purposes of section 97, there is no income of the trust estate for that income year. Whilst the $5,001 which formed part of the trust estate at the start of the income year may be treated by the trustee as income of the trust so as to be distributed (net of expenses) pursuant to a power to distribute income for that year, it is not in fact income derived from the trust estate during that income year. Rather, the additional $5,001 treated as income had *formed part of* the trust estate from the beginning of that year (and could not therefore be said to be the *product* of the trust estate during that year).

22. For tax purposes, the Hobart Family Trust's net income for the income year is $25,000, consisting of the fully franked dividend of $70,000 plus the attached franking credit of $30,000 less interest expenses of $75,000.

23. As there was no income of the trust estate to which any beneficiary could be made presently entitled the trustee will be assessed and liable to pay tax in respect of the Hobart Family Trust's $25,000 net income.

Example 2 – income equalisation clause – notional income

24. For the purposes of the Brisbane Family Trust deed 'income' is defined to mean the net income of the Fund in any Financial Year determined in accordance with subsection 95(1).

25. For the 2009-10 income year, the trust's net income as defined in section 95 is $100,000, made up of a franked dividend of $70,000 and franking credit of $30,000. The trustee has no other relevant income or expenses for that income year.

26. The trustee resolves to distribute the trust income to resident beneficiaries (two of whom, Amy and Barry, are under a legal disability) as follows:

Amy Brisbane	$416
Barry Brisbane	$416
Charitable Brisbane Inc	$20,000
Deal Brisbane Pty Ltd	Balance

27. Despite the terms of the deed, the $30,000 franking credit does not represent an accretion to the trust fund and therefore does not form part of the distributable income of the trust. The trust's distributable income is $70,000.

28. Applying the proportionate approach, each beneficiary's share of the trust's distributable income and their corresponding proportionate share of the trust's net income, is as calculated in the table below:

Entity assessed	**Share of distributable income**	**Share of net income**
Amy Brisbane	**$416** of $70,000 (i.e. 0.59%)	0. 59% x $100,000 = **$594**
Barry Brisbane	**$416** of $70,000 (i.e. 0.59%)	0.59% x $100,000 = **$594**
Charitable Brisbane	**$20,000** of $70,000 (i.e. 28.57%)	28.57% x $100,000 = **$28,571**
Deal Brisbane	**$49,168** of $70,000 (i.e. 70.24%)	70.25% x $100,000 = **$70,240**
Trustee	**$0**	**$0**

29. As Amy and Barry Brisbane are under a legal disability, the trustee will be assessed in respect of their share of the net income of the Brisbane Family Trust (as set out in the table above) under section 98. Both Charitable Brisbane and Deal Brisbane will be assessed on their share of the net income of the Brisbane Family Trust (as set out in the table above) under section 97.[4]

[4] Note that as no beneficiary was made specifically entitled to a share of the franked distribution (the trustee resolution just dealing with the income of the trust estate at large) the tax consequences would be broadly the same if these events and resolutions had occurred in the 2010-11 or a later income year (though the provisions under which each beneficiary is assessed may differ). In such a year, the trustee would still be assessed under section 98 (via subsection 207-35(6) of the ITAA 1997) in respect of Amy and Barry Brisbane's share of the net income of the Brisbane Family Trust. While each beneficiary (including those under a legal disability) would be assessed on their share of that net income (under paragraph 207-35(4)(b) of the ITAA 1997 rather than under Division 6), Amy and Barry Brisbane would receive a deduction for the tax assessed to the trustee in respect of their share of the trust's net income (pursuant to section 98B as adjusted by section 95AAB).

Example 3 – income equalisation clause – notional amounts through chain of trusts

30. The Melbourne Family Trust deed does not define income. Therefore, its distributable income will be calculated having regard to the rules and presumptions in general trust law. Without more, these rules would operate to exclude capital gains from the distributable income.

31. During the 2009–10 income year the trustee derived $5,000 interest income and made a $2,500 (non-discount) capital gain. Accordingly for that year the distributable income of the trust estate is $5,000 but its net income as defined in subsection 95(1) is $7,500.

32. The beneficiary presently entitled to the whole of the income of the Melbourne Family Trust is Sydney Co in its capacity as trustee of the Sydney Family Trust.

33. The trustee of the Sydney Family Trust includes in its assessable income under section 97 the whole of the net income of the Melbourne Family Trust, namely $7,500 (even though its actual entitlement is limited to $5,000).[5]

34. The deed of the Sydney Family Trust defines 'income' as equal to the trust's section 95 net income. However, on these facts, the Sydney Family Trust's distributable income is limited to the $5,000 to which it was entitled from the Melbourne Family Trust. The $2,500 'notional amount' that is included in the assessable income of the Sydney Family Trust, but which is not represented by an accretion to the trust fund, does not form part of its distributable income.

35. Assume that on or before 30 June 2010 the trustee of the Sydney Family Trust distributes the $5,000 it was entitled to receive from the Melbourne Family Trust to its beneficiary, Canberra Company. Although $5,000 is only 66.7 per cent of the income as defined under the Sydney Family Trust's deed, it represents 100 per cent of the 'income of the trust estate' for Division 6 purposes. Accordingly, Canberra Company will be assessed under section 97 on the full $7,500 net income of the Sydney Family Trust, and no amount will be assessed to the trustee of the Sydney Family Trust.[6]

---

[5] Note that even if this occurred in the 2010-11 or a later income year, $7,500 would still be included in the net income of the Sydney Family Trust in respect of its distribution from the Melbourne Family Trust, unless the trustee of the Melbourne Family Trust made a choice under section 115-230 of the ITAA 1997 which had the effect that it would be assessed on the $2,500 capital gain. If such a choice were made, only $5,000 would be included in the net income of the Sydney Family Trust in respect of its distribution from the Melbourne Family Trust.

[6] Note that as no beneficiary was made specifically entitled to a share of the capital gain included in the net income of the Sydney Family Trust (the trustee resolution just dealing with the income of the trust estate at large) the tax consequences would be broadly the same if these events and resolutions had occurred in the 2010-11 or a later income year (albeit they might arise under different provisions). In such a year, Canberra Company would still be assessed on $5,000 of the net income of the Sydney Family Trust under section 97, and the $2,500 balance would (subject to any capital losses of Canberra Company) be assessed as part of its net capital

Example 4 – income equalisation clause – notional income

36. During an income year, the trustee of the Adelaide Family Trust derived the following amounts:

Rental income	$130,000
Franked dividend	$70,000
Exempt income	$100,000
Capital gain (before discount)	$200,000

37. There were no expenses or depletions to the Trust Fund.

38. Before the end of the income year, the trustee of the Adelaide Family Trust resolved to distribute 50% of the income of the trust to each of Victoria and Albert (who are resident beneficiaries not under a legal disability).

39. The trust deed defines the 'income' of the trust as being the net income of the Fund in any Financial Year determined in accordance with subsection 95(1).

40. The effect of the deed is that the exempt income and discount portion of the capital gain is treated as trust capital for the year.

41. The net income of the Adelaide Family Trust as calculated under subsection 95(1), and the deed defined income, is $330,000 ($130,000 rent + $70,000 dividend + $30,000 franking credit + $100,000 net capital gain). However, for section 97 purposes the income of the trust estate cannot exceed:

- the total accretions to the trust fund for the income year (being $500,000 comprised of the $130,000 rent + $70,000 dividend + $200,000 actual capital gain + $100,000 exempt income);
- *less* accretions to the trust fund for the income year which have not been allocated to income (being $200,000 comprised of the $100,000 discount component of the capital gain + $100,000 exempt income); and
- *less* any depletions to the trust fund for that year chargeable against income ($nil);

that is, $300,000.

42. Accordingly, the income of the trust estate for section 97 purposes (its distributable income) is determined by looking at the income otherwise calculated under the deed, limited to a maximum of $300,000.

---

gain under section 102-5 of the ITAA 1997. As in the 2009-10 income year, on these facts no amount would be assessed to the trustee of the Sydney Family Trust in a later year either.

43. Accordingly, for the purposes of Division 6, Victoria and Albert will be regarded as presently entitled to $150,000 of the income of the trust estate.

44. If the income year is the 2009-10 or an earlier income year, Victoria and Albert will each will be assessed under section 97 on their 50% share ($165,000) of the net income of the trust.

45. If the income year is 2010-11 or later, the changes effected by *Tax Laws Amendment (2011 measures No. 5) Act 2011* need to be considered.

46. In a broad sense, as no beneficiary is specifically entitled to the trust capital gain or franked dividend, these amounts will be assessed to beneficiaries based on their original proportionate share to trust income. Specifically, Subdivisions 115-C and 207-B of the ITAA 1997 will apply to each as follows:

- under Subdivision 115-C – they will be taken to have a capital gain equal to the 50% of the capital gain included in the net income of the trust, grossed up to reverse the effect of the discount (that is $100,000 each), which they (being individual taxpayers) can then discount by 50% again in working out their own net capital gain; and
- under Subdivision 207-B – they will be assessed on 50% of the franked distribution and attached franking credits (that is, $35,000 franked distribution plus $15,000 franking credits each).

47. Division 6E will apply to ensure that Victoria and Albert are not taxed on any part of the capital gain or franked distribution under Division 6, and will result in them each being assessed on a 50% proportionate share of the $130,000 that would have been the Adelaide Family Trust's net income if these things were ignored (that is, $65,000 each).

48. Accordingly, assuming Victoria and Albert have no relevant losses available in their own right (for example, capital losses), they will each be assessed on $165,000 in total in respect of their distribution from the Adelaide Family Trust, irrespective of what income year these transactions occurred.

Example 5 – income equalisation clause – net income includes notional income which exceeds notional expenses

49. Assume the same facts as in example 4 but assume also that for the income year the trustee was entitled to a $10,000 capital allowance deduction, that was not attributable to any decline in value of trust assets.

50. Under the deed the income is $320,000 ($130,000 rent + $70,000 dividend + $30,000 franking credit + $100,000 net capital gain – $10,000 capital allowance). For section 97 purposes the income of the trust estate cannot exceed:

- the total accretions to the trust fund for the income year (being $500,000 as set out above);
- *less* accretions to the trust fund for the income year which have not been allocated to income (being $200,000 as set out above); and
- *less* any depletions to the trust fund for that year chargeable against income (this is still $nil, as the $10,000 notional expense, although chargeable against income, does not represent any depletion of the trust estate);

that is, $300,000.

51. Whilst the $10,000 capital allowance deduction reduces the amount the deed defines to be the income of the Adelaide Trust, being only a notional expense it does not reduce the maximum amount that the statutory context dictates can be the income of the trust estate for section 97 purposes. The income of the trust estate for section 97 purposes (its distributable income) in this case is therefore still limited to $300,000.

52. For the reasons given above, Victoria and Albert will each be presently entitled to $150,000 of this income, and will be assessed on 50% of the net income of the Adelaide Family Trust, which in this example has been reduced by the capital allowance deduction to $320,000 ($160,000 each).

Example 6 – income equalisation clause – net income includes notional income which is less than notional expenses

53. Assume the same facts as in example 4 but assume also that the trustee was entitled to a $40,000 capital allowance deduction, that was not attributable to any decline in value of trust assets.

54. Under the deed the income is calculated to be $290,000 ($130,000 rent + $70,000 dividend + $30,000 franking credit + $100,000 net capital gain – $40,000 capital allowance). For section 97 purposes the income of the trust estate cannot exceed:

- the total accretions to the trust fund for the income year (being $500,000 as set out above);
- *less* accretions to the trust fund for the income year which have not been allocated to income (being $200,000 as set out above); and
- *less* any depletions to the trust fund for that year chargeable against income (this is still $nil, as the $40,000 notional expense, although chargeable

against income, does not represent any depletion of the trust estate);

that is, $300,000.

55. Whilst the $40,000 capital allowance deduction reduces the amount the deed defines to be the income of the Adelaide Trust down to $290,000, being only a notional expense it does not reduce the maximum amount that the statutory context dictates can be the income of the trust estate for section 97 purposes, which is still $300,000. This $300,000 is a cap imposed by the statutory context on what the income of the trust estate can be. The statutory context of Division 6 however does not prescribe a minimum amount that the income of the trust estate must be.

56. Not exceeding the statutory limitations, the income of the trust estate for section 97 purposes (its distributable income) in this case is therefore the $290,000 as calculated in accordance with the trust deed.

57. The effect of the deed in this instance is to charge $10,000 of the $40,000 capital allowance against what would otherwise be distributable income of the trust estate, effectively capitalising this amount of income. Only $10,000 (and not $40,000) of what would otherwise be the distributable income of the trust estate is so capitalised, as $30,000 of the notional expense is first sheltered by notional income amounts.

58. For the reasons given above, Victoria and Albert will each be presently entitled to 50% ($145,000) of the $290,000 income of the trust estate. They will each be assessed on 50% of the net income of the Adelaide Family Trust, which in this example is also $290,000 ($145,000 each).

Date of effect

59. When the final Ruling is issued, it is proposed to apply both before and after its date of issue. However, for the 2009-10 and earlier income years, it will not apply to taxpayers who have relied on the Commissioner's prior administrative practice in relation to trusts as outlined in *Law Administration Practice Statement PS LA 2009/7*, to the extent that this prior administrative practice was more favourable to those taxpayers. Additionally, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 to 77 of *Taxation Ruling TR 2006/10*).

Commissioner of Taxation
28 March 2012

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

General

60. In *Commissioner of Taxation v. Bamford*[7] *(Bamford),* the High Court considered the expression 'income of the trust estate' in deciding that a capital gain made by the trustee of the Bamford trust, and treated by the trustee (pursuant to a power in the trust deed) as income to which beneficiaries could be entitled, was income of the trust estate for the purposes of section 97.

61. The High Court in *Bamford* stated:

> The very juxtaposition within s 97(1) of the defined expression 'net income of the trust estate' and the undefined expression 'the income of the trust estate' suggests that the latter has a content found in **the general law of trusts**, upon which Div 6 then operates.[8] [emphasis added]

62. In looking at the composite expression 'presently entitled to a share of the income [of the trust estate]' the Court said that the language of present entitlement is that of 'the general law of trusts, but adapted to the operation of the 1936 Act upon distinct years of income'.[9]

63. The High Court made general observations concerning the 'intersection between the statute and the general law of trusts', namely:[10]

- 'it was to be expected that the treatment of receipts and outgoings by a trustee would not necessarily correspond with that in a taxing statute such as the 1936 Act', and
- 'the degree to which a revenue statute adopts or qualifies or supplants the general understanding of terms with a particular application in property law will be a matter of statutory construction, but bearing in mind … that the transfer from one context to another may breed confusion.'

64. It is clear then that the determination of the income of a trust is grounded in trust law and generally involves a focus on the receipts and outgoings for an income year. The reference to trust law in this context encompasses various factors, including the general law, statutory law, trust accounting principles, the trust deed, the actions taken by the trustee in accordance with the deed (including a resolution to appoint income or capital to particular beneficiaries) and the settlor's intention.

---

[7] [2010] HCA 10
[8] at paragraph 36 of the judgment
[9] at paragraph 37
[10] at paragraph 17

Ascertaining the terms of the trust

65. Ascertaining the terms of the trust is essentially an exercise in ascertaining, and giving effect to, the settlor's intention. In *Re Gulbenkian's Settlement,*[11] Lord Upjohn described that exercise in the following terms:

> There is no doubt that the first task is to try to ascertain the Settlor's intention, so to speak, without regard to the consequences … The court, whose task it is to discover that intention, starts by applying the usual canons of construction; words must be given their natural meaning, the clause should be read literally and in accordance with the ordinary rules of grammar. But very frequently, whether it be in wills, settlements or commercial agreements, the application of such fundamental canons leads nowhere, the draftsman has used words wrongly, his sentences border on the illiterate and his grammar may be appalling. It is then the duty of the court by the exercise of its judicial knowledge and experience in the relevant matter, innate common sense and desire to make sense of the settlor's and parties' expressed intentions, however obscure and ambiguous the language that may have been used, to give a reasonable meaning to that language if it can do so without doing complete violence to it.[12]

66. In *Forrest v. Commissioner of Taxation,*[13] the Court was of the view that the settlor's intention of creating a fixed trust of income other than capital gains would have been defeated if a widely-drawn power to characterise receipts as income or capital was construed as an unfettered discretionary power.

67. The Court held that on the facts of that case, and having regard to the settlor's objective intention ascertained from the provisions of the deed read as a whole, the trustee had no more than an administrative power to honestly classify receipts according to law.

68. The decision highlights that in any trust where those entitled (or potentially entitled) to benefit from 'income' and 'capital' are not the same in all respects it is important to consider whether a trustee power should be interpreted more narrowly than its drafting, considered in isolation, may suggest.

The rules in general trust law

69. The legal rules and presumptions developed by courts with equitable jurisdiction regarding the apportionment of receipts and outgoings between income and capital will be relevant where the terms of the trust are uncertain or silent regarding the ascertainment of the income of the trust estate. Those rules presume the settlor's intention where it is not otherwise discernable and for that reason they yield to a contrary intention expressed or implied in the trust instrument.

---

[11] [1970] AC 508; [1968] 3 All ER 785
[12] ibid; at AC 522; All ER 790
[13] [2010] FCAFC 6; 2010 ATC 20-163

70. The general trust law rules are complex, but ultimately stem from the trustee's duty to act impartially between the beneficiaries in order to avoid benefiting one class of beneficiaries at the expense of another. Their application therefore is most relevant where different persons are entitled to benefit as to income and capital. For example, the general trust law rule in *Upton v. Brown,*[14] that a business loss incurred in one year must first be made good out of profits unless the deed directs otherwise, has been held not to apply to a unit trust where there is only one class of unit holder with co-extensive interests in income and capital: see *Raftland Pty Ltd as trustee of the Raftland Trust v. Commissioner of Taxation* (*Raftland*).[15]

71. For trust law purposes, income of a trust is essentially that which is a product of (that is, 'flows' from) the trust property – for example, rent from the letting of trust property or interest on loans of trust property. On that basis, it is likely to correspond in most cases with what would be ordinary income under section 6-5 of the ITAA 1997 (which may include exempt and non-assessable non-exempt amounts).[16]

72. Whilst there are also complex rules that may apply where a trustee carries on a business, Australian courts have shown a readiness to adopt conventional methods of accounting when determining the distributable income of a trust conducting a trading business (see for example *McBride v. Hudson*[17]).

73. Expenses and outgoings must also be allocated against either income or capital. In *Carver v. Duncan (Inspector of Taxes)*[18] Lord Templeman explained that this allocation is generally as follows:

> The general rule is that income must bear all ordinary outgoings of a recurrent nature, such as rates and taxes, and interest on charges and incumbrances. Capital must bear all costs, charges and expenses incurred for the benefit of the whole estate.[19]

74. However, other trust cases suggest that expenses for the benefit of both income and capital may be apportioned. For example, in *Revenue and Customs Commissioners v. Trustees of the Peter Clay Discretionary Trust*[20] the UK Court of Appeal held that a single expense might be apportioned between income and capital where an element of it can be demonstrated to be incurred for the benefit of the income beneficiaries alone.

75. Other expenses may be initially charged against capital, and later recouped over time from income (such as the cost of capital acquisitions together with subsequent depreciation charges).

---

[14] (1884) 26 Ch D 588
[15] [2008] HCA 21; 2008 ATC 20-029; (2008) 68 ATR 170
[16] For example, in *Orr v. Wendt* [2005] WASCA 199, when determining whether profits from share trading properly constituted income of the trust, at paragraph 37 the Court turned to the income tax cases dealing with ordinary income for assistance.
[17] (1962) 107 CLR 604
[18] [1985] AC 1082; [1985] 2 WLR 1010
[19] at 1120
[20] [2009] STC 469

Role of accounting

76. As explained by the High Court in *Bamford*, a trustee is required to apportion what has come into the fund and what has gone out of it, during the relevant period, between those beneficiaries entitled to income and those entitled to capital. Performance of that duty requires the trustee to engage in a process of accounting for the accretions to and depletions of the trust fund over the relevant period as either income or capital.

77. The process of accounting that is to be adopted must be one that is appropriate given the purposes for which the trust was established, having regard to the trust instrument, and the nature of the trustee's activities. What may be an appropriate form of accounting for one trust (for example, a trust for successive interests) may not be appropriate for another (for example, a collective investment vehicle with one class of beneficiaries).

78. In some contexts it may be appropriate to account for unrealised gains and losses (such as the unrealised gains and losses taken to profit and loss under appropriate mark-to-market accounting practices) in ascertaining the trust profit for an income year.[21]

79. However, such a market value methodology may not be appropriate for trust law purposes if, for example, the settlor's intention is that the value of the assets under the trustee's control are preserved for the long-term for a particular beneficiary or if the deed equated the distributable income of the trust with its net income (unless the trust was subject to taxation on this basis, such as under the Taxation of Financial Arrangements regime contained in Division 230 of the ITAA 1997).

80. Whatever is the appropriate process of accounting, it should be consistently applied. However, if a change of practice is warranted, the starting position in one accounting period must reflect the closing position in the previous accounting period. For example, assume that in year 1 a trustee determined the income of a trust by adopting a mark-to-market accounting policy (this had the effect of including in the trust income an unrealised gain of $50 from an asset). In year 2, the trustee sells the asset and realises a capital gain of $50 to be included in the net income of the trust as defined in section 95. The consistent application of the accounting policy would have the effect that, assuming the trust had no other receipts in year 2, the trust has no income in year 2 to which any beneficiary could be presently entitled.

[21] See, for example, *Clark v. Inglis* [2010] NSWCA 144 where a trustee marked to market the trust's share portfolio, resulting in the recognition of unrealised gains and losses in the calculation of the income of the trust available for distribution to beneficiaries.

Statutory context

81. Whilst determining what is the income of a trust estate depends on the terms of the relevant trust as supplemented by any necessary general trust law rules, for Division 6 purposes, the 'income of the trust estate' also depends on its statutory context.

Income of the 'trust estate'

82. The income considered for Division 6 purposes is that of a 'trust estate'.

83. The expression 'trust estate' is not defined for the purposes of Division 6, although it is generally taken to mean the estate which is vested in a trustee, that is, the trust property.[22]

84. Comments of the majority of the High Court in *FCT v. Everett*[23] support the view that 'trust estate' is synonymous with 'trust property'. In that case, the taxpayer assigned to his wife a share of his interest in a partnership which carried with it an entitlement to receive a share of the future income attributable to it. Consequently an immediate trust was established of a proprietary right which yielded or earned future income.

85. The Commissioner assessed the taxpayer in respect of the share of partnership profits paid to the taxpayer's wife in respect of the 1973 income year. The Commissioner had argued that the profits payable to the taxpayer's wife were not net income in relation to a trust estate for the purposes of section 95. The Court observed

> The appellant's contention is that the income payable to the respondent's wife was not, as the majority in the Federal Court held, 'the net income of a trust estate'' within the meaning of sec. 95 of the Act. The argument is based very largely on the proposition, founded on the judgment of Kitto J. in Stewart Dawson Holdings Pty. Ltd. v. F.C. of T. (1965) 39 A.L.J.R. 300, at p. 301, that income derived by a trustee from his own property or by means of his personal exertion, 'income with respect to which a trust arises at the moment of derivation'', does not answer the statutory description. Kitto J. was making the point that when a person establishes a trust of his future income simpliciter, the income when it is derived is the subject matter or corpus of the trust, not the fruit of it. To use the terminology of sec. 95, it is because the income is the 'trust estate'' that it cannot be 'the net income of'' that trust estate. His Honour's remarks do not touch the case where an immediate trust is established of a proprietary right which yields or earns future income. Then the income is accurately described as income of a trust estate. For reasons which we have already given, this is the situation which obtains here.

[22] *Federal Commissioner of Taxation v. Walsh* 83 ATC 4415; per Lockhart J at 4427
[23] (1980) 143 CLR 440 at 452; [1980] HCA 6 at paragraph 22

86. The many references in Division 6 to the 'income of the trust estate' show that the trust estate and its income are distinct concepts, the income being the product of the estate.[24] The distinction was most recently commented upon by the Full Federal Court in *Leighton v. Commissioner of Taxation.*[25] In that case, Mr Leighton was the trustee of a trust for the benefit of two companies, Salina and Kolton, and the Full Federal Court observed:

> The share sale proceeds deposited … into the Westpac Bank account in Mr Leighton's name … did not represent the income of either Salina or Kolton but rather represented the realisation of the income … already derived by these companies. Upon being deposited, the proceeds were impressed with a trust in favour of Salina and Kolton, but they did not comprise the income of a trust estate. Rather, those deposited proceeds constituted or augmented a trust estate of which Mr Leighton was trustee. The income of that trust estate was such income, if any, as was later derived from the investment of that trust estate, e.g. any bank interest on the deposited proceeds.[26]

87. As the trust estate and its income are distinct concepts, it follows that something which formed part of the trust estate at the start of an income year cannot itself be income for that year.

88. It would seem that in determining the product of (or income flowing from) the trust estate, the trust estate should be thought of in broad terms so as to include, for example, any rights the trustee has to be considered as a discretionary object in other trusts.

89. The income, being a product of, or a flow from, the trust estate, must represent, in total, an actual accretion to the trust estate for the relevant period. In other words, that which is 'income' cannot in total exceed (although it can be less than) the yield or accretion to the fund for the relevant period. And it must represent an accretion that, following its production, is capable of adhering to, or forming part of, the trust estate. However, in this context an accretion need not be a realised gain – it may in appropriate cases reflect an unrealised gain which represents an increase in value which has accrued to the trust.[27]

90. Where the income of a trust is defined by reference to its net income, it may often be the case that an amount which purportedly forms part of the trust income does ***not*** represent anything flowing to or coming home to (or an accretion to) the trust estate. These amounts are described in this draft Ruling as notional amounts – see discussion in paragraph 6.

---

[24] *ABB Australia Pty Ltd v. FC of T* (2007) 162 FCR 189; 2007 ATC 4765; (2007) 66 ATR 460 at paragraph 176
[25] [2011] FCAFC 96
[26] at paragraph 22
[27] *Clark v. Inglis* [2010] NSWCA 144

Income of a distinct income year

91. The notion that the 'income of the trust estate' must be measured in respect of a distinct period derives from the law of trusts. As already discussed at paragraphs 69 to 75, the general law of trusts comprises a complex set of rules, essentially designed to ensure that trustees fairly apportion the receipts and outgoings of a period between those entitled to income and those with an interest in capital.

92. The measurement of trust income in respect of a distinct and ascertainable period is consistent with the fact that income is the product of the trust estate; and that something that formed part of the trust estate at the beginning of the period (such as accumulated or capitalised income of a prior period) cannot, for the purposes of Division 6 and related rules, be treated as income of the trust for that period.

93. The relevant period over which the 'income of the trust estate' must be measured in this context is each income year (given its relevance to Division 6 and related rules which apply to determine the tax treatment of trust income for each income year). Whilst an income year will generally be the year ending 30 June, in appropriate cases it may be an equivalent substituted accounting period.[28]

94. Also, as a beneficiary's share of the income of the trust estate may be used to determine their share of the trust's net income, its measurement and significance in any particular income year must be matched to the income year in respect of which the trust's net income is calculated.

95. Where the income of a particular trust estate is calculated in respect of periods that are different from an income year, the income of the trust estate attributable to each income year must be appropriately determined.[29]

Distributable income

96. Section 97 requires a consideration of the income of a trust estate to which a beneficiary may be made presently entitled. Judicial authority supports the view that the references throughout Division 6 to the 'income of the trust estate' should properly be taken to be references to the income legally available for distribution to beneficiaries, commonly referred to as 'distributable income'.

---

[28] As was the case for example in *GE Capital Finance Pty Ltd (as trustee for the Highland Finance Unit Trust) v Commissioner of Taxation* [2007] FCA 558; 2007 ATC 4487; (2007) 66 ATR 447 and in *Case X69* 90 ATC 531; *AAT Case 6103* 21 ATR 3594.

[29] See how the Court in *Howard v. Commissioner of* Taxation [2011] FCA 1421 at paragraph 131 albeit in a different context, approached the task of attributing income to particular periods.

97. *Federal Commissioner of Taxation v. Totledge Pty Ltd*[30] (*Totledge)* concerned the entitlement to income of a business which had been sold by a company in liquidation into two trusts, 'the scheme fund' and 'the business trust'. Under the terms of the business trust, the trustee was to conduct the company's former business, paying any surplus income to the scheme fund. The scheme fund would then, under its terms, pay the company's creditors. In the relevant years, the trustee of the business trust paid the surplus income directly to the company's creditors.

98. The Full Federal Court held that the trustee of the scheme fund, under basic principles of trust law, had a present beneficial interest in the gross income of the business trust as it was derived and a vested right to be paid the surplus of that income as and when it became available. The Court explained the concepts of beneficiary entitlements and a relevant present entitlement within the statutory context of Division 6 as follows:

> A beneficiary under a trust who is entitled to income will ordinarily only be entitled to receive actual payment of the appropriate share of surplus or distributable income: the trustee will be entitled and obliged to meet revenue outgoings from income before distributing to a life tenant or other beneficiary entitled to income. Indeed, circumstances may well exist in which a trustee is entitled and obliged to devote the whole of gross income in paying revenue expenses with the consequence that the beneficiary entitled to income may have no entitlement to receive any payment at all.[31]

99. As it is clear then that a reference to the 'income of the trust estate' when used in Division 6 is a reference to distributable income, any of the trust's gross income against which trust expenses are offset (whether pursuant to general trust law principles, the specific terms of the trust instrument or by the trustee acting in accordance with a power given in the trust instrument) to arrive at the trust's distributable income will not form part of 'income of the trust estate' for Division 6 purposes. That is, the 'income of the trust estate' for Division 6 purposes is a net concept.

100. This was confirmed by the Full Federal Court in *Cajkusic v. Commissioner of Taxation,*[32] observing:

> this case is concerned with the proper determination of the net distributable income – the s 97 income[33]

101. Accordingly, as the income of the trust estate for an income year for section 97 purposes is a net concept that, as explained in paragraph 89 of this draft Ruling, has to represent an accretion to the trust estate for the relevant income year, it cannot in total exceed:

- the accretions to the trust estate (whether accretions of property, including cash, or accretions of value) for that year;

[30] (1982) 40 ALR 385; 82 ATC 4168; (1982) 12 ATR 830
[31] at ALR 393; ATC 4173
[32] [2006] FCAFC 164; 2006 ATC 4752; (2006) 64 ATR 676
[33] at paragraph 27

- *less* any accretions to the trust estate for that year which have not been allocated, by the deed or by the trustee acting in accordance with a power granted under the deed, to income (and therefore cannot be distributed as income); and
- *less* any depletions to the trust estate (whether depletions of property, including cash or value) for that year which the deed, or the trustee acting in accordance with a power granted under the deed, has allocated as being chargeable against income.

Income equalisation clauses

102. Many trust instruments equate the 'income' of the trust with its net income for tax purposes. That is, the income may be specifically defined to equal the net income or the trustee may by exercising powers under the deed determine that the income is the same as the net income.

103. For these trusts some amounts properly representing accretions to the trust estate, are expressly excluded from forming part of the trust's distributable income. Examples would include exempt income, or non-assessable non-exempt income, and so much of a capital gain accruing to the trust as is reduced by the CGT discount. Similarly, amounts which would ordinarily be regarded as an expense or outgoing chargeable against income (for example, entertainment expenses) are taken by the deed to be instead allocated to capital.

104. On the other hand, the effect of such a definition is to include in the calculation of distributable income:

- accretions that would ordinarily be regarded as capital (for example, net capital gains), and
- depletions that would ordinarily be regarded as an expense or outgoing chargeable against capital, if those outlays are deductible (for example, a capital allowance deduction for the immediate write-off of certain low-value capital items).

105. Such a definition is effective to alter what the distributable income of the trust would otherwise be insofar as these actual accretions to and depletions of the trust estate are concerned.

106. However, despite such definitions of income, the Commissioner's view is that, an amount which is included in the net income of the trust but which is not represented by a net accretion to the trust fund (for example, notional income amounts) cannot generally form part of the distributable income of that trust estate.

107. Notional income amounts are artificial tax constructs and, not having come into (including where relevant by increasing the value of) the trust estate, do not represent any amount to which a beneficiary could be made presently entitled. In terms of the test established in *Harmer and ors v. Federal Commissioner of Taxation*[34] *(Harmer)* that present entitlement requires a present legal right to demand and receive payment, this could never be satisfied in respect of any amount that could never be received by the trustee.

108. Notional income amounts will only form part of the distributable income of a trust estate to the extent that they are matched by notional expense amounts, that is, amounts that are deductible but which do not represent a depletion of the trust estate (or which represent depletions that are coupled with corresponding accretions), for example, deductions for depreciation which may exceed any depletion of the trust estate, a deduction for a LIC capital gain under section 115-280 of the ITAA 1997 or an additional deduction in respect of new business investment asset under Division 41 of the ITAA 1997.

109. The effect of an income equalisation clause is that an entitlement to notional income is able to satisfy any notional expenses chargeable against trust income. However, to the extent that the total notional income amounts for an income year exceed notional expense amounts of the trust estate for that year, they cannot form part of the trust estate's 'distributable income' for that year: see example 5.

110. The treatment of notional amounts was considered by the Court in *Colonial First State Investments Limited v. Commissioner of Taxation*[35] (*Colonial*). In that case Stone J endorsed the Commissioner's argument that these amounts are not on their own capable of funding an entitlement to income. Her Honour explained

> The respondent's written submissions explain its position convincingly. Among the many sources of uncertainty to which the Commissioner refers is 'a range of amounts' that may be included in s 95 income but which 'are not capable of being recognized for accounting purposes, let alone founding an entitlement: e.g. franking credits, attributed foreign investment income, amounts included by operation of Pt IVA of the 1936 Act or deemed capital gains included by operation of the market substitution rule'. …. the submissions conclude that 'it is not conceptually possible for a trustee to determine, in every case and in every year, an amount of trust income equivalent to, or not less than, the Fund's s95 net income'.[36]

111. The more common types of notional income amounts are discussed below, as are Part IVA amounts.

---

[34] (1991) 173 CLR 264; [1991] HCA 51
[35] [2011] FCA 16
[36] at paragraph 88

Franking credits

112. In *Thomas Nominees Pty Ltd v. Thomas and Ors*[37] (*Thomas Nominees*) a trustee applied to the Supreme Court of Queensland for a declaration pursuant to section 96 of the *Trustee Act (Qld)* as to the construction of a resolution to distribute income including franking credits. The Commissioner was not a party to these proceedings.

113. Under clause 4 of the trust instrument, the trustee had the power to separately record various 'categories of income received into the trust property' including dividends to which under the tax law any 'separately identifiable taxation consequences or benefit is attached or arises'. Applegarth J observed:

> [47] If, however, franking credits are not 'income' according to the ordinary meaning of that word then under the terms of the Deed they are a category of income received into the Trust property because they are a taxation benefit that attaches or arises in respect of fully franked dividends. They are included amongst the categories of income governed by clause 4 of the Deed, and fall to be distributed in accordance with its provisions.
>
> [49] …franking credits would appear to be an accretion to the trust fund, and something of substantial value. They are not merely a concept of the income tax regime, they are a benefit. ...In any event, they confer a financial advantage which fall [sic] to be dealt with by the trustee.

114. While accepting that an entitlement to a franking credit offset represents some value, the Commissioner's view (taking into account the subsequent comments of Stone J in *Colonial* already quoted at paragraph 110) is that it does not represent an accretion to the trust estate nor an accounting asset of the trust (that is, it is not a future economic benefit of the trust) that can itself be dealt with by the trustee. It is for this reason that the tax benefit of the franking credit typically remains out of the accounts and off the financial statements.

115. Rather, the Commissioner's view is that such an entitlement is a feature of the income tax law, and the benefit is conferred at the time of assessment by the law. This is so even though the trustee's distribution decision can affect who may, subject to the integrity rules in Subdivision 207-F of the ITAA 1997, be entitled to that benefit in accordance with the rules in Subdivision 207-B of the ITAA 1997.

[37] [2010] QSC 417

Distributions from other trusts

116. Where a trustee of a trust (the distributing trust) distributes income to the trustee of another trust (the beneficiary trust), the net income of the beneficiary trust will include its proportionate share of the net income of the distributing trust. This proportionate share of the net income of the distributing trust may be greater than the beneficiary trust's actual distribution from the distributing trust. If this occurs, without more the difference will not be supported by any accretion to the beneficiary trust and therefore cannot be an amount which can be legally available for distribution by that trust.

Capital gains and market value substitution

117. The calculation of a capital gain made by the trustee of a trust estate may be affected by the CGT market value substitution rules in sections 116-30 and 112-20 of the ITAA 1997. The effect (if any) that these rules have on the trust's distributable income will depend on the reason why the modifications are made.

118. Section 116-30 of the ITAA 1997 sets out the circumstances in which the proceeds from a CGT event are reduced or increased (as appropriate) to equal the market value of the CGT asset that is the subject of the CGT event. The modifications made by section 116-30, where they treat the trustee as having received a greater amount of capital proceeds than that which was actually received, will not result in any matching accretion in the trust fund.

119. Section 112-20 of the ITAA 1997 contains similar rules for modifying the first element of the cost base and reduced cost base of a CGT asset. In some cases, the rules apply to treat the trustee as having paid a lesser amount to acquire a CGT asset than what was actually incurred. A capital gain made by the trustee upon a later disposal of the asset will therefore be greater than the accounting profit reflected as an accretion in the trust estate. However, such adjustments cannot be said to result in any correspondingly greater accretion to the trust estate and therefore represent notional income amounts.

Division 7A dividends

120. Where a private company makes a non-arm's length loan to the trustee of a trust, subsection 109D(1) may apply to treat such loans as assessable dividends of the trustee.

121. Whilst a loan to which Division 7A applies may result in a cash flow into the trust estate (on favourable terms), it is coupled with a corresponding liability and does not result in a relevant overall accretion to the fund.[38] Accordingly, loans deemed by Division 7A to be dividends of the trustee are considered to be notional income amounts.

Attributable income

122. A trustee that is an attributable taxpayer in respect of a trust for the purposes of Division 6AAA of Part III (about non-resident transferor trusts) or a controlled foreign company (CFC) for the purposes of Part X may be required to include in the net income of the trust an amount of attributable income.[39] Attributable income represents income or gains made by the foreign entity in which the trustee has an interest which have not been distributed by that entity. Attributable income does not represent an accretion to the trust estate and as such is considered to be notional income.

Part IVA amounts

123. If in determining a tax benefit obtained from a scheme, the counterfactual involves the receipt of an amount that would have formed part of the income of the trust, that amount should also be treated as part of the trust's distributable income under that counterfactual (notwithstanding that it does not represent an accretion to the trust estate).

124. Thus, for example, if, but for a scheme, a trustee would have been paid an assessable dividend, then that dividend should also be taken to form part of the distributable income of the trust estate under that counterfactual. To include the dividend in the trust's net income, but to disregard any trust law consequences that would have likely followed from its receipt by the trustee, may distort the true tax benefit obtained from the scheme.

125. But that is not to say that a Part IVA adjustment made at the beneficiary level is itself an amount to which the beneficiary could be said to be entitled to from the trust estate. It is a notional amount not capable of founding the basis of a present entitlement. Stone J's comments in *Colonial* are to be understood in this light.

---

[38] In some limited situations, a trust which is entitled to account for unrealised gains may recognise the present value of a loan on favourable terms as some value that has come into the trust. However, this would be separate to (and ordinarily far less than) the amount treated as a dividend under Division 7A.

[39] Similarly, in a relevant year, a trustee with an interest in a foreign investment fund for the purposes of Part XI or a non-resident trust for the purposes of sections 96B and 96C may be required to include an amount in the net income of the trust as a consequence of these provisions.

Appendix 2 – Alternative views

This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.

Treatment of notional amounts

126. It is acknowledged that there are at least three alternative views to that expressed in the ruling about the treatment of notional amounts as income of a trust estate.

Ignore notional amounts

127. The first alternative view is that notional amounts can never be income of a trust estate even if there are offsetting notional expenses.

128. While this approach is simpler to apply, it fails to give full effect to the trust law which, as the High Court said in *Bamford*, founds the content of the income of the trust estate. In summary, the Commissioner's view is that it is only the statutory context as explained in this draft Ruling that can limit, for the purposes of Division 6, what would otherwise be the income of the trust estate determined solely by the trust instrument (or a trustee acting pursuant to a power in it).

129. If the trustee has determined the income of the trust estate to be a certain figure which is less than the net accretion to the trust estate for an income year (excluding any net accretion allocated to capital), the statutory context does not provide any basis for saying that the income of the trust estate for Division 6 purposes is anything other than that which it is for trust law purposes.

130. For example, in Example 6 above, the income of the trust for trust law purposes is $290,000. *Bamford* suggests this should be our starting point. The net accretion to the trust estate for that income year (ignoring any net accretion which has been allocated to capital) was $300,000. The full $290,000 sum is therefore an amount to which beneficiaries could be made presently entitled (and being represented in full by the net accretion, is not simply an appropriated amount of the trust estate at the start of the year). The statutory context therefore provides no basis for the Commissioner saying that, in that example, the income of the trust estate ought to instead be $260,000 as this alternative view would suggest.

Include notional amounts

131. The second alternative view is that the strict effect of a deed is that a notional amount is income to which a beneficiary can be made presently entitled. That is if a deed equates the income of the trust to the trust's net income (whatever it consists of), then beneficiaries are entitled to an amount equal to the net income of the trust.

132. This view is inconsistent with that expressed by the Courts in *Totledge* and *Cajkusic* that references to income of a trust estate are to the distributable net income of a trust. It is also inconsistent with the view expressed by Stone J in *Colonial* that income must be that which is capable of founding an entitlement in a beneficiary. Whilst the High Court in *Bamford* observed that the *content* of the 'income of the trust estate' was to be found in the general law of trusts, they made it clear that this was simply the starting point and that the statutory context may then operate to change that amount.[40]

Include notional amounts – but they are incapable of distribution

133. The third alternative view is that a notional amount may be income, but it is not income to which a beneficiary can be made presently entitled. That is, it is not an amount that that the trustee is able to account to the beneficiaries for and is therefore not an amount to which beneficiaries can (in the *Harmer* and *Totledge* sense) be made presently entitled. Under this view, if the notional amount represents income to which a beneficiary cannot be presently entitled, there will be some part of the trust's net income that is assessed to the trustee under section 99 or 99A.

134. However, this view is likewise inconsistent with that expressed by the Courts in *Totledge, Cajkusic* and *Colonial.* Specifically, whatever the income of the trust estate may be for trust law purposes, for Division 6 purposes the income of the trust estate referred to is that which is distributable and which is capable of founding an entitlement in a beneficiary.[41]

[40] see, for example, paragraphs 17, 36 and 37 of the judgment
[41] Compare *Thomas Nominees.* See also paragraphs 112 to 115 of this draft Ruling

Appendix 3 – Your comments

135. You are invited to comment on this draft Ruling. Please forward your comments to the contact officer by the due date.

136. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Tax Office website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date: **11 May 2012**

Contact officer details have been removed following publication of the final ruling.

Appendix 4 – Detailed contents list

137. The following is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	**1**
Definitions	**6**
Ruling	**7**
Statutory context	9
Measured in respect of distinct income years	9
A product of the trust estate	10
Amount beneficiary can be made presently entitled to	12
Income equalisation clauses	14
Examples	**18**
Example 1 – amounts that already form part of the trust estate cannot be income	18
Example 2 – income equalisation clause – notional income	24
Example 3 – income equalisation clause – notional amounts through chain of trusts	30
Example 4 – income equalisation clause – notional income	36
Example 5 – income equalisation clause – net income includes notional income which exceeds notional expenses	49
Example 6 – income equalisation clause – net income includes notional income which is less than notional expenses	53
Date of effect	**59**
Appendix 1 – Explanation	**60**
General	60
Ascertaining the terms of the trust	65
The rules in general trust law	69
Role of accounting	76
Statutory context	81
Income of the 'trust estate'	82
Income of a distinct income year	91
Distributable income	96
Income equalisation clauses	102
Franking credits	112
Distributions from other trusts	116
Capital gains and market value substitution	117

Division 7A dividends 120
Attributable income 122
Part IVA amounts 123
Appendix 2 – Alternative views **126**
Treatment of notional amounts 126
Ignore notional amounts 127
Include notional amounts 131
Include notional amounts – but they are incapable of distribution 133
Appendix 3 – Your comments **135**
Appendix 4 – Detailed contents list **137**

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- capital gains
- CGT capital proceeds modification market value substitution rule
- CGT cost base modification market value substitution rule
- deemed dividends
- foreign attributable income
- franking credits
- net income of a trust
- Part IVA
- present entitlement
- trust accounts
- trust beneficiaries
- trust deeds
- trust distributions
- trust income
- trustees
- trusts
- year of income

Legislative references:

- ITAA 1936
- ITAA 1936 Pt III Div 6
- ITAA 1936 95
- ITAA 1936 95(1)
- ITAA 1936 95°(2)
- ITAA 1936 95AAB
- ITAA 1936 96B
- ITAA 1936 96C
- ITAA 1936 97
- ITAA 1936 97(1)
- ITAA 1936 98
- ITAA 1936 98B
- ITAA 1936 99
- ITAA 1936 99(2)
- ITAA 1936 99(3)
- ITAA 1936 99(4B)
- ITAA 1936 99A
- ITAA 1936 99A(4A)
- ITAA 1936 Pt III Div 6E
- ITAA 1936 Pt III Div 6AAA
- ITAA 1936 Div 7°
- ITAA 1936 109D(1)
- ITAA 1936 Part IVA
- ITAA 1936 Part X
- ITAA 1936 Part XI
- ITAA 1997
- ITAA 1997 Div 41
- ITAA 1997 102-5
- ITAA 1997 112-20
- ITAA 1997 Subdiv 115-C
- ITAA 1997 115-230
- ITAA 1997 115-280
- ITAA 1997 116-30
- ITAA 1997 Subdiv 207-B
- ITAA 1997 Subdiv 207-F
- ITAA 1997 207-35(1)
- ITAA 1997 207-35(4)(b)
- ITAA 1997 207-35(6)
- ITAA 1997 Div 230
- ITAA 1997 995-1(1)
- Tax Laws Amendment (2011 measures No. 5) Act 2011
  Trustee Act (Qld) 96

Case references:

- ABB Australia Pty Ltd v Commissioner of Taxation (2007) 162 FCR 189; 2007 ATC 4765; (2007) 66 ATR 460
- Cajkusic v Commissioner of Taxation [2006] FCAFC 164; 2006 ATC 4752; (2006) 64 ATR 676
- Carver v Duncan (Inspector of Taxes) [1985] AC 1082; [1985] 2 All ER 645; [1985] 2 WLR 1010
- Case X69 90 ATC 531; AAT Case 6103 21 ATR 3594
- Clark v Inglis [2010] NSWCA 144
- Colonial First State Investments Limited v Commissioner of Taxation [2011] FCA 16
- Commissioner of Taxation v Bamford; Bamford v Commissioner of Taxation [2010] HCA 10; 2010 ATC 20-170; (2010) 75 ATR 1
- Federal Commissioner of Taxation v Totledge Pty Ltd (1982) 40 ALR 385; 82 ATC 4168; (1982) 12 ATR 830
- Federal Commissioner of Taxation v Walsh 83 ATC 4415

- Forrest v Commissioner of Taxation [2010] FCAFC 6; 2010 ATC 20-163
- GE Capital Finance Pty Ltd (as trustee for the Highland Finance Unit Trust) v Commissioner of Taxation [2007] FCA 558; 2007 ATC 4487; (2007) 66 ATR 447
- Gulbenkian's Settlement Trusts, Re; Whishaw v Stephens [1970] AC 508; [1968] 3 All ER 785; [1968] 3 WLR 1127
- Harmer v Federal Commissioner of Taxation [1991] HCA 51; (1991) 173 CLR 264; 91 ATC 5000; (1991) 22 ATR 726
- Howard v Commissioner of Taxation [2011] FCA 1421
- Leighton v. Commissioner of Taxation [2011] FCAFC 96; 2011 ATC 20-273
- McBride v Hudson (1962) 107 CLR 604
- Orr v Wendt [2005] WASCA 199
- Raftland Pty Ltd as Trustee of Raftland Trust v Commissioner of Taxation [2008] HCA 21; (2008) 238 CLR 516; 2008 ATC 20-029; (2008) 68 ATR 170
- Revenue and Customs Commissioners v Trustees of the Peter Clay Discretionary Trust [2009] STC 469; [2009] 2 All ER 683; [2009] 2 WLR 1353
- Taxation, Federal Commissioner of v Everett [1980] HCA 6; (1980) 143 CLR 440; 80 ATC 4076; (1980) 10 ATR 608
- Thomas Nominees Pty Ltd v Thomas and Ors [2010] QSC 417
- Upton v Brown (1884) 26 Ch D 588

ATO references
NO: 1-3N17R81
ISSN: 1039-0731
ATOlaw topic: Income Tax ~~ Assessable income ~~ trust income - other