



# ***TR 2007/4 - Income tax: entitlement to foreign tax credits under Division 18 of Part III of the Income Tax Assessment Act 1936 when foreign income is included in the net income of a trust estate***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *18 July 2007*



## Taxation Ruling

Income tax: entitlement to foreign tax credits under Division 18 of Part III of the *Income Tax Assessment Act 1936* when foreign income is included in the net income of a trust estate

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**ⓘ This publication provides you with the following level of protection:**

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner’s opinion about the way in which a relevant 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.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

## What this Ruling is about

- This Ruling addresses the following:
  - the entitlement to claim a foreign tax credit or apply an excess foreign tax credit from an earlier income year under Division 18 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936) of a resident beneficiary whose trust income includes foreign income; and
  - the circumstances under which the trustee of a trust estate is entitled to claim a foreign tax credit under Division 18 of Part III of the ITAA 1936 or apply an excess foreign tax credit from an earlier income year.
- This Ruling does not apply to:
  - trust income which is subject to the transferor trust measures under Division 6AAA of Part III of the ITAA 1936; or

- trust income of certain unit trusts and public trading trusts which is subject to Divisions 6B and 6C of Part III of the ITAA 1936; or
  - trust income which is subject to the Foreign Investment Fund measures under Part XI of the ITAA 1936; or
  - trust income to which sections 96B and 96C of the ITAA 1936 apply; or
  - trust income of trusts that form part of a consolidated group or multiple entry consolidated (MEC) group; or
  - trust income of superannuation funds, approved deposit funds or pooled superannuation trusts.
3. All subsequent legislative references are to the ITAA 1936 unless otherwise stated.

## Ruling

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4. A resident beneficiary assessed on trust income is entitled to claim a foreign tax credit under subsection 160AF(1) in respect of foreign income<sup>1</sup> included in the trust income together with their other foreign income provided foreign tax<sup>2</sup> has been paid or deducted at source in respect of that foreign income.
5. Where a trustee is assessed on behalf of a resident beneficiary under section 98 (that is, a beneficiary under a legal disability or a beneficiary deemed to be presently entitled by the operation of subsection 95A(2)) on their share of the net income of the trust estate which includes foreign income, the trustee is entitled to claim a foreign tax credit under subsection 160AF(1) on account of the beneficiary provided foreign tax has been paid or deducted at source in respect of that foreign income.
6. Where a resident beneficiary to which subsection 98(1) or 98(2) applies has income from other sources,<sup>3</sup> a credit is given in the beneficiary's assessment under subsection 100(2). This credit is calculated by reducing the gross tax payable by the trustee by the beneficiary's share of the foreign tax credit entitlement, along with any other credits or offsets that the beneficiary is entitled to.
7. Any excess foreign tax credit arising to the trustee under a section 98 assessment on behalf of a resident beneficiary is accounted for separately and is available to be carried forward and applied in the following five income years by the trustee on behalf of that beneficiary under section 160AFE.

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<sup>1</sup> See subsection 6AB(1). Note amendments to subsection 160AF(1) in 2003 that allow for a credit where a resident taxpayer's assessable income includes income, or a profit or gain, derived from a source in an area covered by an international tax sharing treaty to the extent that the income, profit or gain is taxed in Australia (see subparagraph 160AF(1)(a)(ii)). Such amounts are not foreign income.

<sup>2</sup> See subsection 6AB(2).

<sup>3</sup> A beneficiary covered by section 100 has to lodge an individual return. See TD 92/159.

**Example 1**

8. XYZ Trust, a resident trust estate, receives \$9,000 of foreign interest income, on which 10% withholding tax of \$1,000 has been deducted during the income year ended 30 June 2007. An Australian resident, Joe Smith, 16 years old, is the sole beneficiary who is presently entitled to 100% of the income of the trust estate, but is under a legal disability. He also receives \$1,000 in wages from a casual job.

TRUSTEE		BENEFICIARY	
The tax assessed to the trustee under subsection 98(1) would be:		Joe as the beneficiary deriving other income would be assessed as follows:	
Foreign income	\$9,000	Trust distribution	
Foreign tax paid <sup>4</sup>	\$1,000	Foreign income	\$9,000
Net income (subsection 95(1))	\$10,000	Foreign tax paid <sup>5</sup>	\$1,000
		Wages	\$1,000
		Taxable income	\$11,000
Tax payable on \$10,000 × 45% = \$4,500 <sup>6</sup>		Tax payable on \$1,000 is nil <sup>7</sup>	
		Tax payable on \$10,000 × 45% = \$4,500 <sup>8</sup>	
<b>Less</b>		<b>Less</b>	
Foreign tax credit <sup>9</sup>	\$1,000	subsection 100(2) credit	\$2,900
Low income tax offset <sup>10</sup>	\$600	Foreign tax credit	\$1,000
		Low income tax offset	\$600
<b>Tax payable</b>	<b>\$2,900</b>	<b>Tax payable</b>	<b>\$Nil</b>

9. Where the net income or any part of the net income of the trust estate in a year of income is assessed to the trustee under section 99 or section 99A, the trustee is entitled to claim a foreign tax credit under subsection 160AF(1) in respect of the foreign income included in the net income, provided foreign tax has been paid or deducted at source in respect of the foreign income.

10. Any excess foreign tax credit can be carried forward by the trustee for application by the trustee in the following five income years under a section 99 or 99A assessment.

<sup>4</sup> Subsection 6AC(1).

<sup>5</sup> Subsection 6AC(1).

<sup>6</sup> Assessed under Division 6AA of Part III.

<sup>7</sup> Assessed at general individual rates.

<sup>8</sup> Assessed under Division 6AA of Part III.

<sup>9</sup> Subsection 160AF(1).

<sup>10</sup> Sections 159H and 159N.

**Example 2**

11. In the year ended 30 June 2006 Frederick Jones, as executor in the capacity of trustee of a resident deceased estate,<sup>11</sup> derives foreign income of \$40,000 and pays \$9,000 foreign tax on that income. No other income is derived by the trust. No beneficiary is presently entitled to the income and the trustee is assessed under section 99 as follows:

Foreign income	\$31,000
Foreign tax paid <sup>12</sup>	\$9,000
Net income (subsection 95(1))	\$40,000
Tax payable under section 99 <sup>13</sup>	\$7,860
Foreign tax credit	\$7,860
Tax payable	nil
Excess foreign tax credit carried forward <sup>14</sup>	\$1,140

12. In the year ended 30 June 2007 the situation is repeated except that the rate of tax in the foreign jurisdiction changes and foreign tax paid by the trustee on foreign income of \$40,000 is \$4,200. The excess foreign tax credit from the previous year of \$1,140 is carried forward to be applied in the section 99 assessment for 2007 as follows:

Foreign income	\$35,800
Foreign tax paid <sup>15</sup>	\$4,200
Net income (subsection 95(1))	\$40,000
Tax payable under section 99 <sup>16</sup>	\$7,350
Foreign tax credit	\$4,200
Excess foreign tax credit carried forward <sup>17</sup>	\$1,140
Tax payable	\$2,010

<sup>11</sup> Resident deceased estate established in September 2005.

<sup>12</sup> Subsection 6AC(1).

<sup>13</sup> As this is a resident deceased estate, it is not liable to pay a Medicare levy – see paragraph 251S(1)(c).

<sup>14</sup> Section 160AFE.

<sup>15</sup> Subsection 6AC(1).

<sup>16</sup> As this is a resident deceased estate, it is not liable to pay a Medicare levy – see paragraph 251S(1)(c).

<sup>17</sup> Section 160AFE.

13. In a year of income that the trust estate makes a loss; or has zero net income, and has foreign income included in its assessable income in respect of which foreign tax has been paid or deducted at source, no entitlement to a foreign tax credit arises either for the beneficiary or for the trustee for the purposes of subsection 160AF(1) in that year of income. However, an excess foreign tax credit for the purposes of section 160AFE does arise for the trustee only, and can be carried forward for the following five income years for application against a future section 99 or section 99A assessment.

### Example 3

14. In the year ended 30 June 2006 ABC Pty Ltd (as trustee of a resident trust estate) derives domestic rental income of \$15,000 and incurs total rental deductions of \$22,000. The trust estate also receives foreign dividend income of \$1,700 on which there has been 15% withholding tax of \$300 deducted at source. Because there is a loss, no beneficiary is presently entitled to the trust income.

15. The trustee's liability under section 99A in the year ended 30 June 2006 is calculated as follows:

Domestic rental income	\$15,000
Foreign dividend income received	\$1,700
Foreign tax paid <sup>18</sup>	\$300
Total assessable income	\$17,000
Less deductions	(\$22,000)
Net income (subsection 95(1))	(\$5,000)
Tax and Medicare levy under section 99A	nil
Excess foreign tax credit carried forward <sup>19</sup>	\$300

16. In the year ended 30 June 2007 the amount of domestic rental income remains at \$15,000; however the total rental deductions are only \$8,000. The trust estate also receives foreign dividend income of \$2,550 on which there has been 15% withholding tax of \$450 deducted at source. Because the trustee accumulates the income, no beneficiary is presently entitled to the trust income.

<sup>18</sup> Subsection 6AC(1).

<sup>19</sup> Section 160AFE.

17. The trustee's liability under section 99A in the year ended 30 June 2007 is calculated as follows:

Domestic rental income	\$15,000
Foreign dividend income received	\$2,550
Foreign tax paid <sup>20</sup>	\$450
Total assessable income	\$18,000
Less deductions	(\$8,000)
Less trust loss recoupment <sup>21</sup>	(\$5,000)
Net income (subsection 95(1))	\$5,000
Tax and Medicare levy under section 99A	\$2,325
Foreign tax credit (subsection 160AF(1))	\$450
Excess foreign tax credit brought forward <sup>22</sup>	\$300
Tax payable	\$1,575

## Date of effect

18. This Ruling applies to years of income commencing both before and after its date of issue.<sup>23</sup> However, the Ruling does 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 and 76 of Taxation Ruling TR 2006/10).

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**Commissioner of Taxation**

18 July 2007

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<sup>20</sup> Subsection 6AC(1).

<sup>21</sup> See section 36-15 of the *Income Tax Assessment Act 1997*. Trust loss is available for recoupment provided the trust loss rules in Schedule 2F of the ITAA 1936 are satisfied.

<sup>22</sup> Section 160AFE.

<sup>23</sup> Note that Tax Laws Amendment (2007 Measures No. 4) Bill 2007 was introduced into Parliament on the 21 June 2007. This Bill contains measures abolishing foreign loss and foreign tax credit quarantining and streamlining remaining foreign tax credit rules. These amendments also include transitional rules for the treatment of existing quarantined foreign losses and credits. The measures are intended to apply to income years beginning on or after the 1 July following Royal Assent.

## Appendix 1 – Explanation

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

19. The taxation of income of a trust estate is determined under Division 6 of Part III.

20. Where the net income<sup>24</sup> of a trust estate includes foreign income<sup>25</sup> in a year of income, a resident beneficiary, assessed under subsection 97(1) or section 100,<sup>26</sup> will have foreign income included in their assessable income.

21. Subsection 160AF(1) in Division 18 of Part III provides that an Australian resident taxpayer is entitled to a credit for foreign tax paid in respect of foreign income that is included in their assessable income in a year of income.

22. To be entitled to a credit under subsection 160AF(1), an Australian resident taxpayer must have:

- included foreign income in their assessable income (subparagraph 160AF(1)(a)(i));
- paid foreign tax (as defined by subsection 6AB(2)) in respect of that foreign income (paragraph 160AF(1)(b)); and
- been personally liable for the foreign tax (paragraph 160AF(1)(c)).

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<sup>24</sup> As defined in subsection 95(1).

<sup>25</sup> See subsection 6AB(1).

<sup>26</sup> A beneficiary covered by section 100 has to lodge an individual return. See TD 92/159.

**Entitlement to a foreign tax credit for a resident beneficiary assessed under subsection 97(1) or section 100**

23. Income beneficially derived by a person is deemed to be derived from the source to which the income can be directly or indirectly attributed (see subsection 6B(2A)). Subsection 6B(3) provides that a beneficiary in a trust estate who is presently entitled to income of the trust estate is deemed to have derived that amount of income for the purposes of section 6B. Tracing rules are provided in respect of dividend income (subsection 6B(1)), passive income (subsection 6B(1A)) and interest income (subsection 6B(2)) for the purposes of calculating the foreign tax credit available in respect of each class of foreign income.<sup>27</sup> The rules in section 6B therefore ensure that a resident beneficiary assessed under subsection 97(1) or section 100 satisfies the first test in subsection 160AF(1), where the net income of the trust estate includes foreign income.

24. The amount of foreign income included in the resident beneficiary's assessable income via section 97 and section 100 is the gross amount of the income before the payment of any foreign tax (see section 95 and section 6AC).

25. Where foreign income is derived indirectly through a trust estate and tax on that income has effectively been paid on the taxpayer's behalf, subsection 6AB(3) deems the taxpayer, for the purposes of the ITAA 1936, to have been personally liable for, and to have paid the foreign tax. The two circumstances set out in subsection 6AB(3) that are relevant for the purpose of this Ruling are those where foreign tax has been paid:

- by the trustee of a trust estate in which the taxpayer is a beneficiary (subparagraph 6AB(3)(a)(ii)); and
- by deduction (for example, a withholding tax) from the foreign income (subparagraph 6AB(3)(a)(iv)).

26. Subsection 6AB(4) deems a taxpayer deriving foreign income indirectly through a trust estate to have paid an amount of foreign tax equal to the difference between the net income actually derived and the gross amount to which it is attributable. This provision applies in a case where the trust estate itself did not pay the foreign tax, for example, where the resident beneficiary receives a distribution that comprises foreign income on which withholding tax was deducted before the income was received by the trustee.

27. The deeming provisions in subsections 6AB(3) and 6AB(4) therefore allow a resident beneficiary assessed under subsection 97(1) or section 100 to satisfy the second and third basic tests in paragraphs 160AF(1)(b) and (c).

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<sup>27</sup> Subsection 160AF(7).

28. Accordingly, a resident beneficiary assessed under subsection 97(1) or section 100<sup>28</sup> on trust income that includes foreign income is entitled to a credit of:

- the amount of foreign tax (reduced by any relief available to the taxpayer under the law relating to that tax);<sup>29</sup> or
- the amount of Australian tax payable in respect of that income, profit or gain,

whichever is the lesser amount in respect of each class of foreign income.<sup>30</sup>

29. To support a claim for a relevant foreign tax credit, the details of foreign tax paid shown in trust distribution advices provided by the trustee of a trust estate to beneficiaries will normally suffice as sufficient evidence.<sup>31</sup>

30. Any excess foreign tax credit in a year of income can be carried forward by the resident beneficiary for application in any of the following five income years in which foreign income is derived either directly or indirectly through any trust estate under section 160AFE.

### **When can a trustee claim a foreign tax credit?**

31. Division 6 of Part III adopts the scheme of assessing the beneficiary who is entitled to the income from the trust estate, except in special situations. Excepting in these situations provided for in the ITAA 1936, a trustee is not liable as trustee to pay income tax upon the income of the trust estate.<sup>32</sup>

32. The trustee is assessed and is liable to tax where:

- the beneficiary is presently entitled to a share of the income of the trust estate but is under a legal disability (subsection 98(1)) or the beneficiary is deemed to be presently entitled by the operation of subsection 95A(2) (subsection 98(2)); or
- there is trust income to which no one is presently entitled (sections 99 or 99A).

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<sup>28</sup> See paragraphs 34 and 35 of this Ruling.

<sup>29</sup> See paragraph 160AF(1)(d).

<sup>30</sup> See subsection 160AF(7).

<sup>31</sup> See Taxation Ruling IT 2527.

<sup>32</sup> See section 96.

**Trustee assessed under section 98**

33. A trustee assessed on behalf of a resident beneficiary under section 98 is entitled to claim a foreign tax credit under subsection 160AF(1) in respect of the foreign income included in the beneficiary's share of the net income, provided foreign tax has been paid or deducted at source. The trustee, as the legal owner of the trust property and in carrying out the affairs of the trust estate<sup>33</sup> is personally liable for the foreign tax paid or is deemed to be personally liable under subparagraph 6AB(3)(a)(iv).

34. Section 100 provides that where a beneficiary who is under a legal disability or is deemed presently entitled to any trust income under subsection 95A(2) is either:

- a beneficiary of more than one trust estate; or
- derives income from other sources,

the beneficiary is to include their individual interest in the net income of all the trust estates. Accordingly, the foreign income included in their trust income is aggregated with their (other) foreign income in the individual tax return for the purpose of determining the entitlement for a foreign tax credit under subsection 160AF(1) (see paragraphs 23 to 28 of this Ruling).

35. The tax payable by the trustee under section 98 on account of the beneficiary's share of the net income is calculated by deducting from the gross tax payable, the beneficiary's share of the foreign tax credit entitlement under subsection 160AF(1) in respect of the foreign income included. Any other credits or offsets that the beneficiary is entitled to are also deducted from the gross tax payable. The remaining amount constitutes the credit that the beneficiary receives under subsection 100(2) for the Australian tax paid or payable by the trustee on behalf of the beneficiary. As Example 1 above shows, the benefit of the foreign tax credit is not actually allowed twice because the beneficiary is also required to include the income in respect of which the foreign tax credit arises.

36. Any excess foreign tax credit arising under a section 98 assessment on behalf of a resident beneficiary is accounted for separately by the trustee and is available to be applied by the trustee for that beneficiary in the following five income years in accordance with section 160AFE.

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<sup>33</sup> *DFC of T v. Balnaves* (1998) 98 ATC 5123; 40 ATR 431.

**Trustee assessed under sections 99 or 99A**

37. Where the net income (or any part of the net income) of the trust estate in a year of income is income to which section 99 or section 99A applies and foreign income is included in the net income of the trust estate on which foreign tax has been paid or deducted at source, the trustee qualifies as an Australian resident taxpayer who has satisfied the 3 basic tests in subsection 160AF(1).<sup>34</sup>

38. The amount of foreign income included in the net income of the trust estate assessed to the trustee in such situations is inclusive of the amount of foreign tax paid in accordance with section 6AC.

39. Any excess foreign tax credit arising in a year of income as a result of section 99 or section 99A applying to the net income (or any part of the net income) of the trust estate can be carried forward under section 160AFE for the following five income years. Any excess foreign tax credit can be applied under subsection 160AFE(2) to increase the current foreign tax amount in an income year where foreign income is included in the net income (or any part of the net income) of the trust estate to which section 99 or section 99A applies.

**Where the resident trust estate derives foreign income, but returns a loss in a year of income**

40. In a year of income that the trust estate has foreign income included in its assessable income, but returns a loss, any foreign tax paid in respect of foreign income does not give rise to a foreign tax credit in that year of income in the hands of either:

- the beneficiary as there is no income distribution by the trust estate; or
- the trustee of the trust estate.<sup>35</sup>

41. In a loss year, the requirements of subsection 160AF(1) are therefore not satisfied either by the beneficiary or by the trustee. Any foreign tax paid by the trustee or deducted at source cannot be applied as a credit against Australian tax payable by a beneficiary who has (other) foreign income in their hands in the income year that the trust estate returns a loss.

42. However, any foreign tax paid or deducted at source does give rise to an excess foreign tax credit that is available to be carried forward by the trustee only under section 160AFE.

43. Such an excess foreign tax credit can be applied in any of the following five income years in which the trustee is assessed on the net income or any part of the net income of the trust estate which includes foreign income under section 99 or section 99A.

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<sup>34</sup> See paragraphs 31 to 33 of this Ruling.

<sup>35</sup> The amount of Australian tax payable is zero, which is less than the amount of foreign tax paid/deducted: paragraphs 160AF(1)(d) and (e).

44. It is considered that the requirements of subsection 160AF(1) are satisfied only by the trustee because of the inclusion of foreign income in calculating the loss of the trust estate for the earlier income year. As the amount of foreign income included in calculating the loss of the trust estate is the gross amount before the payment of any foreign tax, relief from (future) double taxation is afforded by the trustee carrying forward an excess foreign tax credit. The availability of an excess foreign tax credit to be carried forward by the trustee under these circumstances is aligned with its ability to carry forward foreign losses for offset against future foreign assessable income (of the same class) under section 160AFD for the purposes of the net income calculation under subsection 95(1).

45. Such an excess foreign tax credit is not available to a beneficiary of the trust estate as, in relation to a loss year, there is no trust distribution.

## **Appendix 2 – Detailed contents list**

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

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## References

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*Previous draft:*

TR 2007/D3

*Related Rulings/Determinations:*

IT 2527; TD 92/159; TR 2006/10

*Subject references:*

- beneficiary
- deemed liability
- excess foreign tax credit
- foreign income
- foreign tax
- foreign tax credit
- grossing up
- presently entitled
- trust estate
- trust income
- trust loss
- trustee

*Legislative references:*

- ITAA 1936 6AB(1)
- ITAA 1936 6AB(2)
- ITAA 1936 6AB(3)
- ITAA 1936 6AB(3)(a)(ii)
- ITAA 1936 6AB(3)(a)(iv)
- ITAA 1936 6AB(4)
- ITAA 1936 6AC
- ITAA 1936 6AC(1)
- ITAA 1936 6B
- ITAA 1936 6B(1)
- ITAA 1936 6B(1A)
- ITAA 1936 6B(2)
- ITAA 1936 6B(2A)
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- ITAA 1936 95
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- ITAA 1936 97(1)
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- ITAA 1936 99
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- ITAA 1936 159H
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- ITAA 1936 Pt III Div 18
- ITAA 1936 160AF(1)
- ITAA 1936 160AF(1)(a)(i)
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- ITAA 1936 160AF(1)(b)
- ITAA 1936 160AF(1)(c)
- ITAA 1936 160AF(1)(d)
- ITAA 1936 160AF(1)(e)
- ITAA 1936 160AF(7)
- ITAA 1936 160AFD
- ITAA 1936 160AFE
- ITAA 1936 160AFE(2)
- ITAA 1936 251S(1)(c)
- ITAA 1936 Pt XI
- ITAA 1936 Sch 2F
- ITAA 1997 36-15
- TAA 1953

*Case references:*

- DFC of T v. Balnaves (1998)  
98 ATC 5123; 40 ATR 431

*Other references:*

- Tax Laws Amendment (2007  
Measures No. 4) Bill 2007

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**ATO references**

NO: 2006/7391

ISSN: 1039-0731

ATOlaw topic: Income Tax ~~ Tax offsets, credits and benefits ~~ foreign  
tax credits  
Income Tax ~~ Entity specific matters ~~ trusts  
Income Tax ~~ Assessable income ~~ trust income -  
beneficiaries