TR 92/13 - Income tax: distribution by trustees of dividend income under the imputation system

Taxation Ruling
Income tax: distribution by trustees of dividend income under the imputation system

This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the ***Taxation Administration Act 1953****, is a public ruling for the purposes of that Part . Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

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What this Ruling is about

1. This Ruling considers, for the purposes of the dividend imputation provisions in Part IIIAA of the *Income Tax Assessment Act 1936*, the circumstances in which trust income to which a beneficiary is presently entitled is regarded as attributable to a franked dividend included in the assessable income of the trust estate.

2. A resident beneficiary of a trust estate (other than a company or trustee of another trust estate) is entitled to a franking rebate if:

- a share of net trust income is included in the assessable income of the beneficiary; and
- some or all of that share of net trust income is attributable to a franked dividend included in the assessable income of the trust estate.

For a beneficiary which is a resident company, a franking credit arises if the same conditions are satisfied.

3. For a beneficiary who is not a resident of Australia for income tax purposes, withholding tax does not apply to dividend income derived from the trust estate by the beneficiary to the extent the dividend income is franked.

Ruling

Discretionary trusts

4. Income distributed by a trustee of a discretionary trust estate retains the character it had when it was derived by the trustee unless a statute or the trust deed provides otherwise. If a franked dividend is derived by a trustee during a particular year of income, the trust

income for that income year distributed to beneficiaries will, to some extent, consist of franked dividend income. Generally, this will be so even after deducting trust expenses in the calculation of distributable income.

5. The extent to which a particular beneficiary's share of net trust income is attributable to, or consists of, specific dividend income depends on the extent to which dividend income is allocated to the beneficiary by means of:

- an express term in the trust instrument (e.g., that dividends from certain shares be distributed to specified beneficiaries); or
- the exercise by the trustee of a discretion subject to any constraint imposed by the terms of the trust, or by trust law generally; or
- the operation of any default provision of the trust instrument, if the trustee fails to exercise the discretion to distribute.

6. Notwithstanding wide discretionary powers being conferred on a trustee, a trustee's discretion to selectively allocate dividend income to a beneficiary to the exclusion of another may be fettered by the terms of the trust or by trust law operative in the relevant jurisdiction. The presence of a valid clause in a trust deed which expressly empowers a trustee to selectively allocate particular types of income to beneficiaries would remove uncertainty about the trustee's power in this respect.

7. In each of the situations in paragraph 5, for the allocation of, for instance, the entire amount of a dividend to one beneficiary to the exclusion of another to be effective for income tax purposes, accounting records of the trust need to be maintained. This is necessary so that each class of income derived by the trustee can be identified and traced, less expenses, into a share of the income of the trust distributed to the beneficiary (or specific class of beneficiary).

8. The allocation of dividend income to one beneficiary but not to another is not effective for income tax purposes if:

(a) the terms of the trust deed direct the trustee to mix different classes of trust income (e.g., dividends and interest) and then distribute the blended income in the trustee's discretion to beneficiaries; or

(b) the trustee, in accumulating trust income, does not specifically place different classes of income into separate income accounts so that it is not possible to trace the source of each trust distribution to a particular beneficiary or to a particular class of beneficiary. Unless the trustee clearly reflects what he or she has actually done in accumulating the trust income and in distributing it to particular beneficiaries, it will be most difficult to establish, after the event, what class of income was distributed to particular beneficiaries.

9. In either of the situations in paragraph 8, the net dividend income of the trust estate is to be rateably allocated among the beneficiaries to whom trust income is distributed. The distribution to each beneficiary is to be treated as comprising income of each different class of trust income on the basis that the beneficiary shares in each class of trust income in the same ratio as the beneficiary's share of the net income of the trust estate bears to the total net income of the trust estate.

10. A rateable allocation of different types of trust income among beneficiaries is not necessary if it can be shown that an amount of trust income of a particular type (e.g., interest) distributed to a beneficiary was actually paid to the beneficiary before a different class of trust income (e.g., dividends) was derived by the trustee. The type of income actually distributed to the beneficiary (i.e., interest) retains the same character that it had when it was derived by the trustee.

Fixed trusts

11. Broadly speaking, the same result follows in the case of a fixed trust as outlined in paragraphs 4 to 9 for a discretionary trust subject, of course, to the terms of the deed governing the fixed trust. Under the terms of a fixed trust, the trustees have no discretion as to the persons who are to benefit and each beneficiary has a defined interest in the subject matter of the trust. The terms of a fixed trust may confer a beneficial fractional interest in each item of trust property and/or income. In such cases, the selective allocation of different types of trust income may not be open to the trustee.

Date of effect

12. This Ruling applies (subject to any limitations imposed by statute) for years of income commencing both before and after the date on which it is issued.

Explanations

Imputation credits

13. Under the imputation system of company taxation, a franked dividend paid by a company to a trustee of a trust estate results in an amount, often referred to as the 'imputation credit', being included in the assessable income of the trust estate in addition to the amount of the dividend (section 160AQT). The franked amount of the dividend is grossed-up to include in the assessable income of the trustee of the trust estate the 'imputation credit', i.e., the company tax attributable to corporate profits to which the dividend relates.

14. A resident beneficiary (other than a company or trustee of another trust estate) is entitled to a rebate of tax equal to the part of the imputation credit that bears the same proportion as the beneficiary's share of the franked dividend income bears to the total franked dividend included in net trust income. The potential rebate amount flows through to the beneficiary irrespective of the amount of distributable income distributed by the trustee to that beneficiary.

15. A non-resident beneficiary is exempt from Australian income tax, including withholding tax, on the franked part of dividend income included in trust income to which the beneficiary is presently entitled (subsection 128A(3), paragraph 128B(3)(ga) and section 128D).

16. In providing for the flow-on of imputation credits when dividend income derived by a trustee is distributed to a beneficiary, the imputation provisions are consistent with the so-called 'conduit' theory of trust income. Under that theory, an amount of trust income distributed by a trustee to a beneficiary retains the character it had when it was derived by the trustee, unless a provision of the trust deed or of any relevant statute provides otherwise. There is judicial authority to support this theory; see *Syme v. C of T(Vic)* (1914) 18 CLR 519 and *FC of T v. Tadcaster Pty. Ltd.* (1982) 13 ATR 245 at 249; 82 ATC 4316 at 4319.

17. If the trust estate does not have any distributable income it follows that no beneficiary can be presently entitled to trust income even though the grossing-up of imputation credits may produce a net income result for income tax purposes. If a distribution to a beneficiary is made from corpus, no imputation credits can attach to that distribution.

18. If franked dividend income is derived under a trust but, after deduction of expenses, there is no distributable income, there may still be net income of the trust estate corresponding to the gross-up amount included in the assessable income of the trust estate. In this case,

the trustee will be liable to be assessed, under subsection 99(3), on the net income of the trust. The gross tax on this amount will be offset by the rebate to which the trustee is entitled under section 160AQY.

- **Resident individual beneficiary**

19. If a fully franked dividend of, say, $610 is paid to the trustee of a discretionary trust during the year ended 30 June 1992, the 'gross-up' amount of $390 is included in the assessable income of the trust estate. The assessable income of the trust estate totals $1000 (section 160 AQT). After expenses of, say, $500, the net income of the trust estate is $500 while the distributable income is $110 (i.e., $610 - $500).

20. Assuming the trustee validly exercises a discretion to allocate half of the dividend income included in distributable income to beneficiary A (i.e., $55), A's share of net trust income includes half of the gross-up amount, or imputation credit, i.e., $195, (section 160AQW) in addition to the dividend income (i.e., a total of $250).

21. Beneficiary A, who is an Australian resident individual, is entitled to a franking rebate of $195 (section 160AQX).

- **Resident company beneficiary**

22. Using the same example referred to in paragraph 19 above but assume the trustee validly allocates half of the dividend income to beneficiary X Pty Ltd, an Australian resident company.

23. If X Pty Ltd is entitled to a 50% share of the distributable income of the trust (i.e., $55), X Pty Ltd's share of the net income of the trust includes half of the gross-up amount, or imputation credit, (i.e., $195) in addition to the dividend income (i.e., a total of $250).

24. Although the $250 is included in X Pty Ltd's assessable income an amount equal to the potential rebate amount, i.e., the imputation credit of $195. is deductible (section 160AR). X Pty Ltd is entitled to the intercorporate dividend rebate in relation to the $55 trust income attributable to the dividend (sections 45Z and 46) unless section 46B, 46C, 46D or 46E applies to deny the rebate.

25. X Pty Ltd's franking account is credited by the adjusted amount of the potential rebate amount, i.e., $195 x 61/39 = $305 (section 160APQ).]

- **Non-resident beneficiary**

26. If the remainder of the dividend income referred to in paragraph 20 above is distributed to beneficiary B, a non-resident, B's share of the net income of the trust i.e., $250, is reduced by:

- $195, the amount of the potential rebate amount (section 160ARA); and
- $55, the amount of the dividend included in the distributable income of the trust which would have been subject to withholding tax but for the express exemption conferred by paragraph 128B(3)(ga) [see section 128D].

Taxation Ruling IT 2680 further explains the liability to withholding tax of non-resident beneficiaries of Australian trusts.

Accounting for the allocation of different types of trust income

27. Assuming a trustee is validly empowered to allocate different components of trust income to particular beneficiaries, the exercise of a discretion to allocate franked dividend income included in the net income of the trust estate is dependent on the accumulation and allocation of different types of trust income being reflected in the accounting records of the trust.

28. If separate bank accounts are maintained for different types of trust income, amounts are debited to those accounts and are applied to meet distributions to beneficiaries (as well as trust outgoings), this will enable the amounts distributed to beneficiaries to retain the same character as they had when they were received by the trustee. This approach may, however, involve undue administrative inefficiency and inconvenience.

29. It does not matter that different types of trust income are mixed in a common bank account. The nature of an amount distributed to a particular beneficiary will be determined by debiting the amount distributed to the appropriation account corresponding to the particular income component. This procedure assumes, however, that records are maintained which separately account for different components of income, and that expenses attributable to the gaining or producing of each component are appropriately charged against the respective components.

Examples

Example 1 - discretionary trust

30. During the year ended 30 June 1991, the following income was derived from property the subject of the Daly Family Trust:

	$
• fully franked dividend paid by Lokupp Pty Ltd .... (i.e., imputation credit of $8000 x 39/61 = $5114.75)	8 000
• dividend paid by Australasian Banking Company .... (franked to the extent of 50%, i.e. imputation credit of $4000 x 50/100 x 39/61 = $1278.69)	4 000
• interest income	8 000
• rental property income	32 000
	52 000

31. Trust expenses consisted of:

• expenses directly attributable to the rental property	36 000
• other (deductible) expenses .... (which do not relate directly to dividend income or to other property income)	2 000

32. The amount of distributable income and the net income of the trust estate are calculated as follows:

		$
	Total income	52 000
less	Expenses	38 000
=	Distributable income	14 000
plus	Gross-up amounts ($5114.75 + $1278.69)	6 393
=	Net income for income tax purposes (subsections 95(1) and 160AQT(1))	20 393

33. Arthur Daly, as trustee of the Daly Family Trust, has an absolute discretion either to accumulate the income of the trust estate or to allocate it to one or more members of the beneficiary class specified in the trust deed. The trust deed also expressly confers a power to selectively allocate income by type to each beneficiary.

34. In relation to trust income derived in the year ended 30 June 1991, Mr Daly resolved to allocate:

- all of the fully franked dividend income to Beneficiary A; and

- the remaining distributable income between Beneficiaries B and C in equal shares.

35. Trust records were maintained with separate accounts for each of the types of income specified in paragraph 30. Other expenses were allocated in accordance with the expense allocation rules set out in section 50 of the *Income Tax Assessment Act*. This meant that the other expenses ($2000) and the rental loss ($4000) were set off against the interest income.

36. The balances in those accounts after allocation were as follows:

	$
• fully franked dividends	8000
• 50% franked dividends	4000
• interest	2000

37. The allocation for income tax purposes of the net income of the trust was therefore as follows:

	$
• Beneficiary A (includes potential rebate amount - $5115)	13 115
• Beneficiary B (includes potential rebate amount - $639)	3 639
• Beneficiary C (includes potential rebate amount - $639)	3 639
Net income of the trust	20 393

Example 2 - fixed trust

38. The Long Cheyneman Investment Trust is a unit trust which consists of portfolio investments in equities and debt securities issued by Australian corporations. For the year ended 30 June 1991, the following types of income were derived:

	$
• partly franked dividends paid by Australian corporations (aggregate imputation credits - $50 000)	100 000
• interest income	80 000
• loss on securities trading	(30 000)

39. Distributable income, for trust accounting purposes, is $150 000. With the inclusion of the gross-up amount ($50 000) net income of the trust, for income tax purposes, is $200 000 (subsections 95(1) and 160AQT(1)).

40. The trust deed provides for each unitholder to be entitled to a share of trust income calculated by multiplying distributable income by the fraction that the unitholder's unitholding bears to total issued units at year end.

41. The trust deed is silent on whether the trustee is empowered to allocate different components of trust income to different beneficiaries.

42. The net amount of each component of distributable income is allocated rateably to each unitholder, so that the amounts distributed to unitholders consist of proportionate shares of each component.

43. **Unitholder Y** is a resident individual who holds 20 000 of the 500 000 issued units in the Trust, i.e., 4% of the total issued units. Amount distributed to Unitholder Y is $6 000 (i.e., 4% of distributable income of $150 000).

44. Unitholder Y's share of net income for income tax purposes is $8 000 (i.e., 4% of net income of $200 000). Unitholder Y also has available a franking rebate of $2000 (section 160AQX).

45. **Unitholder Z**, who is not a resident of Australia for income tax purposes, holds 25 000 units in the Trust (i.e., 5% of the total issued units).

46. Unitholder Z's share of net income for income tax purposes, i.e., $10 000, is not subject to tax because:

- $2500, the potential rebate amount, is deducted from that amount to offset the gross-up component which had been included in net trust income (section 160ARA); and
- the remainder is either subject to non-resident withholding tax, or would have been but for an express exemption, and is therefore excluded from assessable income (section 128D).

47. Amount distributed to Unitholder Z is $7086.54. This amount is calculated by deducting from the 5% share of distributable income :

- dividend withholding tax $163.46
  on the share of the unfranked component of
  the dividends from Australian corporations

- interest withholding tax $250
  on the share of the interest income reduced by the securities trading loss (i.e., at the rate of 10% of 5% of $50 000.

The unfranked component of the dividends from Australian corporations is calculated by deducting the franked component ($50 000 x 61/39 = $78 205) from the dividend income ($100 000). Dividend withholding tax is calculated by applying the appropriate rate (i.e., 15%, if Unitholder Z is a resident of a country with which Australia has concluded a comprehensive agreement for the avoidance of double taxation) to the unitholder's share of the unfranked component, i.e., 15% of (5% of $21795).

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legislative references
- ITAA 50; ITAA 128A(3);
- ITAA 128B(3)(ga); ITAA 128D;
- ITAA 160APQ; ITAA 160AQT;
- ITAA 160AQW; ITAA 160AQX
- ITAA 160AR ; ITAA 160ARA

case references
- Syme v. C of T(Vic) (1914) 18 CLR 519
- FC of T v. Tadcaster Pty. Ltd (1982) 13 ATR 245; 82 ATC