

Bamford v Commissioner of Taxation [2010] HCA 10

Bamford is a test case of how the statute in Division 6 taxes a trust and its beneficiaries. The High Court handed down its decision on 30 March 2010, by dismissing the appeal by the Commissioners of Taxation against the decision of the Full Federal Court.

The case before the court was whether "income of the trust estate" in Division 6, Section 97 of Income Tax Assessment Act 1936 (ITAA 1936) referred only to income according to ordinary concepts.

Prior to Bamford there has been no certainty as to how Division 6 applies to income of a trust, in particular:

1. Capital Gains
2. Taxable income not equal to accounting income

The High Court Determined

1. Capital gains - The trust deed can treat a capital gain as income

In Bamford, the trust deed gave the trustee the discretion to treat capital gains as income and therefore, having accounted for a capital gain in that manner in accordance with the requirements of the deed, the relevant amount was considered income for trust purposes.

This situation was reflected in determining the "income of the trust estate" when the provisions of s97 were applied. If the capital gain had been excluded from income for trust purposes, it would not have been possible to effect a distribution of that gain as the "income of the trust estate" would have been nil.

If the court has determined that capital gains were not income under s 97, the trustee would have been taxable on the capital gain at the highest rate of tax .

2. Taxable income not equal to accounting income

For example when the taxable income of the trust is more than the accounting income of the trust (when an expense has reduce the income of the trust, but is not deductible for taxation purposes):

Profit and loss statement of trust

Income

Interest	\$100
Total Income	\$100

Expenses

Fines	\$50
Total Expenses	\$50

Accounting Profit **\$50**

Cash distribution to
Beneficiaries \$50

Tax Calculation

Profit per accounting standards \$50

Add non deductible amounts

- Fines \$50

Taxable net income of trust \$100

Taxable net income of trust is \$100, as the fines are not deductible for income tax. Therefore tax is payable by the beneficiaries on \$100, but cash received by the beneficiaries is only \$50. The High Court held that the beneficiary is taxed on \$100, even though the beneficiary only received \$50.

The other argument been that the beneficiary should be taxed on \$50 (been the sum distributed) and the trustee taxed on \$50 (been the sum which was unable to be distributed) was dismissed by the High Court.

Conclusion

Bamford confirms the beneficiary will be taxed on a proportion of the income of the trust rather than the cash distribution it receives may cause concerns in some cases.

Trust can determine relevant income for distribution and include capital gains, allowing those gains to flow to investors. It does provide flexibility and removes the concern of the trustee been subject to tax on this amounts.

It is important now that you review your trust deed to ensure the deed allows for flexible distribution and where necessary allow for repayment of debt by the trust.

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