Concern over ban on trust streaming - Australian Financial Review, The [3 Day Embargo] (Australia) - November 8, 2010 - page 5

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Accountants have renewed calls for the federal government to rewrite the tax rules for trusts, claiming the Australian Taxation Office was administering the law in a way that punished families and small businesses who used the tax-effective vehicles.

Family trusts should be allowed to divert different types of income, such as franked dividends and capital gains, to different beneficiaries, a method known as "streaming" and used by trusts for years, advisers said.

Yet a practice statement issued by the ATO in June disallowed streaming, and advisers said the uncertainty was now creating problems for clients.

"It's our number one issue at the moment; it's just so uncertain," said WHK Horwarth national tax director Tristan Webb. He said up to 10,000 trusts that were clients of the firm had been affected. The practice statement says trust beneficiaries must be taxed on their "share" of trust income, regardless of the nature of the income actually distributed to them.

The ATO view relied on a High Court decision in the Bamford case.

"The Bamford litigation was not concerned with streaming. It is disingenuous for the Tax Office to link the two," said Mr Webb.

Mr Webb called on the ATO to clarify the rules, saying it was motivated by the perception that trusts are tax avoidance vehicles, although they were often used for succession planning and asset protection.

"Discretionary trusts are under fire already because of the treatment of unpaid present entitlements and there are a lot of clients already questioning their use of a discretionary trust," he said.

Tax lawyer Nicole Sammel said the ATO's view was taken from comments made in the Bamford judgment on a different issue to streaming. "So how can Bamford be said to justify a 180-degree turnaround on streaming?

"If the ATO persists with its new view, not only will certain discretionary trust arrangements be taxed less favourably than before, but wholly unfair tax outcomes could also result," she said.

Ms Sammel gave an example of a trust that distributed a capital gain to one beneficiary, while another beneficiary given nothing could be taxed on the gain, depending on the drafting of the trust deed and the trustee's actions.

Taxation Institute of Australia counsel Robert Jeremenko said taxpayers would continue to face uncertainty until the law was changed.

"The government should grasp this opportunity to rewrite the trust income provisions of the tax law as part of their ongoing reform process, as recommended by the Henry review," Mr Jeremenko said.

Treasury secretary Ken Henry's tax review said the complex and uncertain trust tax rules should be rewritten.

It also noted that "trusts are typically taxed on a flow-through basis" and that "this treatment remains broadly appropriate".

Greenwood & Freehills partner Andrew Mills said the new laws for managed investment trusts (MITs) MITs beginning in July acknowledged "streaming". "Without the MIT review going on, we would have a real problem," Mr Mills said.

He also thought the ATO was concerned about trusts set up to avoid tax.

"But we've already got rules to deal with that. I don't think you shut down all streaming to deal with that.

"It's destroying the foundation just because you don't like the colour of the wall," Mr Mills said.

Advisers said the ATO should test the law in the courts. They are also waiting on the result of a Federal Court case heard in April this year involving the streaming of trust funds by Colonial First State Investments.

KEY POINTS Accountants say family trusts should be allowed to divert different types of income to beneficiaries. An ATO ruling against the practice of streaming had created uncertainty for some thousands of trusts.

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