
Streaming of Franking Credits Curtailed by Bamford-Induced Amendments – an Unintended Consequence?

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In 2011, the provisions providing for allocation to beneficiaries of a trust's franked distributions and associated tax attributes (franking credit tax offsets) were amended in light of the High Court decision in Commissioner of Taxation v Bamford. The concern from Bamford was that streaming of receipts of a discretionary trust may no longer be available in light of the proportionate view interpretation of the rule that allocates the trust's taxable income to beneficiaries. The overwhelming aim of the 2011 amendments was to cement the streaming of a trust's franked distributions and associated tax attributes (and net capital gains) to selected beneficiaries to the exclusion of other entitled beneficiaries. However, the amended provisions prevent streaming of franking credits where the distribution is extinguished by related expenses. However, the old provisions, as confirmed in the recent Thomas v Federal Commissioner of Taxation decisions, permitted streaming in these situations.

I. INTRODUCTION

There are some 650,000 discretionary trusts¹ in Australia, which are used for trading or business activities as well as for passive investment.² They far exceed the number of partnerships (around 330,000),³ and are only somewhat behind the number of private companies (830,000).⁴ Importantly, around \$16.7 billion of franked distributions (and around \$7.1 billion of associated franking credits) were made by discretionary trusts in the 2014–2015 income year.⁵ Around \$14.8 billion of the franked distributions were attributable to the 335,500 discretionary trusts that characterised their activity as investment activities.⁶ Given this, and the undoubted “tax efficiency aims” of many users of discretionary trusts, the ability of a trustee to stream franked distributions and associated tax attributes to particular beneficiaries to the exclusion of other entitled beneficiaries, assumes considerable importance.⁷

Streaming in the discretionary trust context involves the selective allocation by the trustee of particular receipts, profits, amounts etc of the trust to a beneficiary (beneficiaries) to the exclusion of other entitled

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¹ A discretionary trust exists when pursuant to the trust deed the trustee has the absolute discretion as to which beneficiaries will enjoy the income or the capital of the trust estate. It has been observed that there is no fixed meaning of a “discretionary trust”, as it is disclosed by a consideration of usage rather than doctrine: *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226; 37 ATR 393; 98 ATC 4097, 4099 (Brennan CJ, Toohey, Gaudron, McHugh and Gummow JJ); [1998] HCA 4.

² Australian Taxation Office, *Taxation Statistics 2014–15* (2016) Table 4 of Trusts.

³ Australian Taxation Office, n 2, Table 14 of Partnerships.

⁴ Australian Taxation Office, n 2, Table 1 of Companies.

⁵ Australian Taxation Office, n 2, Table 4 of Trusts, Columns DR and DT in Table 4 of Trusts.

⁶ Australian Taxation Office, n 2, Table 4 of Trusts, Column DR in Table 4 of Trusts.

⁷ Although significant, the popularity of the discretionary trust is not limited to income tax minimisation factors; non-tax factors will often feature as well. For example, discretionary trusts can provide asset protection, succession planning, limited liability and family control of assets: see Brett Freudenberg, “Tax on My Mind: Advisors’ Recommendations for Choice of Business Form” (2013) 42(1) AT Rev 33.



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beneficiaries. In regard to franked distributions derived by a discretionary trust, it means the selective allocation of the franked distributions (if any still exist) and the associated tax attributes (eg franking credit tax offset) to particular beneficiaries to the exclusion of other beneficiaries who might be getting an allocation of other trust law income (and therefore an allocation of other taxable income).

Putting aside partnerships, Subdiv 207-B of the *Income Tax Assessment Act 1997* (Cth) (*ITAA 1997*)⁸ deals with the allocation of franked distributions⁹ and/or associated tax attributes¹⁰ of a trust to beneficiaries.¹¹ In 2011, Subdiv 207-B was amended in light of the High Court decision in *Commissioner of Taxation v Bamford*.¹² The concern was that the proportionate view interpretation of ss 97 and 98 of the *Income Tax Assessment Act 1936* (Cth) (*ITAA 1936*) adopted in *Bamford* may have prevented the streaming of franked distributions and/or associated tax attributes to beneficiaries of discretionary trusts.¹³

Two of the decisions in the *Thomas v Federal Commissioner of Taxation* litigation (Greenwood J in the Federal Court in 2015, and the Full Federal Court in 2017)¹⁴ confirmed that, under the pre-*Bamford* amendments (old Subdiv 207-B),¹⁵ streaming of a franked distribution and the associated tax attributes was available where both the franked distribution was not extinguished by expenses, and where it was extinguished by related expenses in the trust. However, under the post-*Bamford* amendments to Subdiv 207-B, streaming appears not to be available where the franked distribution is extinguished by related expenses. While the government did not expressly say that the post-*Bamford* amendments would guarantee streaming of franked distributions and associated tax attributes in all situations, there was little hint or suggestion that streaming would be curtailed in any situation.¹⁶ Instead, all the focus was on “improving” the current law, by ensuring streaming was available for the benefit of users of trusts in receipt of franked distributions. Certainly, no policy justification was provided for curtailing streaming where expenses extinguished the franked distribution.¹⁷

Aside from this introduction and conclusion, the article is in two parts. Part II sets out the key rules of the old and new Subdiv 207-B of the *ITAA 1997*. It provides the foundation for the Part III comparisons, and focuses on identifying the key structural concepts that facilitate the allocation (streaming) of franked distributions and associated tax attributes¹⁸ of the trust to beneficiaries under the old and new rules.

⁸ All references to tax legislation are to the *Income Tax Assessment Act 1997* (Cth), unless stated otherwise.

⁹ The terms “distributions” and “dividends” can be used interchangeably.

¹⁰ In regard to franked distributions, the term “associated tax attributes” means: (1) the gross-up (assessable income inclusion) or the franking credit amount as mentioned in *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [512]; 2015 ATC 20-526; [2015] FCA 968; and (2) the franking credit tax offset.

¹¹ As discussed below, there are times where associated tax attributes are allocated, but the distribution itself is not allocated (in the sense of an assessable income inclusion). This is the case under the old *Income Tax Assessment Act 1997* (Cth) Subdiv 207-B, and can be the case under the new Subdiv 207-B.

¹² *Commissioner of Taxation v Bamford* (2010) 240 CLR 481; 75 ATR 1; [2010] HCA 10. *Income Tax Assessment Act 1997* (Cth) Subdiv 115 (net capital gains of trusts) was also substantially amended.

¹³ *Commissioner of Taxation v Bamford* (2010) 240 CLR 481, [45]; 75 ATR 1; [2010] HCA 10. The same concern applied to a trust’s net capital gains. There is no reason why the same concern should not arise in regard to a trust’s foreign source income and associated foreign income tax offsets. The same concern may also arise in regard to dividends and interest passed-through to non-resident beneficiaries of Australian trusts.

¹⁴ *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576; 2015 ATC 20-526; [2015] FCA 968 (Greenwood J); *Thomas v Federal Commissioner of Taxation* (2017) 105 ATR 413; 2017 ATC 20-612; [2017] FCAFC 57. There is also the High Court decision, *Federal Commissioner of Taxation v Thomas* [2018] HCA 31; 2018 ATC 20-663.

¹⁵ Descriptions of the old and new *Income Tax Assessment Act 1997* (Cth) Subdiv 207-B are not strictly correct as there was not a complete repeal of the “old” Subdiv 207-B from 2010–2011; there were merely amendments and additions to the subdivision. Descriptions and headings should be understood in this light.

¹⁶ See Assistant Treasurer, “Improving the Taxation of Trust Income” (Media Release, No 052, 13 April 2011); Explanatory Memorandum, *Tax Laws Amendment (2011 Measures No 5) Bill 2011* (Cth) [2.1], [2.18], [2.20], [2.25].

¹⁷ This article does not examine whether streaming, as a matter of sound tax policy, ought to be permitted where expenses extinguish a franked distribution. However, some of the likely considerations in that debate are set out in sub-part III(E).

¹⁸ The term “associated tax attributes” means the gross-up (assessable income inclusion) and the franking credit tax offset that “comes with” a franked distribution. In *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576; 2015 ATC 20-526;

Identifying their constituent elements is also a major aim of Part II. Part III compares and contrasts seven scenarios to test the application of the old rules and new rules, with the aim of identifying whether the tax outcome differs under any scenarios.

The key conclusion from the article is that the new Subdiv 207-B prevents streaming of franked dividends where the franked dividend is extinguished by related expenses. Under the old Subdiv 207-B, streaming was available where related expenses extinguished the franked dividend. It is not clear that this change in position was intended. However, even if intended, it was not canvassed widely in the tax profession and no policy justification was put forward for it. It is argued that it is important to reflect and consider whether this change should be retained or whether the old rules should be reinstated.

II. OLD AND NEW SUBDIV 207-B RULES

A. Old Subdiv 207-B Rules

1. Background

Subdivision 207-B was introduced into the *ITAA 1997* from 1 July 2002¹⁹ as a “rewrite” of the rules in Pt IIIAAA of the *ITAA 1936* and, in particular for present purposes, ss 160AQW and 160AQX. Whether or not Subdiv 207-B was designed precisely to replicate the Pt IIIAA outcome for trusts and beneficiaries is not clear, but in any event is not examined in this article.

2. Overview of Old Rules

The old rules interacted with, and piggybacked on, the normal trust taxation rules in Div 6.²⁰ Accordingly, the first step is to determine the “net income” of the trust, and then potential allocation of net income to a beneficiary occurs on the basis of the beneficiary’s present entitlement to trust law income for the corresponding year. This may perhaps provide for “allocations” to the trustee for trustee representative taxation of part or all of the trust’s taxable income.²¹ For the purpose of this article, the term “trust’s taxable income” refers to “net income” as used in s 95 of the *ITAA 1936*. The reason for this is to try to avoid the confusion that can arise because many trust deeds, judicial decisions, Administrative Appeals Tribunal decisions, Board of Review decisions, tax commentators etc use or adopt the term “net income” to refer to trust law income, as the term “net income” may actually appear in the trust deed.²² The proportionate approach is then applied to make the allocation so the beneficiaries include their share of net income in their own assessable income.²³

“Trust law income” refers to revenue profits of the trust (revenue less expenses) for the financial year corresponding with the (income tax) income year.²⁴ In terms of allocation of expenses by a trustee, there are a number of principles that can be gleaned from case law in respect of the allocation of trust receipts between a life tenant and that of a remainderman. In the decision of *Carver v Duncan*, Lord Templeman explained as a general rule in terms of allocating expenditure between income and capital that

[2015] FCA 968, Greenwood J used the terms “stapled” ([466], [516]) and “linked” ([517]) to describe the relationship between a franked distribution and the associated tax attributes.

¹⁹ It will be appreciated that the reference solely to *Income Tax Assessment Act 1997* (Cth) Subdiv 207-B is not correct. Subdivision 207-B links up with the normal trust taxation rules in *Income Tax Assessment Act 1936* (Cth) Pt III Div 6.

²⁰ *Income Tax Assessment Act 1936* (Cth) Pt III Div 6.

²¹ Trustee representative taxation could be for a beneficiary (eg *Income Tax Assessment Act 1936* (Cth) s 98(1), (2)), or for the beneficiaries (trust) as a whole (ss 99, 99A).

²² For a thorough exploration of this confusion, see Dale Boccabella, “The Taxation of Trusts: Discourse Has Not Been Helpful” (2014) 14 *Weekly Tax Bulletin* 472.

²³ The proportionate approach was widely accepted before the High Court decision in *Commissioner of Taxation v Bamford* (2010) 240 CLR 481; 75 ATR 1; [2010] HCA 10 as the correct interpretation of s 97 (and s 98): see *Zeta Force Pty Ltd v Commissioner of Taxation* (Cth) (1998) 84 FCR 70; 39 ATR 277; 98 ATC 4681 and the authorities cited and discussed therein.

²⁴ *Commissioner of Taxation v Bamford* (2010) 240 CLR 481; 75 ATR 1; [2010] HCA 10. See Brett Freudenberg, “Are Asset Revaluation Reserve Distributions ‘Ordinary Income’ for Discretionary Beneficiaries?” (2005) 20(1) *Australian Tax Forum* 3.

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consideration must be had of the expenditure to allocate it to either the life tenant or the remainderman's allocation so that "income must bear all ordinary outgoings of a recurrent nature. ... Capital must bear all costs; charges and expenses incurred for the benefit of the whole estate".²⁵ Thus in terms of a business conducted in a testamentary trust it was stated "any profit which [the] capital earns as the result of a strict method of accountancy belongs to the life tenant as soon as the profit is realized in cash".²⁶

In determining the "income of the trust estate" the High Court in *Bamford* stated that the general law of trusts applies in determining it;²⁷ and as part of determining this the decision of Sundberg J in *Zeta Force Pty Ltd v Commissioner of Taxation (Cth)* is insightful in referring "to the distributable income. That is to say distributable income is the income ascertainable by the trustee according to appropriate accounting principles and the trust instrument".²⁸ Historically, rules were developed in Chancery regarding apportionment between capital and income receipts, and outgoings and losses.²⁹ In determining the "distributable" income of the trust, the High Court in *Bamford* referred to the decision of *Commissioner of Taxation (Cth) v Totledge Pty Ltd*:

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.³⁰

This highlights that present entitlement is to the "distributable surplus", which is looking at the income of the trust less relevant outgoings. That is: "presently entitled to a share of income of the trust estate" is to be taken as a whole, then a beneficiary can only be presently entitled to income that can be or is capable of being 'paid over' to the beneficiary".³¹

In terms of allocating expenses in determining the income of the trust estate, Emmett J in the Federal Court decision of *Bamford* noted: "Receipts and outgoings of a trustee in relation to the trust estate must be allocated among the beneficiaries, according to their respective interests, on an equitable and fair basis."³²

In terms of allocating expenses/outgoings to income receipts, in *CPT Custodian Pty Ltd v Commissioner of State Revenue*³³ reference was made to *Baker v Archer-Shee*³⁴ where Lord Wrenbury held the beneficiary had a beneficial interest in income because she had "an equitable right in possession to receive during her life the dividends, subject to deduction for the costs, charges and expenses of the trustees, and for United States tax".³⁵ Also a number of cases have referred to the apportionment of expenses to determine present entitlement of trust income, generally between income and capital beneficiaries.³⁶ Additionally, a broad principle is that a person who gets the benefit carries the burden.³⁷

²⁵ *Carver v Duncan* [1985] AC 1082; [1985] 2 All ER 645, 652.

²⁶ *Re Porter* (1930) 31 SR (NSW) 115, 115 (Harvey CJ).

²⁷ *Commissioner of Taxation v Bamford* (2010) 240 CLR 481, [36]–[39]; 75 ATR 1; [2010] HCA 10.

²⁸ *Zeta Force Pty Ltd v Commissioner of Taxation (Cth)* (1998) 84 FCR 70, 74–75; 39 ATR 277; 98 ATC 4681.

²⁹ Paul Dowd, "The Meaning of 'Income of the Trust Estate' in Div 6" (2013) 47(11) *Taxation in Australia* 707.

³⁰ *Commissioner of Taxation (Cth) v Totledge Pty Ltd* (1982) 40 ALR 385, 393; 12 ATR 830.

³¹ Dowd, n 29, 711. Similarly in *McBride v Hudson* (1962) 107 CLR 604, 623–624 (Taylor J), the "amount of profit" implies taking into account outgoings. This can be compared to Mark Robertson, "Bamford v Federal Commissioner of Taxation" (25th National Convention, Taxation Institute of Australia, Melbourne, 3–5 March 2010).

³² *Bamford v Commissioner of Taxation* (2009) 176 FCR 250, [51]; 73 ATR 49; [2009] FCAFC 66.

³³ *CPT Custodian Pty Ltd v Commissioner of State Revenue* (2005) 224 CLR 98; 60 ATR 371; [2005] HCA 53.

³⁴ *Baker v Archer-Shee* [1927] AC 844.

³⁵ *Baker v Archer-Shee* [1927] AC 844, 866.

³⁶ For management costs, see *Re Corbetts Settlement* (1907) 24 WN (NSW) 300. For repairs, see *Wilkie v Equity Trustees Executors & Agency Co Ltd* [1909] VLR 277.

³⁷ *Re Baillie; Whiting v Cavendish* [1928] VLR 171.

In terms of a discretionary trust there is probably greater latitude for the trustee in terms of how expenses are allocated against income of the trust (although this depends upon the precise terms of the relevant Trust Act and the trust deed). For example under the *Trustee Act 1925* (NSW) the trustee has the express power to allow for “any deductions for duties costs charges and expenses which the trustee may think proper or reasonable”³⁸ in relation to the interest in property or the proceeds of sale. Additionally, the trust deed itself may have specific provisions dealing with the allocation of expenses. For example:

determines.

The trustee has full discretion to apply particular expenses and outgoings (or part of them) of the trust fund against any one or more categories of income of the trust fund. Should the trustee not use this discretion, expenses and outgoings are to be applied against categories of income in accordance with the order set out in clause 7(2) of this trust deed.

Additionally, the trust deed may provide that the accounts of the trust should reflect different categories of income, and the allocation of expenses against such income. For example:

The trustee must maintain trust accounts so that separate categories of income of the trust can be separately identified and recorded, and so that expenses and outgoings related to those separate categories of income can also be identified and recorded.

Importantly, it is profits on revenue account so that generally capital profits or capital outgoings are not included in this calculation of trust law income;³⁹ unless of course the trustee has recharacterised what would otherwise be a capital profit or amount as a revenue amount under a recharacterisation power in the trust instrument.⁴⁰

“Taxable income”⁴¹ is an income tax term and means assessable income less deductions.⁴² This will incorporate all of the normal rules in the income tax dealing with these two items. A tax loss arises where the trust’s deductions exceed the sum of assessable income and net exempt income (if any).⁴³

Example One demonstrates how trust law income of a trust could differ from taxable income due to the gross-up of dividends, and the non-deductibility of entertainment expenses.

3. Example One

In Example One,⁴⁴ the trustee resolution of a discretionary trust allocates the trust law income to two natural person adult beneficiaries (Ann and Ben) equally (\$8,500 each).⁴⁵ The allocation resolution makes no reference to components of trust law income. As Ann and Ben are presently entitled to \$8,500 each, they each include \$10,500 in their assessable income under s 97(1).⁴⁶

³⁸ *Trustee Act 1925* (NSW) s 40(1)(c).

³⁹ Depreciation expenses of a capital asset are generally a proper expense in determining trust law income (ie it would appear in the accounting records of the “income statement”): *Re Mitchell; Mitchell v Trustees Executors & Agency Co Ltd* [1955] VLR 120, 124.

⁴⁰ *Bamford v Commissioner of Taxation* (2009) 176 FCR 250, [26], [68]; 73 ATR 49; [2009] FCAFC 66 provides a high-profile example of a trust deed with a power to recharacterise trust receipts.

⁴¹ The legislation refers to this as “net income” in all relevant provisions.

⁴² *Income Tax Assessment Act 1997* (Cth) s 4-15(1).

⁴³ *Income Tax Assessment Act 1997* (Cth) s 36-10.

⁴⁴ This example is discussed throughout the article, with some variations.

⁴⁵ The trustee resolution simply states that each beneficiary is entitled to 50% of trust law income.

⁴⁶ *Income Tax Assessment Act 1936* (Cth) s 97(1).

EXAMPLE ONE		
<u>Trust Law Income</u>		
Revenue		
Rent	\$22,000	
Franked Distribution	<u>\$7,000</u>	\$29,000
Expenses		
Entertainment	\$1,000	
Rent Expenses	\$10,000	
Interest on Loan (Shares)	<u>\$1,000</u>	\$12,000
Trust Law Income		<u>\$17,000</u>
<u>Taxable Income (Net Income per s 95)</u>		
Assessable Income		
Rent	\$22,000	
Franked Distribution	\$7,000***	
Gross-Up	<u>\$3,000</u>	\$32,000
Deductions		
Entertainment	Zero	
Rent Expenses	\$10,000	
Interest on Loan (Shares)	<u>\$1,000</u>	\$11,000
Taxable Income		<u>\$21,000</u>
<u>Notes to Income Statements etc</u>		
* The trust deed confers power on the trustee to direct expenses against particular items of income. However, the trustee has not exercised the power here.		
** The trust deed permits the trustee to create accounts for different categories of receipts, profits etc and it allows for the streaming of those to particular beneficiaries to the exclusion of other beneficiaries receiving an entitlement. The trustee has maintained separate accounts, but has not streamed any category of receipt.		
*** There is just one dividend, and it is 100% franked.		

4. Old Subdiv 207-B

After application of the Div 6 rules, the rules in Subdiv 207-B link up with Div 6 with the main aim of allocating the franking credit tax offset to the beneficiaries. There is no need to allocate the cash dividend or the gross-up to beneficiaries under Subdiv 207-B as this has already been done under s 97, with the resulting potential tax liability.⁴⁷

This subdivision purported to do two things – namely, to “allocate” the gross-up to a beneficiary,⁴⁸ and allocate the franking credit tax offset to a beneficiary.⁴⁹ There was no rule within Subdiv 207-B that purported to allocate the franked distribution to a beneficiary in terms of making it assessable income to the beneficiary.

(a) Gross-up

If certain conditions⁵⁰ were satisfied, s 207-35(3) stated that “the entity’s assessable income for that year also includes so much of the franking credit amount as is equal to its *share of the *franking credit on

⁴⁷ The presence of and/or the role of *Income Tax Assessment Act 1997* (Cth) s 207-35(3) is somewhat of a mystery because, on its face, it appears (or appeared) to allocate the gross-up for inclusion in beneficiaries’ assessable income. However, to do this would be double taxation of the gross-up. See discussion below.

⁴⁸ *Income Tax Assessment Act 1997* (Cth) s 207-35(3).

⁴⁹ *Income Tax Assessment Act 1997* (Cth) s 207-45.

⁵⁰ In *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [125]; 2015 ATC 20-526; [2015] FCA 968, Greenwood J refers to the s 207-35(5) conditions as “integers”.

the distribution”.⁵¹ It is clear from earlier paragraphs in s 207-35(3), one of which links up with s 207-35(1) (gross-up inclusion in trust’s assessable income), that the reference to the franking credit amount is the gross-up.

The gross-up has already been taken into account in determining the amount included in assessable income pursuant to s 97(1) for each beneficiary. If s 207-35(3) also includes the gross-up (part of it) in a beneficiary’s assessable income, that is double taxation of the same amount.⁵² Taylor in a 2005 article argued that s 207-35(3) ousts the s 97(1) assessable income mechanism that would otherwise include the gross-up in a beneficiary’s assessable income because the gross-up would be a component within (slice of) the beneficiary’s s 97(1) assessable income inclusion.⁵³ In *Thomas*, Greenwood J seems to proceed on the basis that s 207-35(3) includes the gross-up in the assessable income of the beneficiary.⁵⁴ There is no deduction provision that reverses the double taxation.⁵⁵ It may be that the general anti-double taxation rule in s 6-25 prevents the double taxation.⁵⁶ Both ss 207-35(3) and 97(1) of the *ITAA 1936* are listed in s 10-5 dealing with assessable income inclusions.⁵⁷

Although somewhat difficult to justify, one interpretation of s 207-35(3) is that the subsection does not include an amount in assessable income. Instead, all it does is to give a tax profile to part of the beneficiary’s s 97(1) assessable income inclusion – that is, the beneficiary’s trust allocation has the gross-up within it. Taylor made the point that ousting the s 97(1) assessable inclusion and then allowing s 207-35(3) to perform the assessable income inclusion of the gross-up for beneficiaries means that streaming of the franked dividend to some beneficiaries to the exclusion of other income entitled beneficiaries should generally ensure that the gross-up is allocated to the beneficiaries that have had the dividend streamed to them.⁵⁸ Arguably, this would not be possible if s 97(1) performed the gross-up inclusion for beneficiaries because s 97(1) operates on a proportionate basis across all income beneficiaries (including beneficiaries not entitled to a dividend). Note, Taylor did not suggest the ousting of s 207-35(1) as this subsection includes the gross-up in the trust’s assessable income (likely no other provision would have), which is needed for the operation of s 207-35(3).⁵⁹

Taylor also explored the possible alternative positions of trust and partnership income, including possible interpretations of the allocation of franking credits to beneficiaries who are not entitled to dividend income due to allocated dividend expenses exhausting the dividend income.⁶⁰ It is submitted that assessable income attributable to the franked distribution in s 207-35(3)(d) meant something very similar to the wording in column 3 of item 3 in the table in s 207-55(3) – namely, so much of a dividend

⁵¹ The first three conditions appear fairly straightforward, albeit requiring reference to further provisions in Subdiv 207-B. The fourth condition appears to require that the beneficiary’s assessable income inclusion (s 97(1)) has embodied within it some of the franked distribution made to the trust. It states “the entity has an amount of assessable income for that year that is attributable to all or a part of the distribution”: s 207-35(3)(d). If the franked distribution was taken into account in working out the beneficiary’s assessable income inclusion, this condition should be satisfied: *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [511]; 2015 ATC 20-526; [2015] FCA 968. As discussed below, this condition is very much like the condition in regard to having a “share of a franked distribution”.

⁵² The double taxation issue is also hinted at in the Explanatory Memorandum, *Tax Laws Amendment (2011 Measures No 5) Bill 2011* (Cth) [2.24]. This Bill amended *Income Tax Assessment Act 1997* (Cth) Subdiv 207-B. The double taxation concern was also raised in Ken Schurgott, “Trust Streaming 2011” (2011) 46(2) *Taxation in Australia* 18, 20.

⁵³ C John Taylor, “Problems with Franking Credits Flowing Through Partnerships and Trusts: The 2004 Amendments and a Simpler Alternative” (2005) 34(3) *AT Rev* 154.

⁵⁴ *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [125], [501], [518]; 2015 ATC 20-526; [2015] FCA 968.

⁵⁵ There was (is) no rule that negated *Income Tax Assessment Act 1936* (Cth) s 97(1) operating in regard to the gross-up for beneficiaries. This can be compared to the old s 115-215(6) that ensured there was not a double taxation of discounted capital gains allocated to beneficiaries.

⁵⁶ *Income Tax Assessment Act 1997* (Cth).

⁵⁷ The issue was not identified in the *Thomas* litigation, and therefore was not dealt with.

⁵⁸ Taylor, n 53.

⁵⁹ Taylor, n 53.

⁶⁰ Taylor, n 53. See the discussion at 161 and then the following examples commencing from 170.

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is taken into account in working out an assessable income inclusion.⁶¹ Where expenses extinguish a dividend, the assessable income of a beneficiary can still be attributable to a dividend, otherwise it is near impossible to see how the meaning of s 207-55(2) and column 3 of item 3 in the table in s 207-55(3) are consistent with the objects clause in s 207-55(1).

In light of the above discussion, it is very unlikely that double taxation of the gross-up will occur. Accordingly, there is no practical need to examine the conditions supporting the assessable income inclusion of the gross-up in s 207-35(3).

(b) Franking Credit Tax Offset

Section 207-45 stated that an individual to whom a franked distribution flows indirectly is entitled to a tax offset equal to its share of the franking credit on the distribution. This then links up with s 207-57. Section 207-57(1) states that an entity's share of a franking credit is an amount notionally allocated to the entity as its share of the credit whether or not the entity actually receives any of that credit or distribution.⁶² Section 207-57(2) contains the formula for working out the amount of the franking credit under s 207-57(1). It states:

$$\text{Amount of *franking credit on the franked distribution} \times \frac{\text{entity's *share of the *franked distribution}}{\text{amount of the *franked distribution}}$$

The key condition in s 207-45 is that the franked distribution flowed indirectly to the individual (beneficiary). The relevant provision for a beneficiary is s 207-50(3). There are three conditions. The first two conditions will nearly always be satisfied, and will be satisfied in Example One – that is: (1) a distribution was made to a trustee;⁶³ and (2) the beneficiary has a share of the trust's taxable income that is covered by s 97(1) (called a share amount).⁶⁴ The second condition is satisfied because: (a) the trust had trust law income; (b) the beneficiary was presently entitled to some of that trust law income; and (c) the trust had taxable income. The failure of any of these three requirements (as part of the second condition) would mean that the beneficiary cannot obtain a franking credit tax offset under s 207-45.

This leaves the all-important third condition. It reads: “[T]he beneficiary's share of the [franked] distribution under section 207-55 is a positive amount (whether or not the beneficiary actually receives any of that share).” Section 207-55 is dealt with separately below.

⁶¹ This appears to be supported by the later comment made by Greenwood J in *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [124]; 2015 ATC 20-526; [2015] FCA 968 as Greenwood J states that “attributable to” in s 207-35(3)(d) means “plays some part in”.

⁶² The reference to receipt of a franking credit seems out of place here.

⁶³ *Income Tax Assessment Act 1997* (Cth) s 207-50(3)(a).

⁶⁴ *Income Tax Assessment Act 1997* (Cth) s 207-50(3)(b). Determining the precise role of the words in brackets below s 207-50(3)(b) is elusive. They read: “(whether or not the share amount becomes assessable income in the hands of the beneficiary)”. Taylor's explanation for this is that this could be referring to an entity that is tax-exempt: Taylor, n 53, 163.

(c) Section 207-55

It is worth setting out in full the material parts of s 207-55:⁶⁵

Excerpt One: SECTION 207-55 Share of franked distribution			
<i>Object of section</i>			
207-55(1) The object of this section is to ensure that:			
(a) the amount of a *franked distribution made to a partnership or the trustee of a trust is allocated notionally amongst entities who *derive benefits from that distribution; and			
(b) that allocation corresponds with the way in which those benefits were derived.			
Note: An entity can derive a benefit from the distribution (and therefore has a share of the distribution) without actually receiving any of the distribution: see subsection (2) of this section and the example at the end of section 207-50.			
207-55(2) An entity's <i>share</i> of a *franked distribution is an amount notionally allocated to the entity as its share of the distribution, whether or not the entity actually receives any of that distribution.			
207-55(3) That amount is equal to the entity's <i>share</i> of the distribution as the focal entity in column 3 of an item of the table.			
...			
<i>Share</i> of a franked distribution			
Item	Column 1 For this intermediary entity and this focal entity:	Column 2 The intermediary entity's share of the franked distribution is:	Column 3 The focal entity's share of the franked distribution is:
3	the trustee of the trust is the intermediary entity and the...beneficiary of the trust is the focal entity if: (a) a franked distribution is made to the trustee; and (b) the...beneficiary has, in respect of the trust, a share amount mentioned in subsection 207-50(3)...	(a) if the trust has a positive amount of *net income for the year – the amount of the franked distribution; or (b) otherwise – nil	so much of the amount worked out under column 2 of this item as is taken into account in working out that share amount.

Accordingly, to establish a beneficiary's share of the franked distribution, s 207-55(2) and 207-55(3) direct attention to column 3 in the table, and therefore, all three columns in the table.

Column 1: The trustee is the intermediary entity and the beneficiary is the focal entity, provided the two conditions (ie (a) and (b)) in this column are satisfied. They usually will be, and they are in the example above – that is, a franked distribution was made to the trustee and the beneficiary had a share amount (s 97(1) assessable income inclusion) under s 207-50(3).⁶⁶

Column 2: Pursuant to (b) in this column, if there is no taxable income for the income year,⁶⁷ the trustee's share of the franked distribution will be zero. In turn, the column 3 amount will also be zero because column 3 takes as its starting point the amount under column 2. If there is taxable income, the trustee's⁶⁸ share of the franked distribution will be the amount of the franked distribution. This is the full cash amount of the distribution, and not just the franked portion of the distribution.⁶⁹ The amount of the distribution is the relevant amount even if the distribution exceeds the trust's taxable income.

⁶⁵ The setting out of (relevant parts) s 207-55 in full will also assist the discussion concerning the new *Income Tax Assessment Act 1997* (Cth) Subdiv 207-B.

⁶⁶ *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [140]; 2015 ATC 20-526; [2015] FCA 968. The share amount condition was the second condition to be satisfied in s 207-50(3) (see Part II(A)(4) of this article).

⁶⁷ To recall, the legislation uses the term "net income".

⁶⁸ Referred to as the "intermediary entity" in the heading to column 2.

⁶⁹ *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [140]; 2015 ATC 20-526; [2015] FCA 968.

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Column 3: As noted, if the column 2 amount is zero (eg no taxable income), then the column 3 amount must also be zero. In turn, this means the beneficiary cannot obtain a franking credit tax offset under s 207-45.

If the column 2 amount is the amount of the franked distribution, which is the usual case and is the case in Example One above (\$7,000), the question then becomes how much (if any) of the franked distribution amount was taken into account in working out that share amount? There is no further legislative guidance in answering that question (in column 3).

Before referring to the guidance in the *Thomas* litigation, three observations or submissions should be made. First, for s 207-55 purposes, and for that matter all of Subdiv 207-B purposes, the rules operate on a distribution-per-distribution basis. The distribution-per-distribution basis is the correct approach as it is the only way to cater for differential franking percentages on different distributions. There is nothing to suggest that the rules operate on an aggregation of franked distributions. It is submitted that the fact that the Courts in the three *Thomas* cases⁷⁰ dealt with the franked distributions and associated tax attributes as aggregations does not undermine this. Second, the wording in column 3 does not say that the franked distribution was included in the share amount; it says instead that it was taken into account in working out the share amount.

Third, at first glance it may appear a bit odd that part or all of a quantum amount (amount of franked (cash) distribution) is the item to be identified in working out what is a proportionate amount (ie the beneficiary's s 97(1) assessable income inclusion (share amount)), and that the sum of quantum amounts will often not equal the sum of assessable income allocations to all beneficiaries (ie taxable income). There is nothing unsound in column 3 concerning this because the focus must be on a quantum amount (franked distribution) as s 207-55 is designed to facilitate the allocation of tax attributes associated with a quantum amount (franked distribution).⁷¹

In *Thomas*, Greenwood J said this in regard to s 207-55 and, more particularly, column 3:

Section 207-55 seeks to ensure relevantly that the amount of a franked distribution made to a trustee is allocated notionally amongst the beneficiaries who derive benefits from the distribution and that the notional allocation corresponds with the way in which those benefits were derived. Thus, the section operates to notionally allocate an amount to a beneficiary as its share of the franked dividends made to the trustee, whether or not that beneficiary actually receives any of those franked dividends. The *amount* notionally allocated is equal to an amount determined by Item 3 of the [table]. That item asks, by the conjunction of Columns 3, 2 and 1, a relatively straightforward question of how much of the amount of the franked distribution was taken into account by the trustee in *working out* the beneficiary's s 207-50(3)(b) share amount (discussed earlier) – that is, the beneficiary's share of the s 95 net income [taxable income] of the trust covered by s 97(1)(a) of the *1936 Act*.⁷²

After concluding on the facts in *Thomas* that none of the franked distributions were taken into account in working out the beneficiaries' share amount,⁷³ his Honour continued:

The trustee might have chosen to separately set aside the franked dividends in the books of account and records of the trust and might have allocated particular expenses against that income category. The trustee might then have resolved to apply the franked dividend income to Mr Thomas as to 90% and MAPL [bucket company] as to 10%. ... Mr Thomas and MAPL would be unlikely to receive 90% and 10% respectively of the trust income referable to separately recorded franked dividends as the trustee would necessarily meet all trust law expenses incurred in relation to that income. ... Those expenses might well

⁷⁰ *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576; 2015 ATC 20-526; [2015] FCA 968; *Thomas v Federal Commissioner of Taxation* (2017) 105 ATR 413; 2017 ATC 20-612; [2017] FCAFC 57; *Federal Commissioner of Taxation v Thomas* [2018] HCA 31; 2018 ATC 20-663.

⁷¹ Another way to put it is that s 207-55 is not concerned with the allocation of a trust's taxable income to a beneficiary, aside from the beneficiary needing to have had some allocation of the trust's taxable income. Section 97(1) performs the function of allocating the trust's taxable income.

⁷² *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [514]; 2015 ATC 20-526; [2015] FCA 968 (emphasis in original).

⁷³ *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [515]; 2015 ATC 20-526; [2015] FCA 968, discussed further below.

very considerably reduce or almost extinguish the amount of the franked dividend receipt to the trust with the result that each beneficiary would actually receive very little of the streamed income.⁷⁴

Immediately after the above, his Honour indicated the trustee would ordinarily determine the s 95 net income (taxable income) having regard to all income items and deductible expenses:

[The trustee] would then ordinarily distribute the s 95 net income in a way that took account, in determining or working out each beneficiary's share of the s 95 net income, each beneficiary's share of the streamed franked dividends (whether or not each beneficiary actually received all of the quantum of the streamed franked dividends). There would need to be some *demonstrated relativity* or nexus between the shares of the streamed income category (franked dividends in this case) and the shares of the s 95 net income of the trust. If a 90% share of the streamed franked dividends is then shown (by various accounting methods) to have been taken into account in working out the s 95 net income share of Mr Thomas in each income year, he would be entitled to a 90% share of the franked dividend under s 207-55 and a share of the franking credit on the franked distribution under the s 207-57 formula. He would then have 90% of the franked dividends grossed-up in his assessable income under s 207-35(3) and he would be entitled under s 207-45 to a tax offset equal to his share of the franking credit on the distribution under the s 207-57 formula.⁷⁵

Briefly, in *Thomas*, the trustee made two resolutions as follows:⁷⁶

Beneficiary	Amount of Taxable Income	Percentage of Taxable Income
Mr Thomas	The first \$21,600	2.7%
MAPL	The balance (\$780,000)	97.3%

Beneficiary	Amount of Franking Credits	Percentage of Franking Credits
Mr Thomas	\$2,416,217	91.2%
MAPL	\$234,000	8.8%

Pagone J (Dowsett and Perram JJ agreeing) in the Full Federal Court said:

[T]he resolutions above do not reveal whether [an allocation] of \$21,600 of the net income of the trust estate ... by the [first resolution] was a distribution to Mr Thomas of the "share amount" of the trust income for the 2006 year which, for the purpose of Div 207, would result in Mr Thomas having the benefit of franking credits to the extent of \$2,416,217 in the [second resolution] for that year.⁷⁷

In regard to the second resolution, Pagone J continued:

[T]he resolution, on one reading of its terms, did not distribute to any beneficiary any amount or share needed to have been distributed for the effect of Div 207 to have "flow" to them the amount of franking credits stated in the second resolution. The franking credits available in the 2006 year to each of Mr Thomas and MAPL, on that view, for example, would be that proportion of the total franking credits received as corresponds to their respective proportions of the amounts distributed to them by the [first resolution].⁷⁸

⁷⁴ *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [518]; 2015 ATC 20-526; [2015] FCA 968. The bucket company phenomenon is a company that is made a beneficiary of a discretionary trust so that the controller (trustee) has an available taxpayer with a capped income tax rate of 30%. This ensures that the taxable income of the trust is not subjected to a tax rate above 30% (eg where the average tax rate of other available natural person beneficiaries is already at 30%). The bucket company, as the name suggests, does not pursue any business or any productive activity. The facts in *Thomas* looked like a classic bucket company situation: see *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [249], [515]; 2015 ATC 20-526; [2015] FCA 968.

⁷⁵ *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [518]; 2015 ATC 20-526; [2015] FCA 968 (emphasis in original).

⁷⁶ The numbers for the 2005–2006 income year are not precise, but they roughly reflect the true numbers involved. The facts in *Thomas* are fairly unusual but, for present purposes, the trust had taxable income that included franked distributions that gave rise to gross-ups and franking credit tax offsets. The trust also made a substantial tax loss on a business, hence the relatively small amount of taxable income in spite of considerable franked distributions.

⁷⁷ *Thomas v Federal Commissioner of Taxation* (2017) 105 ATR 413, [21]; 2017 ATC 20-612; [2017] FCAFC 57.

⁷⁸ *Thomas v Federal Commissioner of Taxation* (2017) 105 ATR 413, [22]; 2017 ATC 20-612; [2017] FCAFC 57.

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From the above extracts, and the terms of s 207-55(2), it is submitted that a beneficiary who has been allocated some trust law income and therefore has an assessable income inclusion under s 97(1) (of trust's taxable income) can be "allocated" a part or all of a franked distribution received by the trust where the allocation of the franked distribution to that beneficiary (eg 100%) is completely disproportionate to the allocation of taxable income to that beneficiary (eg 5%). It is also submitted that the disproportionate allocations asserted here are possible where the franked distribution has been extinguished by related expenses, and the franked distribution exceeds a beneficiary's s 97(1) assessable income inclusion (and for that matter, exceeds the trust's taxable income).⁷⁹ Greenwood J's comments appear more comprehensive and conclusive than those of Pagone J. Nevertheless, Pagone J's comments endorse the views asserted above.⁸⁰

In a discretionary trust, the obligation to show how much of a franked distribution was taken into account in a beneficiary's assessable income inclusion will usually fall on the trustee. Greenwood J stated that this could be shown by various accounting methods.⁸¹ Pagone J seemed to suggest the trustee income resolution would be the usual place to show the required notional allocation.⁸² In a fixed trust, the trust deed may indicate the allocation of the franked distribution to a beneficiary.

As a matter of logic, if a beneficiary is (actually) allocated a franked distribution, or a part of it, that "exists" (not completely extinguished by expenses), the requirement of column 3 will be satisfied to give that beneficiary a 100% share of the franked distribution (whole amount), or the relevant portion if a part allocation was involved.

In the end, the "old s 207-55" permitted the streaming of franked distributions and associated tax attributes to a beneficiary even where the franked distribution was fully extinguished by expenses.⁸³ If the trustee did not make the notional allocation required for streaming, however, the franked distribution is allocated in the proportion of beneficiaries' share of taxable income.⁸⁴

5. Application of Old Subdiv 207-B Rules to Example(s)

Below Examples Two, Three and Four provide simple scenarios to illustrate what occurs when there is no streaming (Example Two), streaming (Example Three) and extinguishment of expenses with streaming (Example Four).⁸⁵

⁷⁹ In *Income Tax Assessment Act 1997* (Cth) s 207-55(1), the "objects clause", and the note thereunder, strongly supports the assertion in this article because they contemplate the notional allocation of the franked distribution to a beneficiary with no regard to the allocation of taxable income to that beneficiary, and also where the franked distribution has been extinguished by related expenses.

⁸⁰ The effect is that the s 97(1) assessable income inclusions of beneficiaries are sliced up to reveal their components or their profile.

⁸¹ *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [518]; 2015 ATC 20-526; [2015] FCA 968.

⁸² *Thomas v Federal Commissioner of Taxation* (2017) 105 ATR 413, [21], [22]; 2017 ATC 20-612; [2017] FCAFC 57.

⁸³ There are statements in two of the *Thomas* cases that the ATO agreed that the taxpayers' desired outcome of having a (very significant) disproportion between the allocation of the taxable income and the allocation of the franked distribution and associated tax attributes could have been achieved: *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [177]; 2015 ATC 20-526; [2015] FCA 968; *Thomas v Federal Commissioner of Taxation* (2017) 105 ATR 413, [9]–[10]; 2017 ATC 20-612; [2017] FCAFC 57. The problem for the taxpayers was that the resolutions were not well drafted to ensure that outcome. Even though full information is lacking, it is most likely that the *Thomas* facts are not a situation where the franked distribution was fully extinguished by expenses. The reason for saying this is that in the absence of a selective allocation of expenses by the trustee against particular receipts, the ordering of application of expenses is such that they effectively should only be applied against franked distributions when all other categories of receipts are exhausted: *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [21]; 2015 ATC 20-526; [2015] FCA 968. Given there is no indication in the reports of the trustee exercising its discretion in selectively applying expenses, and that the trust was treated as having trust law income, the franked distributions were likely not exhausted by expenses: see [360] on the non-application of expenses by trustee point.

⁸⁴ *Thomas v Federal Commissioner of Taxation* (2017) 105 ATR 413, [22]; 2017 ATC 20-612; [2017] FCAFC 57. This is effectively the default position. The comments of Greenwood J in the first instance decision in *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [515], [520]; 2015 ATC 20-526; [2015] FCA 968 that none of the franked distributions was taken into account in working out the beneficiaries' share amounts must be taken as incorrect.

⁸⁵ The following assumes that either s 207-35(3) does not include the gross-up in a beneficiary's assessable income or that, if it does make such an inclusion, double taxation is prevented through the operation of *Income Tax Assessment Act 1997* (Cth) s 6-25.

(a) *No Streaming*

EXAMPLE TWO			
Referring to the facts in Example One, the trustee has allocated 50% of the trust income to Ann and Ben. On the basis of the plain allocation (no streaming) of 50% of trust law income to Ann and Ben, it is submitted that the income tax outcome should be as follows:			
Beneficiary and/or Trustee and Total	Section 97(1) Assessable Income Inclusion	Share of Franked Distribution	Franking Credit Tax Offset
Ann	\$10,500	\$3,500	\$1,500
Ben	\$10,500	\$3,500	\$1,500
Totals	\$21,000	\$7,000	\$3,000
The table can accommodate rows for: (1) trustee taxation in representative capacity for a beneficiary (s 98(1) and/or 98(2)); and (2) trustee taxation in representative capacity for trust as a whole (ss 99 or 99A).			

(b) *Streaming*

EXAMPLE THREE			
Referring to the facts in Example One, the trustee has allocated 50% of the trust income to Ann and Ben, except that this time the trustee indicates by resolution or in the trust’s accounting records that 90% (or \$6,300) of the dividend was taken into account in Ann’s s 97(1) assessable income inclusion and 10% in Ben’s inclusion.			
It is submitted that the income tax outcome would be as follows:			
Beneficiary and/or Trustee and Total	Section 97(1) Assessable Income Inclusion	Share of Franked Distribution	Franking Credit Tax Offset
Ann	\$10,500	\$6,300	\$2,700
Ben	\$10,500	\$700	\$300
Totals	\$21,000	\$7,000	\$3,000

(c) *Dividend Extinguished by Expenses and Streaming*

EXAMPLE FOUR			
Referring to Example One again, but let us assume that interest on the loan for purchase of the shares was \$9,000 (instead of \$1,000). The trust deed along with trustee discretion operates so that the interest expense extinguishes the \$7,000 dividend. The trust law income of the trust is now only \$9,000 (\$29,000–\$20,000), and taxable income of the trust is only \$13,000.			
Ann and Ben are still allocated 50% each of trust law income (\$4,500 each). Again, the trustee indicates that 90% (or \$6,300) of the dividend was taken into account in Ann’s s 97(1) inclusion and 10% in Ben’s inclusion.			
It is submitted that the income tax outcome would be as follows:			
Beneficiary and/or Trustee and Total	Section 97(1) Assessable Income Inclusion	Share of Franked Distribution	Franking Credit Tax Offset
Ann	\$6,500	\$6,300	\$2,700
Ben	\$6,500	\$700	\$300
Totals	\$13,000	\$7,000	\$3,000

Consequently, it is concluded that under the old Subdiv 207-B rules, it was possible for the streaming of franking credits to beneficiaries out of proportion to allocations of taxable income, even in the circumstances when the (franked) distribution was extinguished by related trust expenses.

B. New Subdiv 207-B Rules

1. Background

As noted in the introduction, Subdiv 207-B (along with Subdiv 115-C: net capital gains of trusts) was amended in the aftermath of the *Bamford* case. The reasons were that the Australian Taxation Office (ATO) documents,⁸⁶ the ATO's withdrawal of Taxation Ruling TR 92/13⁸⁷ and the practitioner commentary⁸⁸ that emerged subsequent to the 2010 *Bamford* case (30 March 2010) put doubt over the ability of a discretionary trust to stream particular tax receipts and associated tax attributes (if any) to particular beneficiaries.⁸⁹ The concern focused on the High Court's adoption of the proportionate view interpretation of s 97. The reasoning appeared to be that each beneficiary had to have an allocation of each receipt category that made up the trust's "trust law income",⁹⁰ and therefore had to have an allocation of each receipt category of the trust's "taxable income".⁹¹ The authors describe this as "proportionate item-by-item approach".⁹² In other words, the proportionate approach was not only to operate at the "global" trust law income level (and therefore taxable income), but also down at the components of that trust law income (and therefore components of taxable income).⁹³ Indeed, the exposure draft Explanatory Memorandum to the new Subdiv 207-B expressly asserted that the result of the proportionate view was that a beneficiary includes in their assessable income a "blended" amount of all of the different types of income and capital gains of the trust.⁹⁴

While the authors were sceptical of the proportionate item-by-item approach argument, it was effectively accepted by the Full Federal Court in regard to a discretionary trust's net capital gains under the old Subdiv 115-C in *Federal Commissioner of Taxation v Greenhatch*.⁹⁵ *Greenhatch* involved the allocation of net capital gains made by a discretionary trust where the trustee had the power to stream trust receipts, and did in fact stream the trust law profit representing the net capital gain to some beneficiaries to

⁸⁶ ATO, *Practice Statement Law Administration*, PSLA 2010/1, 2 June 2010. Note the ATO did not expressly canvass the streaming issue in this statement. Decision Impact Statement, *Commissioner of Taxation v Phillip Bamford*; *Phillip Bamford v Commissioner of Taxation* (2 June 2010). This Decision Impact Statement did raise the issue of uncertainty regarding the interaction between Div 6 and the old Subdiv 207-B.

⁸⁷ This ruling generally endorsed streaming of franked distributions and associated tax attributes to particular beneficiaries of discretionary trusts under the original imputation system in *Income Tax Assessment Act 1936* (Cth) Pt IIIAA. The ruling was withdrawn on 22 June 2011.

⁸⁸ Claire Malone, "A Matter of Trusts: Streaming Capital Gains ... If Any" (2010) 45(1) *Taxation in Australia* 49; Joseph Santhosh, "The ATO's New Era for Trusts: The Bamford Decision Impact Statement and Its Implications" (*Western Australian State Convention*, Taxation Institute of Australia, Perth, June 2010); Nabil (Bill) Orow, "Post-Bamford Trustee Resolutions" (*49th Victorian State Convention*, Taxation Institute of Australia, Creswick, October 2010); Dianne Cuka and Darryn Male, "Trusts in a Post-Bamford World" (*2010 Tasmanian State Convention*, Taxation Institute of Australia, Port Arthur, October 2010).

⁸⁹ In Explanatory Memorandum, *Tax Laws Amendment (2011 Measures No 3) Bill 2011* (Cth) [1.9]: trust income (Exposure Draft (11/04/2011)), there is the express statement that each beneficiary includes a blended amount of all the different types of income and capital in their assessable income.

⁹⁰ Trust law income is a concept taken from the law of trusts, referring to the distributable income. Pursuant to this, income is ascertained by the trustee according to appropriate accounting principles and the trust instrument. For a general discussion of this, see Freudenberg, n 24.

⁹¹ For the purpose of this article, the term "trust's taxable income" has been adopted to refer to "net income" used in the legislation: *Income Tax Assessment Act 1936* (Cth) s 95. Refer to the above discussion about the use of this to try to avoid confusion that can arise between terms used in trust deeds and the income tax legislation.

⁹² *Zeta Force Pty Ltd v Federal Commissioner of Taxation (Cth)* (2015) 84 FCR 70; 39 ATR 277; 98 ATC 4681, 4686 (Sundberg J); *Davis v Commissioner of Taxation (Cth)* (1989) 86 ALR 195; 20 ATR 548.

⁹³ The Explanatory Memorandum referred to this as a "blended approach": Explanatory Memorandum, *Tax Laws Amendment (2011 Measures No 5) Bill 2011* (Cth) [2.9]. The ATO also used the term "blended": Taxation Ruling TR 92/13, [8]. This ruling was withdrawn on 22 June 2011.

⁹⁴ Explanatory Memorandum, *Tax Laws Amendment (2011 Measures No 3) Bill 2011* (Cth) [1.9]: trust income (Exposure Draft (11/04/2011)).

⁹⁵ *Federal Commissioner of Taxation v Greenhatch* (2012) 203 FCR 134; 88 ATR 560; [2012] FCAFC 84.

the exclusion of another entitled beneficiary.⁹⁶ Put simply, the Court held that the streaming of the net capital gain was not effective under the tax law, and that each beneficiary obtained a portion of each tax item (proportionate item-by-item approach).⁹⁷

2. Overview of the Post-Bamford Amendments

The broad aim of the new rules is similar to the aim of the old rules – namely, to allocate to beneficiaries the franked distribution and/or the associated tax attributes to determine the tax liability. The broad framework of the old rules is maintained. However, there are differences in how the broad aim is achieved. The biggest difference is that, unlike the old rules, the new rules use two separate and discrete regimes to allocate out to beneficiaries the trust’s taxable income when a franked distribution forms part of that taxable income. Subdivision 207-B allocates out the franked distribution and associated tax attributes, and Div 6 (along with the Div 6E modifications to Div 6 amounts) allocates the rest of the taxable income.

3. New Subdiv 207-B

It is possible that a beneficiary will have a gross-up and a franking credit tax offset, while not having any part of the franked distribution included in her assessable income. This can occur, for example, where a franked dividend is extinguished by related expenses but the trust still has trust law income and taxable income. In these circumstances, the rules clearly contemplate the outcome stated by operation of the adjusted Div 6 percentage mechanism.

(a) Franked Distribution

Section 207-35(4)(b)(ii) includes an amount in a beneficiary’s assessable income. The amount is worked out under s 207-37. The formula in s 207-37(1) is:

$$\begin{array}{l} \text{Amount of franked distribution} \\ \text{(less directly relevant deductions)} \end{array} \quad \times \quad \frac{\text{beneficiary's share of the franked distribution}}{\text{amount of franked distribution}}$$

Income tax deductions that are directly relevant to the franked distribution will reduce the first component in that formula – namely, the amount of the franked distribution. If directly relevant deductions are equal to or more than the distribution, that component will be zero. If so, there will be no assessable income inclusion for the beneficiary under s 207-35(4)(b)(ii).

The test for directly relevant deductions is determined under income tax law principles, and not trust law rules.⁹⁸ The term “directly relevant” deductions is not defined in the legislation yet the term expenses that are directly relevant to a distribution appear in the definition of “net financial benefit”.⁹⁹ The Explanatory Memorandum provided the following guidance on directly relevant expenses:

The net financial benefit referable to a franked distribution will normally equal the amount of the franked distribution after being reduced by directly relevant expenses. Directly relevant expenses could include any annual borrowing expenses (such as interest) incurred in respect of the underlying shares (allocated rateably against any franked and unfranked dividends from those shares) or management fees incurred in respect of managing an investment portfolio of shares for the purpose of deriving dividend income (allocated against dividend income as relevant).¹⁰⁰

⁹⁶ The discretionary trust in the *Greenhatch* litigation also had a franked distribution but this was not considered in the two *Greenhatch* cases, one at Administrative Appeals Tribunal level (*Greenhatch v Federal Commissioner of Taxation* (2011) 80 ATR 480; 2011 ATC 10-191; [2011] AATA 479) and the other in the Full Federal Court (*Federal Commissioner of Taxation v Greenhatch* (2012) 203 FCR 134; 88 ATR 560; [2012] FCAFC 84).

⁹⁷ *Federal Commissioner of Taxation v Greenhatch* (2012) 203 FCR 134, [36]; 88 ATR 560; [2012] FCAFC 84.

⁹⁸ *Income Tax Assessment Act 1997* (Cth) s 207-58(1).

⁹⁹ *Income Tax Assessment Act 1997* (Cth) s 207-58(1).

¹⁰⁰ Explanatory Memorandum, *Tax Laws Amendment (2011 Measures No 5) Bill 2011* (Cth) [2.53]. It is unfortunate that the Explanatory Memorandum refers to interest as a “borrowing expense” as this could cause confusion with “borrowing costs”, which refer to those expenses of a capital nature in establishing a loan.

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Also, it appears that “directly relevant” is an objective test to determine the “direct relevance” of the expenses to the shares held, and these would appear to not include those costs incurred regardless of the investment activity but instead those additional costs incurred due to the purchase of the shares. This means that the application of trust law expenses by a trustee under an expense allocation power in the trust deed does not govern the directly relevant deductions issue.¹⁰¹ The term “directly relevant” does not appear elsewhere in the legislation, although a number of cases have considered whether activities are directly relevant in determining the nexus between a loss or outgoing and deriving assessable income in terms of “incurred” in s 8-1.¹⁰² While dividends are income from property, some guidance can be gained from cases considering personal exertion income. In terms of employees claiming deductions pursuant to s 8-1 (or the previous s 51(1)), Hill J indicated the following in allowing a flight attendant a deduction for expenditure on moisturisers in *Mansfield v Commissioner of Taxation (Cth)*:

In my view, expenditure for moisturizer, the necessity for which was brought about by the harsh conditions of employment which Mrs Mansfield was called upon to endure, is incidental and relevant to her occupation as a flight attendant. It has the necessary connection with her activities in the cabin itself. It is these activities which are directly relevant to her gaining and producing assessable income by way of salary.¹⁰³

In *MacLean v Federal Commissioner of Taxation*,¹⁰⁴ which considered a deduction for a registered clinical nurse for expenses relating to a postgraduate degree, member Shead JA made the following observations:

The phrase “incidental and relevant” was explained in *FC of T v DP Smith* 81 ATC 4114 at 4117; (1981) 147 CLR 578 at 586:

“... What is incidental and relevant in the sense mentioned falls to be determined not by reference to the certainty or likelihood of the outgoing resulting in the generation of income but to its nature and character and generally to its connection with the operations which more directly gain or produce the assessable income.”¹⁰⁵

This would imply that in terms of determining what is directly relevant there would need to be connection (nexus) between the expenditure and the dividend income.

Further, in the case dealing with property income of *Lee McKeand & Son Pty Ltd v Federal Commissioner of Taxation*, the following was noted by BH Pascoe (Senior Member) when discussing the management fee from subsidiary to parent company:

However, the issue of deductibility of the expenditure incurred by Son in any of the years is not before me. Nor is there any evidence of what specific expenses, if any, related directly to Holdings. It should be said, however, that it appears that the calculation of the management fee was not done on the basis of an analysis of expenditure of Son and identifying specific expenses as being directly relevant to Holdings. It would seem that the fee of \$234,000 per annum was based on one-third of the aggregation of a number of overhead expenses, property costs and 10 per cent of personnel costs.¹⁰⁶

This would seem to imply that for expenses to be “directly relevant” some analysis of expenditure would be required to identify specific expenses that are directly relevant to the outgoing. The idea of “nexus” is illustrated in *Case No NT 90/157* regarding entertainment expenses under the prior s 51AE of the *ITAA 1936*, where Dr YFR Grbich (Senior Member) stated:

The expenditure in question was incurred on a range of lunches, cocktail parties, dinners and other forms of social contact which were directly relevant to his negotiating duties and the discharge of the protocols of his exacting office. Direct business was done at many of these occasions.¹⁰⁷

¹⁰¹ Equally, a set of rules or formula in the trust deed as to the application of trust expenses against revenue does not govern the directly relevant deductions issue under *Income Tax Assessment Act 1997* (Cth) s 207-37(1).

¹⁰² *Income Tax Assessment Act 1997* (Cth) s 8-1.

¹⁰³ *Mansfield v Commissioner of Taxation (Cth)* (1995) 31 ATR 367; 96 ATC 4001, 4007.

¹⁰⁴ *MacLean v Federal Commissioner of Taxation* (2001) 48 ATR 1160; 2001 ATC 2326; [2001] AATA 899.

¹⁰⁵ *MacLean v Federal Commissioner of Taxation* (2001) 48 ATR 1160, [22]; 2001 ATC 2326; [2001] AATA 899.

¹⁰⁶ *Lee McKeand & Son Pty Ltd v Federal Commissioner of Taxation* (2005) 59 ATR 1157, [8]; 2005 ATC 2222; [2005] AATA 650.

¹⁰⁷ *Case No NT 90/157* (1991) 22 ATR 3063, [1]; 91 ATC 184.

It would appear similar to “incidental and relevant” that directly relevant expenses will be a question of fact to be determined by reference to all the relevant facts.¹⁰⁸ It is possible that, in relation to shareholdings, directly relevant expenses could cover interest on a loan to purchase the shares, brokerage, portfolio management fees and borrowing costs. It would then be required to determine if these expenses were deductible under the tax law.

In Example One, the first component of the formula will become \$6,000 as the \$1,000 of interest is a directly relevant deduction to the \$7,000 distribution. If the interest was instead \$8,000, then the first component of the formula would be zero.

The second component of the formula requires determination of the beneficiary’s share of the franked distribution. Like the old rules, this takes us to s 207-55. Putting aside one major qualification, s 207-55 is in the same terms as the old version. In fact, the wording of s 207-55(1), 207-55(2) and 207-55(3) are identical to that under the old rules.¹⁰⁹ The major qualification is that the wording of column 3 in item 3 in the table has changed. It now reads: “the amount mentioned in subsection (4)”. Section 207-55(4) was also added.

The effect of that “small change” is that a beneficiary’s share of a franked distribution is solely determined by reference to s 207-55(4). Section 207-55(4) provides only two mechanisms for determining the share of a franked distribution – namely, the specifically entitled mechanism and the adjusted Div 6 percentage mechanism. The starting point is the specifically entitled mechanism. The reason is that the adjusted Div 6 percentage mechanism only comes into operation (activated) where there is an amount of the franked distribution to which no beneficiary is specifically entitled.¹¹⁰

Before dealing with specific entitlement, it is worth noting that s 207-55(1) and 207-55(2) (notional allocations of a franked distribution) look like they had a clear role under the old Subdiv 207-B, but they largely look out of place under the new Subdiv 207-B. A very strong argument can be made that they serve no purpose because the two mechanisms for a beneficiary having a share of a franked distribution (specific entitlement and adjusted Div 6 percentage) cover the field, and that the adjusted Div 6 percentage mechanism would seem to be able to operate to achieve its ostensible purpose whether or not s 207-55(2) existed.

(i) Specific Entitlement Mechanism

It will be demonstrated that the specific entitlement mechanism¹¹¹ is the only streaming mechanism.¹¹² The beneficiary’s share of the franked distribution is the amount of the franked distribution to which the beneficiary is specifically entitled, and s 207-58 provides the formula for that amount, which is:

$$\text{*Franked distribution} \quad \times \quad \frac{\text{Beneficiary's share of net financial benefit}}{\text{Net financial benefit}}$$

Franked Distribution

The first component in the formula is referring to a tax item. In Example One, the first component of the formula is \$7,000, as there is no scope in the formula to reduce the distribution.¹¹³

¹⁰⁸ *Case No NT 90/157* (1991) 22 ATR 3063; 91 ATC 184.

¹⁰⁹ Aside from column 3 in item 3, the wording in the table in *Income Tax Assessment Act 1997* (Cth) s 207-55(3) has remained the same.

¹¹⁰ *Income Tax Assessment Act 1997* (Cth) s 207-55(4)(b).

¹¹¹ The choice of the term “specific entitlement” is a poor choice of legislative term in the context of the trust taxation rules, as they do not represent beneficiaries’ trust law entitlement to relevant profits, but rather the tax law consequence (outcome) of having a trust law entitlement (share of net financial benefit). The terms “presently entitled” and “absolutely entitled” are well-established terms in the trust taxation area, and these terms refer or represent the non-tax law feature of a transaction or circumstance. The tax law will then provide for consequences should the facts establish present entitlement or absolute entitlement – namely, an assessable income inclusion (or attribution of a net capital gain) and the triggering of a capital gain respectively.

¹¹² To be clear though, the specific entitlement mechanism can also apply in a fixed trust situation to allocate a franked distribution and associated tax attributes to beneficiaries with fixed entitlements to trust law income.

¹¹³ Some would say the gross dividend.

Net Financial Benefit

The third component of the formula, even though constructed off the back of a tax term, is a trust law concept, in the sense that it involves notions of economic benefits, profits and receipts made by a trust.¹¹⁴ It reads the amount of financial benefit referable to the franked distribution after any application by the trustee of expenses that are directly relevant to the franked distribution.¹¹⁵ It is submitted that the last reference to franked distribution is not correct; it should be financial benefit or gross financial benefit because it is the financial benefit that is being reduced by expenses. Use of the term “franked distribution” can cause confusion because it wrongly injects a tax law term into what is a trust law concept (trust law surplus or economic surplus). For the most part, the drafter of the Explanatory Memorandum dealing with net financial benefit proceeds on this correct basis,¹¹⁶ and this article does the same.¹¹⁷

If the “directly relevant expenses” are equal to or more than the financial benefit, then the third component of the formula will be zero. In such a circumstance, by including zero, pursuant to the formula there will be no specific entitlement amount. And, as discussed below, no streaming of associated tax attributes will be possible.

The words “after any application by the trustee of expenses that are directly relevant to the financial benefit” are problematic, and may in particular circumstances be important to the ability to stream. They are problematic because the first part of the formulation suggests the exercise of a power conferred on the trustee to apply expenses against financial benefits, whereas the second part of the formulation strongly suggests expenses over which there would normally be no power of application. To what extent such a power to apply expenses against income exists would depend upon the relevant Trustee Act and the trust deed.¹¹⁸ To stream tax attributes, the distribution made to the trust (as a trust law amount) must remain a positive amount. It is suggested that there are only two credible interpretations, being:

- (1) all directly relevant expenses to the financial benefit (distribution) are taken into account (reduce the financial benefit) per se – this is an objective test and the trustee has no power to not apply some expenses that would otherwise be directly relevant to the distribution; or
- (2) only the directly relevant expenses to the financial benefit that have been applied by the trustee are taken into account – on this interpretation, only directly relevant expenses that the trustee applies will reduce the financial benefit.

This issue may be important because the second interpretation would allow for trustee discretion to preserve a net financial benefit where directly relevant expenses are equal to or exceed the financial benefit. The first interpretation would not. For example, if the financial benefit is \$3,000 and directly relevant expenses are \$3,100, the first interpretation means there is no net financial benefit as the financial benefit is reduced by the \$3,100 to less than zero. However, under the second interpretation, the trustee could choose to (only) apply say \$2,800 of the \$3,100 of directly relevant expenses so that there would be a net financial benefit of \$200.

First, the fact that the term “directly relevant deductions” as used in s 207-37(1) (calculating assessable income inclusion) does not support either one of the two arguments under consideration because s 207-37(1) has a quite different aim to the notion of a net financial benefit. Section 207-37(1) is focused on the beneficiary’s assessable income inclusion for the “net franked distribution”, whereas the “net financial benefit” definition is directed at the trust law surplus. Second, the fact that the analogous provision under Subdiv 115-C (net capital gains of trusts)¹¹⁹ clearly encompasses the discretionary allocation of trust

¹¹⁴ The second component of the formula (beneficiary’s share of net financial benefit) is also a trust law concept.

¹¹⁵ Definition of “net financial benefit” in *Income Tax Assessment Act 1997* (Cth) s 207-58(1).

¹¹⁶ See references to “(gross) financial benefit” being the concept that is reduced by expenses to arrive at net financial benefit in Explanatory Memorandum, *Tax Laws Amendment (2011 Measures No 5) Bill 2011* (Cth) [2.49]–[2.51], [2.56]. The drafter, however, also uses the term franked distribution or distribution at times: see Explanatory Memorandum, *Tax Laws Amendment (2011 Measures No 5) Bill 2011* (Cth) [2.57], [2.135]–[2.137], [2.139].

¹¹⁷ It probably does not matter anyway because in terms of amount, which is the important thing here, the same result ensues because the franked distribution amount is the same as the gross financial benefit amount.

¹¹⁸ See the above discussion and example of the trust deed clause with such a power.

¹¹⁹ Definition of “net financial benefit” in *Income Tax Assessment Act 1997* (Cth) s 115-228(1).

losses against particular profits also does not support either argument under consideration. The reason is because in Subdiv 115-C, the net financial benefit rule is dealing with multiple transactions where a trust has made at least one (capital) loss and has two or more (capital) profits. In these circumstances, the use of losses (or loss) for trust law purposes has effect if the use of those losses is consistent with the application of the related capital losses under the capital gains tax (CGT) method statement in s 102-5(1). The CGT method statement clearly contemplates a trustee that has choices.¹²⁰

Third, and although not determinative, the fact that non-directly relevant expenses cannot reduce the financial benefit tends to support the first interpretation. The application of non-directly relevant expenses against certain financial benefits would normally require a clause in the trust deed or the exercise of a trustee power. In both instances, we are in the realm of choice. On the other hand, the subtraction of directly relevant expenses does not require choice; the directness of them on its own requires the subtraction.¹²¹

Fourth, in all the commentary and examples in the Explanatory Memorandum dealing with expenses directly relevant to a financial benefit, there is no mention that the trustee has any role in determining the amount of expenses to be applied.¹²² Instead, all the commentary and examples only seem to contemplate the direct relevance of the expense to the financial benefit. Depending upon the relevant Trustee Act and trust deed it is likely that the trustee may play a key role in determining which expenses are “directly relevant” and this is likely to consider a nexus or connection between the expense and the derivation of the financial benefit.

Lastly, the presence of s 207-59, strongly suggests that the first interpretation is the correct one. Section 207-59 was added as part of the new Subdiv 207-B. Section 207-59 permits a trust to aggregate two or more franked distributions and treat them as one single franked distribution.¹²³ Although the purpose of the section is not apparent on its face, the Explanatory Memorandum states:

Where a trustee distributes all of the franked distributions received in an income year within a single class of income, Subdivision 207-B operates as if all of the franked distributions were “pooled” into one single franked distribution. This allows trustees to “stream” part or all of a class of income that includes franked distributions even where some of the individual franked distributions are entirely sheltered [extinguished] by directly relevant expenses.¹²⁴

For example, say the trust has two franked distributions of \$70 each (A and B), and the A dividend has zero directly relevant expenses but dividend B has \$100 of directly relevant expenses.¹²⁵ Under the normal rules, there can be a net financial benefit for A (\$70), but not for B (−\$30, therefore zero). In turn, there can be no streaming of the B dividend. However, by using the s 207-59 pooling mechanism, the gross financial benefit for the “one dividend” is \$140 (\$70 + \$70) and the directly relevant expenses to this one dividend is \$100, leaving a \$40 net financial benefit for this one dividend. In turn, streaming is now permissible in regard to the B dividend whereas it would not have been possible but for the s 207-59 pooling mechanism.

The short point is that if the second interpretation was the correct one, there would be a lesser need, if any need, for s 207-59. The reason is that it would then be possible, assuming the terms of the trust deed permitted, for the trustee to only apply (effectively, disapply) directly relevant expenses that are

¹²⁰ A taxpayer, which includes a trustee, with say one capital loss and two capital gains, can choose the capital gain against which that capital loss is to be used. The same applies to a (prior-year) net capital loss.

¹²¹ In the context of trust law, both returns on and the cost of an investment should be taken into account in determining the surplus for the investment.

¹²² See Explanatory Memorandum, *Tax Laws Amendment (2011 Measures No 5) Bill 2011* (Cth) [2.51], [2.53], [2.56], [2.57], [2.135]–[2.136], [2.137], [2.139] and Examples 2.4, 2.5, 2.17.

¹²³ *Income Tax Assessment Act 1997* (Cth) s 207-59(1), s 207-59(2).

¹²⁴ Explanatory Memorandum, *Tax Laws Amendment (2011 Measures No 5) Bill 2011* (Cth) [2.137].

¹²⁵ This is a slightly modified version of Example 2.18 in the Explanatory Memorandum, *Tax Laws Amendment (2011 Measures No 5) Bill 2011* (Cth). In Example 2.18 there were four franked distributions of \$70 each.

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lower than the amount of the dividend (financial benefit).¹²⁶ Section 207-59 implies that this corrective mechanism is not available to the trustee.

In the end, it is argued that the better view is that the first interpretation should prevail and this article adopts that position.¹²⁷ That is, in determining directly relevant expenses it is an objective test in determining the relevance of any expenses and the trustee has no power to try to alter this. Example Five provides a simple example of how the third component of the formula would be calculated.

EXAMPLE FIVE

Referring back to the facts of Example One, there is only \$1,000 of directly relevant expenses (ie interest). It is not possible for the trustee to alter how much interest expense is allocated to the dividend beyond what is objectively relevant. Accordingly, the third component of the formula (net financial benefit) will be \$6,000 (\$7,000–\$1,000).

Share of Net Financial Benefit

Like the third component, the second component of the formula is also a trust law concept, and it is a defined term. Briefly, this is the financial benefit that the beneficiary has received or can be reasonably expected to receive before year end that is referable to the franked distribution.¹²⁸ The definition seems to suffer from the same poor drafting that is present in the definition of net financial benefit (third component of formula) concerning expenses. However, consistent with the approach above to net financial benefit, a beneficiary's share of net financial benefit is after application of directly relevant expenses objectively determined (ie trustee has no power to not apply expenses). Subject to the comment below, there should be no scope for application of any other expenses, so that assuming a 100% allocation under the specific entitlement mechanism, the sum of the beneficiaries' "share of net financial benefit" will equal the sum of the trust's "net financial benefit".

However, if as a matter of trust law, the trustee has applied non-directly relevant expenses against the dividend and those expenses extinguish the dividend, the beneficiary cannot have a share of net financial benefit because the beneficiary cannot expect to receive an amount referable to the franked distribution.¹²⁹

(ii) Adjusted Div 6 Percentage Mechanism

Where there is an amount of franked distribution to which no beneficiary is "specifically entitled", the entity's share of the franked distribution (column 3 of item 3 in the table in s 207-55(3)) is the amount of the franked distribution multiplied by the beneficiary's adjusted Div 6 percentage of the income of the trust.¹³⁰ A beneficiary's adjusted Div 6 percentage of the income of a trust is essentially a beneficiary's percentage of trust law income they are presently entitled to (on the assumption of ignoring any amount of franked distribution to which any beneficiary is specifically entitled).¹³¹ When one disregards a franked distribution one must also remember to disregard expenses in relation to that disregarded distribution. Example Six continues Example One with a variation.

¹²⁶ Effectively "dis-apply" some directly relevant expenses.

¹²⁷ It is possible that the drafter has simply copied the words "after any application by the trustee of" from the definition of "net financial benefit" in the net capital gains rules (*Income Tax Assessment Act 1997* (Cth) s 115-228(1)), into the franked distribution rules without fully considering the consequences.

¹²⁸ Definition of "share of net financial benefit" in *Income Tax Assessment Act 1997* (Cth) s 207-58(1). There is no need to analyse this concept in detail but one comment is made: for a beneficiary to have a share of net financial benefit, there must also be a recording of the financial benefit in the accounts of the trust before year-end.

¹²⁹ As soon as one component in the formula in s 207-58(1) is zero, the product of the formula must be zero. As discussed above, there can be no specific entitlement to a franked distribution (and therefore no streaming) where: (1) the distribution is exceeded by directly relevant expenses; and (2) the distribution is not exceeded by directly relevant expenses, but the trustee applies non-directly relevant expenses to extinguish the distribution.

¹³⁰ *Income Tax Assessment Act 1997* (Cth) s 207-55(4)(b)(i).

¹³¹ Definitions of "adjusted Division 6 percentage" and "Division 6 percentage" in *Income Tax Assessment Act 1936* (Cth) s 95(1).

EXAMPLE SIX

This example builds on the facts in Example One, but assumes that Ann and Ben are not entitled to trust income. Instead of the trust law income of \$17,000, Connie (another beneficiary) is to receive 4/7ths of the net dividend (\$3,428 $(\$7,000 - \$1,000) \times 4/7$), and therefore has specific entitlement to \$4,000 of the \$7,000 franked distribution (ie $\$4,000 = \$7,000 \times [\$3,428/\$6,000]$: s 207-58(1)). No other beneficiary has specific entitlement to any part of the distribution. Under a trustee resolution, another beneficiary David is presently entitled to \$5,000 of the balance of trust law income (after Connie's entitlement to \$3,428 of the net dividend), and another beneficiary Eddie is allocated the balance remaining of trust law income (\$8,572).

Adjusted Trust Law Income

Revenue

Rent	\$22,000	
Franked Distribution	\$7,000	
Franked Distribution	<u>\$3,000</u>	\$25,000

Expenses

Entertainment	\$1,000	
Rent Expenses	\$10,000	
Interest on Loan (Shares)	\$1,000	
Interest on Loan (Shares)	<u>\$428*</u>	\$11,428

Adjusted Trust Law Income \$13,572

Note to Income Statement

* While Connie's \$4,000 portion of the (gross) franked distribution is excluded, one must also exclude a portion of the interest expenses related to the \$4,000 because they would not have existed had the \$4,000 not existed. This explains the exclusion of \$572 $(\$4,000/\$7,000) \times \$1,000$ of the interest on loan expense.

David's adjusted Div 6 percentage is 36.8% $(\$5,000/\$13,572)$ and Eddie's is 63.2% $(\$8,572 / (\$13,572 - \$5,000))$. The end result in terms of a share of the franked distribution is (column 3 in item 3 in table in s 207-55(3) and 207-55(4)):

Beneficiary	Share of Franked Distribution
Connie	\$4,000 (specific entitlement)
David	\$1,104 (adjusted Div 6 percentage)
Eddie	<u>\$1,896</u> (adjusted Div 6 percentage)
Total	\$7,000

(b) Gross-up

Section 207-35(4)(b)(i) provides for the inclusion of the gross-up in a beneficiary's assessable income. Unlike the old rules, it is clear that this subsection includes an amount in assessable income. The conditions for that occurring are mainly in s 207-35(3), and are mostly the same as the conditions under the old Subdiv 207-B.

The amount of a beneficiary's assessable income inclusion is so much of the franking credit amount as is equal to the beneficiary's share of the franking credit on the distribution, similar to s 207-57 of the old Subdiv 207-B that provides a beneficiary's share of the franking credit. The key, again, will be whether the beneficiary has a share of the franked distribution (see immediately above).

(c) Franking Credit Tax Offset

Section 207-45 provides the franking credit tax offset for a beneficiary, and the amount of the tax offset is the beneficiary's share of the franking credit on the distribution. This again links to s 207-57, where the key will be whether the beneficiary has a share of the franked distribution (see above). Example Seven continues the example to illustrate the franking credit tax offset.

EXAMPLE SEVEN

Continuing from Example Six, the Subdiv 207-B outcome is this:

Beneficiary	Share of Net Franked Distribution Included in Assessable Income	Gross-up Included in Assessable Income	Franking Credit Tax Offset
Connie	\$3,428	\$1,714	\$1,714
David	\$947	\$473	\$473
Eddie	\$1,625	\$813	\$813
Total	\$6,000	\$3,000	\$3,000

4. Division 6 (with Div 6E Modifications)

If the trust has taxable income and has received a franked distribution,¹³² Div 6E applies.¹³³ Where Div 6E applies, the division replaces the three central concepts that govern and determine the allocation of taxable income under Div 6.¹³⁴ The broad idea is to remove the franked distribution, associated tax attributes (gross-up), expenses related to the distribution and deductions from the three relevant concepts in Div 6, which are:

- (1) trust law income (becomes Div 6E income);¹³⁵
- (2) beneficiaries' present entitlement to trust law income (beneficiaries' present entitlement to Div 6E income);¹³⁶ and
- (3) taxable income (Div 6E taxable income).¹³⁷

Example Eight provides an illustration of the operation of Div 6E.

¹³² In one sense, this is not crucial to the central assertion made in this article, but it is provided for completeness.

¹³³ *Income Tax Assessment Act 1936* (Cth) s 102UW.

¹³⁴ *Income Tax Assessment Act 1936* (Cth) ss 102UX, 102UY.

¹³⁵ This is a trust law concept, although mentioned in the income tax law.

¹³⁶ This is a trust law concept, although mentioned in the income tax law.

¹³⁷ This is an income tax law concept.

EXAMPLE EIGHT

Continuing with Example Seven (which builds from Example One), the position of the trust would look like this:

Division 6E Trust Law Income

Revenue

Rent	\$22,000	
Franked Distribution	\$7,000	\$22,000

Expenses

Entertainment	\$1,000	
Rent Expenses	\$10,000	
Interest on Loan (Shares)	\$1,000	\$11,000

Division 6E Trust Law Income

\$11,000

Division 6E Taxable Income

Assessable Income

Rent	\$22,000	
Franked Distribution	\$7,000	
Gross-Up	\$3,000	\$22,000

Deductions

Entertainment	Zero	
Rent Expenses	\$10,000	
Interest on Loan (Shares)	\$1,000	\$10,000

Division 6E Taxable Income

\$12,000

Continuing with the example, David's present entitlement to Div 6E trust law income is \$4,048 (36.8% of \$11,000) and Eddie's is \$6,952 (63.2% of \$11,000). Their respective allocations of Div 6E taxable income are therefore \$4,416 ($[\$4,048/\$11,000] \times \$12,000$), and \$7,584 ($[\$6,952/\$11,000] \times \$12,000$). The allocation of taxable income from the trust is summarised as:

Beneficiary	Net Franked Distribution Included in Assessable Income	Gross-Up Included in Assessable Income (and Franking Credit Tax Offset)	Section 97(1) Assessable Income Inclusions	Total Assessable Income Inclusions
Connie	\$3,428	\$1,714	Zero	\$5,142
David	\$947	\$473	\$4,416	\$5,836
Eddie	\$1,625	\$813	\$7,584	\$10,022
Total	\$6,000	\$3,000	\$12,000	\$21,000

III. SCENARIOS COMPARING THE TAX TREATMENT UNDER THE OLD AND NEW SUBDIV 207-B

A. Tabular Summary Comparing Tax Treatment of Various Scenarios Under Old and New Subdiv 207-B

Table 1 below provides a summary of the ability of discretionary trusts to stream franked dividends to beneficiaries under both the old and new Subdiv 207-B.¹³⁸ The scenarios provide for variations as to whether the relevant expenses exceed or do not exceed the franked dividend. This summary is based on

¹³⁸ The number of scenarios could be a lot longer by taking into account a larger range of circumstances (eg trustee representative taxation for a beneficiary: *Income Tax Assessment Act 1936* (Cth) s 98(1)), but to do so would not add significantly to the main message of the article.

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the discussion in the preceding examples. The key observation is that the new Subdiv 207-B does not permit the streaming of franking credit tax offsets in circumstances where the franked distribution has been extinguished by related expenses. In stark contrast, the old Subdiv 207-B did permit the streaming of franking credit tax offsets in such circumstances. The alteration that caused this change is highlighted in Part III(D).

TABLE 1. Scenario Summary

Scenarios	Old Subdiv 207-B	New Subdiv 207-B
<p>SCENARIO ONE</p> <p>(i) Trust does not have trust law income;</p> <p>(ii) trust has a franked distribution; and</p> <p>(iii) trust does not have taxable income (ie tax loss or break-even).</p>	<p>(a) There can be no beneficiary taxation under Div 6;</p> <p>(b) there can be no pass-through of franked distributions and associated tax attributes; and</p> <p>(c) there is no trustee representative taxation for the trust as a whole under ss 99 or 99A.</p>	<p>The comments are the same as those under the old Subdiv 207-B column.</p>
<p>SCENARIO TWO</p> <p>(i) Trust does have trust law income;</p> <p>(ii) trust has a franked distribution; and</p> <p>(iii) trust does not have taxable income (ie tax loss or break-even).</p>	<p>Subject to comments in the note, the comments are the same as those under Scenario One.*</p>	<p>The comments are the same as those under the old Subdiv 207-B column.</p>
<p>SCENARIO THREE</p> <p>(i) Trust does not have trust law income;</p> <p>(ii) trust has a franked distribution;</p> <p>(iii) trust does have taxable income;</p> <p>(iv) taxable income exceeds franked distribution; and</p> <p>(v) there are zero expenses against franked distribution.</p>	<p>(a) There can be no beneficiary taxation under Div 6;</p> <p>(b) there can be no pass-through of franked distributions and associated tax attributes to beneficiaries;</p> <p>(c) there is trustee representative taxation for the trust as a whole under ss 99 or 99A; and</p> <p>(d) trustee can use franking credit tax offsets against its tax liability.**</p>	<p>Subject to comments in the note, the comments are the same as those under the old Subdiv 207-B column.***</p>
<p>SCENARIO FOUR</p> <p>(i) Trust has trust law income;</p> <p>(ii) trust has a franked distribution;</p> <p>(iii) trust does have taxable income;</p> <p>(iv) taxable income exceeds franked distribution; and</p> <p>(v) there are zero expenses against franked distribution.</p>	<p>(a) There can be beneficiary taxation under Div 6;</p> <p>(b) there can be pass-through of franked distributions and associated tax attributes;</p> <p>(c) there can be streaming of franked distributions and associated tax attributes; and</p> <p>(d) in the absence of streaming, franked distribution and associated tax attributes are allocated in proportion to allocation of trust law income (and therefore taxable income).</p>	<p>The comments are the same as those under the old Subdiv 207-B column.</p>

TABLE 1. *continued*

<p>SCENARIO FIVE (i) Trust has trust law income; (ii) trust has franked distribution; (iii) trust does have taxable income; (iv) taxable income exceeds franked distribution; and (v) there are expenses against franked distribution but franked distribution exceeds expenses.</p>	<p>The comments are the same as those under Scenario Four.</p>	<p>The comments are the same as those under old Subdiv 207-B.</p>
<p>SCENARIO SIX (i) Trust has trust law income; (ii) trust has franked distribution; (iii) trust does have taxable income; (iv) taxable income exceeds franked distribution; and (v) there are expenses against franked distribution and the expenses exceed the franked distribution (ie distribution extinguished).</p>	<p>(a) There can be beneficiary taxation under Div 6; (b) there can be pass-through of franked distributions and associated tax attributes; (c) there can be streaming of franked distributions and associated tax attributes; and (d) in the absence of streaming, franked distribution and associated tax attributes are allocated in proportion to allocation of trust law income (and therefore taxable income).</p>	<p>(a) there can be beneficiary taxation under Div 6; (b) there can be pass-through of franked distributions and associated tax attributes; (c) there cannot be streaming of franked distributions and associated tax attributes;**** and (d) as streaming is not possible, franked distribution and associated tax attributes are allocated in proportion to allocation of (other) trust law income (and therefore taxable income) using adjusted Div 6 percentage mechanism.</p>
<p>SCENARIO SEVEN (i) Trust has trust law income; (ii) trust has franked distribution; (iii) trust does have taxable income; (iv) franked distribution exceeds taxable income; (v) there are expenses against franked distribution and the expenses exceed the franked distribution (ie distribution extinguished).</p>	<p>The comments are the same as those under Scenario Six.</p>	<p>The comments are the same as those under Scenario Six (which includes no streaming).</p>

Notes

* On a literal reading of s 99B of the *ITAA 1936*, the section would seem to apply when a beneficiary receives an amount of trust income that is not represented by a s 97(1) amount. However, the ATO does not appear to apply the section in these “plain vanilla” circumstances of a domestic Australian trust. As an alternate, CGT event E4 may also apply in the case of a fixed trust. CGT event E4 will not apply in the case of a discretionary trust: Taxation Determination TD 2003/28. For a detailed discussion of CGT event E4, see Freudenberg and McDermott.¹³⁹

** Put briefly, the trustee is assessed on the whole of the taxable income, which would include the franked distribution and the gross-up. The trustee is entitled to the franking credit tax offset: s 207-45(c). Section 67-25(1) states that tax offsets under Div 207

¹³⁹ Freudenberg, B & McDermott, P, “The Forgotten CGT Events: Are Asset Revaluation Reserve Distributions by Trustees of Discretionary Trusts Capital Gains?” (2005) 34(2) *AT Rev* 67–87.

Streaming of Franking Credits Curtailed by Bamford-Induced Amendments – an Unintended Consequence?

(which includes Subdiv 207-B) are subject to the refundable tax offset rules, unless otherwise stated later in s 67-25. Section 67-25(1B) states that where a trustee is liable to be assessed under s 99A, the refundable tax offset rule does not apply. The end result is that where the trustee assessment is under s 99, the trustee can use the franking credit tax offset against tax liability and any excess tax offset is refunded in cash. Where s 99A applies, the franking credit tax offset can be used against tax liability, but any excess tax offset will not be refunded. The position is the same in both the old and new Subdiv 207-B environment.

*** Put briefly, the trustee is assessed on the whole of the (net) franked distribution and the gross-up: s 207-35(6). The trustee is entitled to the franking credit tax offset: s 207-45(c).

**** The definition of “net financial benefit” or the definition of a “share of net financial benefit” in s 207-58(1) cannot be satisfied.

B. Expenses Against Franked Distributions and Streaming

Although touched on above, some brief extra comments are required in regard to these two concepts as mentioned in Table 1.

1. Expenses Against Franked Distributions

The key thing here is whether, as a matter of trust law, the distribution has ceased to exist because expenses that are “related to” the distribution exceeds the distribution. Whether a distribution is extinguished is a matter of the operation of the trust deed and/or the exercise of a power conferred on the trustee to apply expenses against particular trust receipts. In the absence of direction from the trust deed, the general law of trusts, taking into account principles of accounting, should govern the situation.

While the overriding focus here is on trust law rules, the income tax law may complicate this area somewhat. In particular, the tax law may provide an operative rule regarding the application of trust law expenses, and thereby modify the position that would otherwise pertain under trust law, for the purpose of applying the tax rules. Under the old Subdiv 207-B, the tax law did not contain any such modification to the trust law rules. In other words, the outcome of application of expenses operative under trust law was not modified in any way in order to apply the tax rules. In the absence of specific provisions in the trust deed, generally the trustee would have to do such an allocation “on an equitable and fair basis”.¹⁴⁰

On the other hand, and assuming the analysis in this article concerning application of expenses is correct, the new Subdiv 207-B may modify the trust law outcome. Under the new Subdiv 207-B, it is only expenses that are directly relevant to the dividend that are subtracted in determining the trust law surplus in terms of the dividend (net financial benefit). Accordingly, a trust could still have a net financial benefit where the trustee pursuant to a power has applied expenses (eg \$1,000) that are not directly relevant to the dividend (eg \$900), and where there are zero directly relevant expenses. The net financial benefit would be \$900 in this example, even though for trust law purposes the dividend has been extinguished.

Take the opposite of the situation above. There are directly relevant expenses of \$1,000 against a dividend of \$900. The trustee uses its power to apply the \$1,000 against other trust income (ie disapply the \$1,000 against the \$900). In this circumstance, even though the \$900 dividend exists for trust law purposes, the trust does not have a net financial benefit.

It does not appear that the “mismatch” outlined in the two examples above is of any significance. Take the first example. Even though there will be a net financial benefit (denominator in formula in s 207-58(1)), there will be no beneficiary with a share of the net financial benefit (numerator in the formula in s 207-58(1)) because as a matter of trust law the \$900 dividend no longer exists and therefore a beneficiary cannot reasonably expect to receive anything that represents that \$900 dividend. Accordingly, no beneficiary can obtain specific entitlement to the \$900 dividend.¹⁴¹

In regard to the second example, again no beneficiary can obtain specific entitlement to the \$900 dividend because the trust does not have a net financial benefit. This is in spite of the fact that for trust law purposes alone, a beneficiary (or beneficiaries) will receive the \$900 dividend.

¹⁴⁰ *Bamford v Commissioner of Taxation* (2009) 176 FCR 250, [51]; 73 ATR 49; [2009] FCAFC 66.

¹⁴¹ To repeat, as soon as one component in the formula in s 207-58(1) is zero, the product of the formula must be zero.

In light of the above, whether the franked dividend is extinguished by directly relevant expenses or non-directly relevant expenses does not seem to matter in terms of ability to stream (have specific entitlement). The scenarios in Table 1 proceeded on this basis.

2. Streaming

It is widely accepted that streaming of tax items is not possible unless the trust deed and/or the exercise of a trustee power streams the related trust law items.¹⁴² It is submitted that a trust law streaming power is needed whether or not the particular trust law receipt involved has been extinguished by related expenses or losses (ie deficit or surplus). Therefore, where a (franked) distribution has been extinguished by expenses, streaming would still require some indication that the trustee has treated the distribution as “belonging” to a particular beneficiary.

In addition to a trust law basis for streaming, compliance with any tax law requirements must also occur. The old s 207-55 only required the trustee to indicate how much of the franked distribution was taken into account in working out the beneficiary’s s 97(1) assessable income inclusion (called share amount). Under the new s 207-55, all the requirements of specific entitlement must be satisfied, including the necessary recording of the entitlement (share of net financial benefit) by year end.

For completeness, “streaming” under the tax law may still be achieved by an “indirect approach” where the “direct approach” has failed. In the current context (franked distributions), under both the old and new s 207-55, if the express streaming mechanism is not used, the allocations are made on the basis of allocations of trust law income. Accordingly, albeit often undesirable, this basis can also be used to “stream” franked distributions and associated tax attributes. This is undesirable, perhaps, because the rest of the trust’s taxable income must also be allocated in the proportions in which the franked distribution and associated tax attributes are allocated.

C. Key Area(s) of Differential Treatment

As can be seen in the comparative Table 1 in Part III(A), under the first five scenarios streaming is (was) available under both the old and new Subdiv 207-B. However, under scenarios six and seven, where the franked distribution is extinguished by related expenses, streaming is available under the old Subdiv 207-B but it is not available under the new Subdiv 207-B. This represents a change in the tax law.

Aside from one low-profile exception, there is no express reference in official material accompanying the new Subdiv 207-B that streaming was to be curtailed in any situation in the new provisions. Indeed, the overwhelming message was on attaining certainty in regard to enabling, ensuring etc streaming of capital gains and franking credits.¹⁴³ Further, the wording of s 207-55(1) and 207-55(2) were not changed in the new Subdiv 207-B. These two provisions indicate that a beneficiary can have a share of a franked distribution (and therefore streaming) even where the distribution ceases to exist because related expenses exceed the distribution. In other words, notional allocations are still contemplated even in direct contradiction of the law.¹⁴⁴ This is especially the case given that the trustee has no power to alter how relevant expenses are allocated to determine the “net financial benefit” given that it is an objective test.

¹⁴² *Thomas v Federal Commissioner of Taxation* (2015) 101 ATR 576, [128]; 2015 ATC 20-526; [2015] FCA 968; *Federal Commissioner of Taxation v Thomas* [2018] HCA 31 [17]; 2018 ATC 20-663. The ATO adopted this view very early on: see Taxation Ruling TR 92/13, [4]–[10] (now withdrawn). Although this view is not expressly stated in the Administrative Appeals Tribunal decision in *Greenhatch v Federal Commissioner of Taxation* (2011) 80 ATR 480; 2011 ATC 10-191; [2011] AATA 479, it is strongly implied in the reasoning. See also Explanatory Memorandum, *Tax Laws Amendment (2011 Measures No 5) Bill 2011* (Cth) [2.35].

¹⁴³ Assistant Treasurer, “Providing Certainty for Trusts” (Media Release, No 40, 4 March 2011); Assistant Treasurer, “Improving the Taxation of Trust Income” (Media Release, No 52, 13 April 2011); Australian Government, “Improving the Taxation of Trust Income” (Discussion Paper, March 2011) 1, 13, 15; Explanatory Memorandum, *Tax Laws Amendment (2011 Measures No 5) Bill 2011* (Cth) [2.1], [2.12], [2.20], [2.25].

¹⁴⁴ There is a statement in the relevant Explanatory Memorandum that the amendments modify the current law to “clarify how an entity’s share of a franked distribution within the meaning of section 207-55 is to be calculated”: Explanatory Memorandum, *Tax Laws Amendment (2011 Measures No 5) Bill 2011* (Cth) [2.118].

D. Little Notice of Curtailment of Streaming

Given the analysis of this article it appears that there has been a subtle change in the law in terms of trustees being able to stream franking credits when the franked distribution is extinguished by related expenses. With the *Bamford* amendments there appears to be little notice that such a change was intended by the amendments. The only exception that hints or suggests a curtailment of streaming appears in a six-page document entitled “Interim Changes to Improve the Taxation of Trust Income: Summary of Intended Outcomes” (Australian Treasury, undated). In a footnote to commentary stating that capital gains and franked distributions can be streamed to beneficiaries, the following appears: “To clarify, this will require more than a ‘notional’ allocation for tax purposes.”¹⁴⁵

This Treasury document was a summary of the exposure draft Explanatory Memorandum. Nowhere in the exposure draft Explanatory Memorandum does the above statement in regard to franked distributions appear. While the statement certainly hints at streaming being curtailed where allocations are only notional, that statement was not repeated in the final version of the main official explanatory document – namely, the Explanatory Memorandum to the new Subdiv 207-B (*Tax Laws Amendment (2011 Measures No 5) Bill 2011* (Cth)). Further, the change was not highlighted or given prominence anywhere. And there was no policy justification put forward to justify the change.

Overall, it is argued that in response to the perceived uncertainty created by the High Court decision in *Bamford*, the amendments have, it appears, inadvertently reduced the capacity for the streaming of franked dividends and associated tax attributes compared to under the old rules.

E. Recommendations and Observations

A critical element of good tax policy is the notion of certainty. If the government intends to legislatively alter how the tax law applies then it is prudent that it clearly articulates this, as well as providing policy justification for such alterations.

Of course, it is possible that the legislature did not know that in enacting the new Subdiv 207-B they were curtailing streaming of franking credit tax offsets. If this is the case, then it raises the question of whether this change should be reversed. If the legislature was aware of what it was doing, it is clear that no policy rationale was put forward as to why streaming should be taken away in the circumstance where expenses extinguish the franked distribution. It is argued such transparency is preferable to allow for debate over the issue.

It is respectfully submitted that no matter how informed or uninformed the current position was or is, there is a strong case for examining the policy rationale for and against the streaming of franking credit tax offsets where expenses extinguish a franked distribution. Indeed, it is recommended that as a matter of policy it is apt to revisit the appropriateness of streaming of any form of tax receipt that passes through a trust to particular beneficiaries, especially given the restrictions that can be placed on corporations and their shareholders.¹⁴⁶ Further, the over-utilisation of franking credits, including their current refundability, has gained attention, especially due to the budgetary costs.¹⁴⁷

Additionally, it is suggested that the following considerations should be relevant to the question as to whether streaming of franked distributions and, perhaps of more relevance, associated tax attributes, should be permitted where expenses extinguish the distribution. First, the selective allocation to beneficiaries of particular receipts must be possible under the trust deed, and the trustee does in fact make such allocations under a power in the trust deed. Second, the benchmark comparison position should be the receipt of a franked distribution by an individual shareholder in the company. In this

¹⁴⁵ See Treasury, “Interim Changes to Improve the Taxation of Trust Income: Summary of Intended Outcomes” (Commonwealth Government, 2008) note 1 <https://archive.treasury.gov.au/documents/2008/PDF/Advanced_summary_of_Explanatory_Material.pdf>.

¹⁴⁶ For example, the anti-streaming rules that apply to corporations and the distribution of their franked dividends: *Income Tax Assessment Act 1936* (Cth) s 177EA.

¹⁴⁷ Chris Bowen, “A Fairer Tax System: Dividend Imputation Reform” (Media Release, 13 March, 2018) <<https://www.chrisbowen.net/media-releases/a-fairer-tax-system-dividend-imputation-reform/>>.

situation, currently the presence of sufficient expenses that extinguish the franked distribution does not prevent the normal assessability of the franked distribution and gross-up, and full usage of the franking credit tax offset. Third, what significance ought to be given to the lack of pass-through to beneficiaries of tax losses of a trust, and perhaps, at the same time, the allowance of pass-through of tax losses to partners in a partnership? It appears that the lack of pass-through to beneficiaries is solely due to difficulties of working out which beneficiaries are to bear the related economic loss, especially in a discretionary trust.¹⁴⁸ In spite of this, the lack of pass-through of tax losses of trusts has become a structural feature of the taxation of trusts. This raises the question as to whether the situation of receipt of a franked distribution by a trust and its streaming to a beneficiary is truly analogous to the situation of an individual in direct receipt of a franked distribution. A trust situation, at least on receipt of the franked distribution, is a collective economic vehicle situation (group of taxpayers), and this is not the case where an individual is involved. It is only after allocation to a beneficiary that the franked distribution becomes “individualised”. The point is that in the case where expenses extinguish the distribution that has been allocated to a beneficiary and this is that beneficiary’s sole allocation from the trust, it is the surplus belonging to other taxpayers that is ensuring the access to the franked distribution etc for the first beneficiary. It is not a structural feature of Australia’s income tax to have the circumstances of other taxpayers impact the tax outcome for another taxpayer (ie a form of group taxation).

IV. CONCLUSION

Overwhelmingly, the tax profession’s concerns in light of the *Bamford* decision was that streaming of franked distributions and associated tax attributes (and net capital gains of trusts) was in jeopardy. The government response was overwhelmingly directed at this concern and was to ensure streaming was available for these two types of receipt – franked dividends and capital gains. There was very little hint that streaming was to be curtailed in any situation, and there was virtually zero publicity given to the fact that streaming was to be curtailed in the situation where the franked distribution was extinguished by related expenses.

The decisions and reasoning in the fairly recent *Thomas* litigation confirm that streaming of franked distributions and associated tax attributes was available under the old Subdiv 207-B where expenses extinguished the franked distribution. The new Subdiv 207-B does not permit streaming of franked distributions and associated tax attributes where expenses extinguish the franked distribution. Aside from the fact the change to the law was not highlighted or given any prominence, no policy justification has been put forward supporting the change. Given the number of discretionary trusts in receipt of franked distributions and the quantum of such distributions and associated franking credit tax offsets, the case for a policy examination of the issue is very strong. It is only in the bright light of policy analysis that a final position can be taken. This is particularly preferable to changes in tax policy that may result in more unintended consequences.

¹⁴⁸ For historical analysis of Australian business structures and tax flow-through of losses, see Brett Freudenberg, “Losing My Losses: Are the Loss Restriction Rules Applying to Australia’s Tax Transparent Companies Adequate?” (2008) 23(2) *Australian Tax Forum* 125.