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# Trust taxation

## Proposed reform

by Tony Davey



**General proposal**

The *2013 Budget Review* proposes legislative amendments supposed to curb tax avoidance through the use of trusts.

**Flow-through principle curb**

Specifically, the Treasury proposes that local discretionary trusts should no longer act as flow-through vehicles, in that taxable income should be taxed within the trust.

*Prima facie,* therefore, other than special trusts (that is, disability vehicles), the income tax rate for trusts will be 40% and the CGT rate 26,6%. Thereafter, a distribution to beneficiaries is received tax free by them.

**Status quo?**

But the *Review* also proposes (Chapter 4, page 54) that 'distributions will be deductible payments to the extent of current taxable income'.

This proposal merely restates the current *status quo*, since, if a trust distributes 100% of its taxable income, there is nothing left in the trust to tax, and the beneficiaries are—and seemingly will continue to be—subjected to tax at their individual marginal rates, both for income tax and the CGT.

Naturally, the devil is in the detail, and I anticipate enlightenment as the proposals meander through the National Assembly.

In any event, tax-efficient investment strategy, under which the investment is taxed at source (for example, dividend-producing shares and endowment policies), will negate adverse taxation within the trust.

**Conclusion**

The conduit principle pertaining to discretionary trusts is a well-established principle of tax case law. See, for example *SIR v Rosen,* in which, forty years ago, the Appellate Division confirmed the principle.

Also, to tamper with the common-law concept of discretionary trusts and assume for tax purposes vested rights is dangerous territory, since it interferes with the trustees' fiduciary decision-making process recognized since the time, eons ago, of the Crusades.

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