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The Taxation of Capital Gains in Trusts after Bamford: A critical evaluation of the streaming regime in Subdivision 115-C ITAA97

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Abstract

The streaming regime in Subdivision 115-C ITAA97, which was enacted after the High Court's decision in Commissioner of Taxation v Bamford (2010) 240 CLR 481 ('Bamford'), is an integral component of the taxation of trusts in Australia. The main purpose of the 2011 measures was to ensure that the streaming of capital gains (as well as franked distributions) to specific beneficiaries would be effective for tax purposes as the Government had assumed that the 'proportionate approach', which was confirmed in Bamford, necessarily implied an inability to stream particular categories of income. Although the Government intended to appraise Subdivision 115-C ITAA97 after a broader review of the taxation of trusts, more than nine years later, this has not taken place. The current regime is highly problematic due to its extreme complexity, with evidence that it is largely inaccessible to both the profession and scholars. This paper critically evaluates the streaming regime by first considering whether streaming was precluded under the previous law (as assumed), and then considering the application of the current regime to a series of examples that cover key scenarios of interest. Centrally, this paper aims to show that the streaming regime in Subdivision 115-C is unnecessarily complex. It is also shown that the regime leads to some anomalous outcomes. Improvements are suggested by outlining ways in which streaming could be accommodated by simpler processes that also more consistently give effect to the entrenched policy of ensuring a *reasonable nexus between beneficiaries' distributable income and assessable income.*

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1 Introduction

Amendments to the Australian income tax legislation in 2011, effective from the 2010-2011 income year, which aim to ensure that capital gains and franked distributions can be effectively 'streamed' for tax purposes, introduced significant complexity to the taxation of trusts. Specialist practitioner publications and the academic literature have provided valuable guidance on how to apply the provisions.[1] This paper specifically focuses on a critical evaluation of the regime, which is intended to encourage both further scholarly analysis and provide assistance to regulators. Centrally, this paper aims to show that the immense complexity in the relevant provisions is in fact unnecessary. It outlines alternative, simpler processes that enable streaming, which also more closely give effect to the entrenched policy objective of achieving an alignment between beneficiaries' distributable income and assessable income.[2] The analysis in this paper is limited to examining the streaming regime applicable to net capital gains that are included in the taxable income of a trust estate.[3] While the essential framework and key concepts introduced by the 2011 legislation apply to both the streaming of capital gains and franked distributions, the paper

1 A detailed (practitioner-oriented) coverage of the operation of the provisions is contained in Gaal, *Discretionary Trust Distributions* (3rd edition) (Tax Institute, 2013) Chapters 4 and 5. For academic analysis of the provisions, which usefully suggests a systematic method for approaching and applying the rules, see Dale Boccabella, 'Net capital gains of trusts: A systematic method of allocating those gains and other taxable income and analysis of problematic and anomalous issues' (2018) 47 *Australian Tax Review* 128.

2 As noted by the Federal Court in *Bamford v Commissioner of Taxation* [2009] FCAFC 66 [56] (Emmett J), this is a central assumption underlying the taxation of trust income in Australia (the Federal Court's decision, which was upheld in the High Court, provides pertinent, detailed analysis and is drawn upon later in the paper). To similar effect, see *Richardson v Federal Commissioner of Taxation* (1997) 150 ALR 167, 181 (Merkel J). In the Discussion Paper that preceded the enactment of the streaming regime, the Government indicated that it was important to ensure a better alignment of the concepts of trust distributable income and trust taxable income and invited submissions on this point: 'Improving the Taxation of Trust Income' (Treasury, 2011) 19.

3 The scope of the capital gains streaming regime is described in these terms in s115-210 ITAA97 (the provision refers to the 'net income' of the trust estate within the meaning of s95 ITAA36 and this is equivalent to trust taxable income as outlined in Part II of the paper). As pointed out by Boccabella, above n 1 (at 130), the streaming regime only becomes relevant if there is a net capital gain that remains after applying the method statement in s102-5 ITAA97. While the core example in this paper contains a capital loss, a net capital gain remains, triggering the application of the streaming regime.

does not consider specific issues that arise with respect to franked distributions.[4] The tax treatment of capital gains in trusts raises issues of a fundamental nature; it is not simply that capital gains are associated with specific tax consequences insofar as they could be more advantageous to certain beneficiaries with personal capital losses (which could be used to offset those gains)—the more basic consideration flows from the general law position that capital gains are not part of distributable income without specific provision in the trust deed. As shown in the paper, the legislative scheme creates an anomalous outcome in at least one situation where capital gains are not included in trust income.

Although the 2011 provisions were described as 'interim,' and the Government indicated that they would be re-examined as part of a broader review of the taxation of trusts,[5] more than nine years later, this has not taken place and they may be here to stay for the foreseeable future. The streaming regime, which is located in Subdivision 115-C of the *Income Tax Assessment Act 1997* (ITAA97), together with related amendments to Division 6 of the *Income Tax Assessment Act 1936* (ITAA36), represent a vital component of the taxation of trusts in Australia. Notably, the 2011 provisions altered the legislative basis on which net capital gains (and franked distributions) are taxed even where a trustee does not undertake streaming. Several new terms and concepts were introduced by the 2011 amendments. The intricate, complicated process of working out beneficiaries' (and trustees,' as the case may be) attributable capital gains under the current regime tends to obscure an understanding of its overall purpose. In 2011, the Tax Institute suggested an 'inability to understand the law' among practitioners.[6] Some years later, in 2015, CPA Australia described the provisions as 'causing significant confusion among the membership.'[7] As an indicator of the inaccessibility of the current provisions, it is noted that leading Australian taxation law textbooks either do not cover the regime, or rely principally on the explanatory memorandum without any further substantial analysis of the provisions.[8]

The impetus for the 2011 amendments was the High Court's decision in *Commissioner of Taxation v Bamford* ('*Bamford*').[9] *Bamford* confirmed two central propositions concerning the operation of section 97 ITAA36, which is the core provision that governs the assessable income of a beneficiary under a trust. Firstly, the High Court confirmed that the reference to a beneficiary's 'present entitlement' to the 'income of the trust estate' in section 97 ITAA36 refers to the conception of income under trusts law (and means distributable income), which in turn respects any variation of normal presumptions effected by the trust deed.[10] Secondly, as a matter of statutory construction, the High Court confirmed that a beneficiary is assessed for income tax under section 97 pursuant to the so-called

4 Regarding judicial consideration of Subdivision 207-B ITAA97 concerning the streaming of franked distributions, see *FCT v Thomas* [2018] HCA 31. Notably, the High Court here considered that franking credits could not be streamed or allocated to beneficiaries separately to the underlying dividends to which they relate (see at [16]-[18]). For academic analysis of Subdiv 207-B ITAA97 in a specific context (where the franked distribution is extinguished by directly relevant expenses), see Norman Hanna, 'Applying Subdiv 207-B and Div 6 to franked distributions' (2019) 54(3) *Taxation in Australia* 138.

5 Treasury, 'Improving the Taxation of Trust Income', above n 2, 1.

6 Schurgott, *Trust Streaming Manual* (Tax Institute, 2011) 2.

7 CPA Australia, *Trust Streaming Manual* (CPA Australia, 2015) 1. Relatedly, in 2016, Schurgott commented in relation to Subdivision 115-C ITAA97 that '[a]nyone familiar with the extreme complications of the legislation will understand how hard it is to comply with exactitude. The interrelation of trust law, tax law general principles and the streaming provisions is very demanding': Ken Schurgott, 'Practical issues with trusts: Important updates' (2016) 20(1) *Tax Specialist* 2, 4.

8 E.g., see Sadiq, Coleman, Hanegbi et al, *Principles of Taxation Law* (Thomson Reuters, 2020) Chapter 20; Barkoczy, *Foundations of Taxation Law* (Oxford, 2020) Chapter 26.

9 (2010) 240 CLR 481.

10 Ibid 505-506 (French CJ, Gummow, Hayne, Heydon and Crennan JJ).

'proportionate' approach, which had been applied in earlier Federal Court decisions.[11] Under this approach, the same percentage share or proportion of distributable income to which a beneficiary is entitled under the principles of trust law, is also applied to the trust's taxable income to determine the beneficiary's income tax liability.[12]

The Government considered that *Bamford* 'highlighted longstanding problems with the taxation of trusts,'[13] including that the amount on which a beneficiary is assessed for tax may be different to the amount that they are entitled to receive under trusts law.[14] Further, the Government took the view that the proportionate approach cannot be reconciled with an ability to stream capital gains to specific beneficiaries for tax purposes, on the reasoning that a beneficiary's percentage share of a trust's assessable income would include a 'blended amount of all of the different types of income and capital gains included in the trust's taxable income.'[15] The Federal Court's decision in *Commissioner of Taxation v Greenhatch* ('*Greenhatch*'),[16] which was decided under the pre-2010/2011 law, appears to be consistent with the Government's interpretation.[17] The Government considered that the 2011 amendments 'address key anomalous outcomes and provide certainty in relation to the streaming of capital gains and franked distributions.'[18]

With the ultimate aim of evaluating the effectiveness of the regime, and obtaining a clear understanding of the perceived problem(s) it sought to tackle (and indeed whether a problem existed), this paper first examines the pre-2011 position and undertakes a detailed analysis of the 'proportionate approach' as conceptualized in *Bamford* and other cases. It considers whether the streaming of capital gains was unavailable under the proportionate approach (as claimed) by considering the application of the proportionate approach to a series of examples, which are designed to reveal the extent to which the proportionate approach (as conceptualized in *Bamford*) would in fact have obstructed the trustee's streaming intentions. As will be outlined, there was some scope for streaming even pursuant to the proportionate approach. A complete inability to stream capital gains is an assumed (but not a necessary) consequence of the proportionate approach confirmed in *Bamford*. The paper then examines the significance and effectiveness of the 2011 streaming provisions. Improvements and anomalies introduced by the amendments are identified. This paper highlights complexity in two central aspects of the regime and their interaction—the 'specific entitlement' mechanism (the method for allowing tax-effective streaming), and the 'adjusted Division 6 percentage' (which is activated to the extent that streaming is not undertaken). Most importantly, it is argued that this complexity is unnecessary. A simpler approach is presented based on a proportionate approach on a 'class of income' basis, which allows for streaming without the use of either of these concepts. Compared to the current Subdivision 115-C ITAA97, the suggested alternative approach more closely gives effect to the interest in achieving an alignment between beneficiaries' economic entitlements and their taxable income. Achieving a nexus between

11 The key previous decision that applied the 'proportionate' approach is *Zeta Force Pty Ltd v Commissioner of Taxation* (1998) 98 ATC 4681 (Sundberg J). *Davis v Federal Commissioner of Taxation* (1989) 86 ALR 195 (Hill J) provides a further earlier example.

12 *Bamford* (2010) 240 CLR 481, 507-508 (French CJ, Gummow, Hayne, Heydon and Crennan JJ).

13 See the Explanatory Memorandum to the Tax Laws Amendment (2011 Measures No. 5) Bill 2011 ('EM'), paragraph 2.7. (Amending legislation with the same title as this Bill introduced the streaming regime in Subdivision 115C ITAA97.)

14 Ibid.

15 EM 2.9

16 [2012] FCAFC 84.

17 Ibid [27]-[36] (Edmonds, Greenwood, and Robertson JJ).

18 EM 2.18

economic entitlements and taxable income is of chief interest to the Government,[19] and the judiciary has also recognized that a reasonable match between economic entitlements to trust income and the liability to taxation is a central and entrenched assumption underlying the taxation of trust income under Australian income tax legislation.[20]

2 Scheme for the taxation of trust income and a basis for evaluation

This section will first outline core provisions and concepts that are relevant to the taxation of trusts and will then proceed to provide a basis for evaluating the 2011 amendments.

2.1 General points

Prior to the 2011 amendments, the scheme for the taxation of trust income could be discerned from the provisions of Division 6, Part III of the ITAA36.[21] From the 2010-2011 income year onwards, it is necessary to consider the ITAA97 alongside Division 6 ITAA36 in all cases where a trust (excluding managed investment trusts and certain other widely held trusts[22]) has either capital gains or franked distributions. Division 6E ITAA36 (inserted by the 2011 amendments) stipulates that capital gains and franked distributions are assessed under Subdivision 115-C ITAA97 and Subdivision 207-B ITAA97, respectively. Table 1 in the Appendix to this paper sets out the basic scheme before and after the 2011 amendments.

A trust is not a legal person. Rather, a trust describes a legal relationship recognized in equity where one person (the trustee), as the owner of some specific property, comes under an obligation to deal with that property for the benefit of one or more persons (beneficiaries).[23] The basic principle underlying Division 6 ITAA36 is that income generated by the trust is to be assessed in the hands of the beneficiaries or the trustee, and is ascertained by reference to the 'net income of the trust estate,' which essentially corresponds to the concept of taxable income. It is defined by section 95 ITAA36 to mean assessable income minus allowable deductions,[24] calculated as if the trustee were a resident.

The legislation contemplates that the liability to tax will primarily fall on beneficiaries, and provides disincentives to accumulate income within the trust. In *Bamford*, the High Court began its discussion of Division 6 ITAA36 by noting that section 96 provides that the trustee shall not, except as provided by the legislation, be liable as trustee to pay income tax on the income of the trust estate.[25] The concept of a 'present entitlement' to trust income (discussed below) is critical as penalty rates of tax can be avoided in respect of income to

19 EM 2.7.

20 For detailed support of this point, which traces the legislative history of Division 6 ITAA36, see AH Slater, 'Taxing Trust Income after *Bamford's* case' (2011) 40 *Australian Tax Review* 69, especially at 80-81. (AH Slater QC was Counsel for the taxpayer in the *Bamford* litigation.)

21 While the ITAA97 still needed to be consulted in connection with beneficiaries' capital gains (and grossing this up, where applicable), net capital gains and franked distributions were brought to tax within Division 6 ITAA97.

22 See the EM at 2.16.

23 Lee, Bryan and Glover, *Ford and Lee: The Law of Trusts* (2010, Thomson Reuters, online edition) 1.010. For a detailed judicial analysis of the nature of a trust, see *DKLR Holding Co (No 2) Pty Ltd v Commissioner of Stamp Duties (NSW)* (1980) NSWLR 510, 518-520 (Hope JA).

24 Except for deductions under Div 393 ITAA97 (farm management deposits), and in respect of any beneficiary who has no interest in the corpus of the trust estate, deductions under Division 36 ITAA97 (tax losses).

25 (2010) 240 CLR 481, 502.

which a beneficiary is presently entitled (either pursuant to s97 or s98[26]). A penal rate of tax (the highest individual marginal rate applied as a flat rate) applies under section 99A ITAA36 if there is net income of the trust to which 'no beneficiary is presently entitled,' unless the trust falls into one of the categories (principally testamentary trusts) to which s99A does not apply and 'the Commissioner is of the opinion that it would be unreasonable' to apply the provision,[27] in which case the rates under s99 ITAA36 apply (being the ordinary marginal rates for individuals).

2.2 What was decided in Bamford?

Section 97 ITAA36, the core provision governing the liability of beneficiaries to taxation, and the provision from which the 'proportionate' approach is derived, provides (in s97(1)) that:

> [w]here a beneficiary of a trust estate who is not under any legal disability is presently entitled to *a share of the income of the trust estate* the assessable income of the beneficiary shall include so much of *that share of the net income of the trust estate* … [emphasis added]

In *Bamford*, the High Court confirmed two central propositions regarding the operation of section 97:

Firstly, that the legislative reference in s97(1) to a beneficiary being 'presently entitled to a share of the income of the trust estate' relies on principles of the general law of trusts, and accepted earlier High Court authority to the effect that this entailed a present legal right to demand payment of a share of trust income.[28] The High Court also indicated, consistently with trust law principles, that this meant a share of distributable income, after the trustee had met revenue outgoings.[29]

Secondly, the court concluded, adopting Sundberg J's judgment in *Zeta Force Pty Ltd v Commissioner of Taxation* ('*Zeta Force*'),[30] that a beneficiary's tax liability under s97, i.e., their share of the trust's 'net income of the trust estate' (which is equivalent to the trust's taxable income[31]) corresponds to their percentage or proportionate 'share' of trust distributable income—this being the so-called proportionate approach to the determination of a beneficiary's tax liability under s97.[32] In other words, if a beneficiary is presently to 50% of the trust's distributable income, they will also have a 50% share of the trust's taxable income. The High Court in *Bamford* rejected the contention of the taxpayers that a beneficiary's share of a trust's taxable income would be limited to their trust distribution

26 In certain situations where a beneficiary is presently entitled to trust income (including where a beneficiary is under a legal disability), as an administrative matter, section 98 requires the trustee to pay tax on behalf of the beneficiary (at rates applicable to the beneficiary).

27 s99A(2) ITAA36 provides for this exception.

28 (2010) 240 CLR 481, 505. The principal authority relied on was *Harmer v FCT* (1991) 173 CLR 264.

29 Ibid 506. The Court here relied on the Federal Court's decision in *Federal Commissioner of Taxation v Totledge Pty Ltd* (1982) 60 FLR 149.

30 (1998) 98 ATC 4681, 4686-4687. As noted by AH Slater QC, Counsel for the taxpayer in the *Bamford* litigation, the High Court judgment contains little analysis or discussion of relevant principles, and essentially adopts the position taken in certain previous decisions, particularly *Zeta Force*: see Slater above n 20, 83.

31 Ibid 4685.

32 (2010) 240 CLR 481, 507. For an early exposition of the proportionate approach, see *Davis v Federal Commissioner of Taxation* (1989) 86 ALR 195, 230 (Hill J). On the point that the High Court simply confirmed the existing (consensus) view on the meaning of 'share' in s97 ITAA36, see Alex Evans, 'The economic benefits model for trusts – fool's gold?' (2014) 43 *Australian Tax Review* 162, 164.

amount where the trust deed provided for a fixed monetary amount to the beneficiary (rather than a proportion of trust income).[33]

As a means of obtaining a fuller understanding of the operation of these principles, it is instructive to consider the Federal Court's detailed reasons in the *Bamford* litigation,[34] which were upheld in the High Court. It is noted that the exact ascertainment of the 'income of the trust estate' according to trust law principles (i.e., distributable income) is essential for tax purposes as a beneficiary's percentage share of distributable income under general law principles will first need to be worked out to determine a beneficiary's tax liability (their share of the trust's taxable income). With regard to the general law notion of distributable trust income, Emmett J outlined the key principle of relevance in the law of the trusts, which views the trustee's 'first duty' as being 'to comply with the terms of the instrument governing the relevant trust estate.'[35] Of relevance for present purposes, Emmett J stated that:

> Where the relevant trust instrument expressly stipulates the entitlement of particular beneficiaries by, for example, specifying that receipts that would be for capital account under the general law principles are to be distributed to life tenant beneficiaries, that provision prevails and determines the amount which the respective beneficiaries are entitled to receive.[36]

Accordingly, and importantly, where the trust deed specifies that the trustee has the power to treat capital receipts as income available for distribution, and the trustee distributes such receipts to beneficiaries consistently with the trust deed, beneficiaries are to be treated as presently entitled to those amounts for the purposes of income taxation.[37]

2.3 A basis for evaluation

It is suggested that both the proportionate approach confirmed in *Bamford* and the 2011 amendments can be evaluated against the following three considerations, which have variously been endorsed in court judgments or government statements:

1. The extent to which beneficiaries' economic entitlements correspond with their taxable income;
2. Related to (1): the extent to which there is equity in the relative division of taxable income among beneficiaries;
3. The extent to which streaming intentions are accommodated.

While there is a measure of endorsement for all of these considerations, from a policy perspective, they should not be regarded as ranking equally. The first two considerations are both more important than the third, and it is suggested that the second consideration is more important than the first.

33 (2010) 240 CLR 481, 507-508.
34 *Bamford v Commissioner of Taxation* [2009] FCAFC 66 (Emmett, Stone and Perram JJ).
35 Ibid [52].
36 Ibid.
37 Ibid [58] (Emmett J). Relatedly, in *Forrest v Commissioner of Taxation* [2010] FCAFC 6, the Court emphasised that, even where the trust deed appears to confer an unlimited discretion to characterise receipts, the trustee merely has a power to classify receipts according to law, such that it is not possible for a trustee to classify a receipt as capital when it is ordinary income according to law: [35]-[41] (Spender, Sundberg, McKerracher JJ).

2.3.1 Correspondence between economic entitlements and taxable income

In the Federal Court's decision in *Bamford*, the court reiterated the view expressed in some earlier cases[38] that a central policy objective of Division 6 ITAA36 is to ensure an appropriate relation between beneficiaries' distribution entitlements and their income tax obligations. As Emmett J puts it:

> An important assumption underlying Division 6 is that a beneficiary who derives a share of the net income should be in a position to pay the tax out of that income; otherwise, the beneficiary could be placed in a difficult position … as a general rule, liability for tax on receipts of a trust estate should correspond with the enjoyment of those receipts.[39]

At one extreme, one possibility is perfect correspondence between a beneficiary's entitlement to distributable income and their taxable income under the trust. This notion is reflected in the so-called 'quantum approach,' which posits that a beneficiary's taxable income should be limited to their distribution amount.[40] The 'quantum approach' has been the main theoretical comparator to the proportionate approach, and was considered by Hill J in *Davis v FCT*.[41] While such an approach most clearly gives effect to the interest in ensuring that tax liability is determined by distributable income, it has been held to be unavailable as a matter of statutory construction.[42] Furthermore, as a matter of principle, the quantum approach is not a viable alternative to determining a beneficiary's tax liability. It cannot provide a solution to all situations. When taxable trust income is less than distributable income, a proportionate approach must be used to determine beneficiaries' respective liabilities.[43] Additionally, where a trust tax return is amended by the Commissioner such that trust taxable income is increased or decreased, again, resort to a proportionate approach is needed to determine the parties' share of any further tax liability or refund.

As far as the proportionate approach is concerned, the chief obstacle to meeting the policy objective that the liability for tax corresponds with the enjoyment of trust receipts is caused by discrepancies, in the individual case, between the trust's distributable income and the taxable income of the trust. Where trust distributable income is less than taxable income, the proportionate approach leads to beneficiaries being taxed on amounts they may never be entitled to receive.[44] However, this can be overcome to a significant degree (but not completely) by appropriate trust deed provisions, for example, which provide that capital

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38 E.g., *Richardson v Federal Commissioner of Taxation* (1997) 150 ALR 167, 181 (Merkel J).

39 *Bamford v Commissioner of Taxation* [2009] FCAFC 66 [56]. Generally, on the point that the entrenched assumption of Division 6 is that a beneficiary's economic entitlement and taxable income should be as nearly as possible the same, see Slater, above n 20, 80. See also Evans, above n 32, 171, which in the context of proposals to reform the taxation of trusts, notes strong support in Treasury for the policy position that 'tax liability on income should be allocated to the taxpayer who obtained the economic benefit from it.'

40 This was Merkel J's preferred approach in the situation where trust assessable income exceeded trust distributable income: *Richardson v Federal Commissioner of Taxation* (1997) 150 ALR 167, 183-184. On this approach, Merkel J also noted that the excess of assessable income (over distributable income) would have to be assessed to the trustee under s99A or s99 ITAA36.

41 (1989) 86 ALR 195, 230.

42 Ibid.

43 E.g., Merkel J conceded that a proportionate approach was appropriate here, although preferring a quantum approach where trust distributable income was less than trust assessable income: *Richardson v Federal Commissioner of Taxation* (1997) 150 ALR 167, 181, 183-184.

44 *Davis v FCT* (1989) 86 ALR 195, 230 (Hill J). In *Zeta Force*, Sundberg J also adverted to the potential for unfairness where distributable income is different to (less than) the trust's taxable income: (1998) 98 ATC 4681, 4686.

gains constitute part of distributable income, or more effectively, with 'income equalization' clauses which define distributable trust income as net tax income.[45]

2.3.2 *The extent to which there is equity in the relative division of taxable income among beneficiaries*

Given the potential for differences between trust income and taxable income in individual cases, perfect correspondence between a beneficiary's trust distribution and their share of taxable income is not attainable in many cases. However, what is possible, and arguably the more important consideration, is ensuring fairness in the division of tax liabilities among beneficiaries. Indeed, this is the implicit rationale of the proportionate approach, pursuant to which beneficiaries' percentage share of taxable income reflects their percentage share of distributable income. While not synonymous with economic entitlements, in a setting with multiple beneficiaries, the proportionate approach does ensure an appropriate nexus or relation between economic entitlements and taxable income. It meets the policy objective underlying Division 6 to the extent that it is practically feasible (without having to resort to legislative alteration of the concept of taxable income in the trust setting). The notion that 'liability for tax on receipts' should 'correspond with the enjoyment of those receipts'[46] is given effect insofar as tax liability among beneficiaries corresponds to their proportionate enjoyment of economic receipts.

2.3.3 *The extent to which streaming intentions are accommodated*

Legislative recognition of the trustee's streaming intentions is not so obviously a legitimate interest. An inability to stream particular classes of income does not entail undermining the central policy objective of Division 6 that there ought to be a correspondence between economic entitlements and taxable income. However, it seems to be widely accepted and assumed by the Government and taxpayers that trustees should be able to strategically allocate capital gains (and franked distributions) so that particular beneficiaries can take advantage of the tax consequences associated with such distributions.[47] In the EM to the 2011 amendments, by way of apparent support for the streaming regime, the Government also suggested that provisions in the tax law assume that trust income retains its character when it flows through to beneficiaries.[48] While such a trust 'conduit' theory has been doubted as a general proposition,[49] when the CGT regime was introduced in the 1980s,

45 As to such clauses, see generally, Gaal, n 1, 134. But there will be circumstances where it is not possible to equate the two concepts; e.g., where assessable income includes the market value of a disposed asset (sold for less than market value) or franking credits: see Slater, above n 20, 85.

46 *Bamford v Commissioner of Taxation* [2009] FCAFC 66 [56] (Emmett J).

47 Prior to *Bamford*, the ATO had a practice of allowing trustees to stream capital gains and franked distributions. On this point, see Gaal, n 1, 156.

48 EM 2.8. Relatedly, Glover suggests that '[t]he availability of streaming is arguably an implication from the Anglo-Australian and American "conduit" theory of the trust': John Glover, 'Taxing trust income by "entitlement": The end of the road?' (2014) 43 *Australian Tax Review* 101, 109. However, as indicated in the note immediately below, the so-called trust 'conduit' theory has not been fully observed in Australian tax law.

49 As Dirkis's analysis indicates, *Webb v Syme* (1910) 10 CLR 482, *Syme v Commissioner of Taxes (Vic)* (1914) 18 CLR 519 (Privy Council) and *Charles v Federal Commissioner of Taxation* (1953) 90 CLR 598, which are sometimes cited for a general trust conduit theory, appear to be confined to their specific circumstances: Michael Dirkis 'Humpty Dumpty's Rule: Income Streaming and Trusts' (1995) 5 *Revenue Law Journal* 141, 145-148. To similar effect, see David Schabe, 'The Trust Conduit Principle: A Foundationless Theory?' (1999) 2(4) *Journal of Australian Taxation* 194. Greenhatch, discussed below, is also inconsistent with the notion that a general trust conduit theory applies in Australian tax law.

the relevant EM assumed that the streaming of capital gains was possible in the context of trusts.[50]

As indicated in the EM to the 2011 amendments, a source of dissatisfaction with the proportionate approach is that it has been assumed to imply an inability to allocate or stream particular classes of income with distinct tax consequences (capital gains, franked distributions) to specific beneficiaries.[51] As discussed below, this appears to be the case only in some circumstances.

3 Evaluation of the proportionate approach

The extent to which the proportionate approach meets the above criteria is now examined by considering how it applies to various iterations of a core example. Variations of the same example will be used subsequently when examining the effectiveness of the 2011 amendments.

Core example used in this paper

In a particular income year, a trust has:

- rental income of $100,000
- a capital gain of $110,000 (in some illustrations below, this will be treated as benefiting from the discount for long-term capital gains)
- a carry forward capital loss of $10,000

The trust has two resident beneficiaries, A and B, neither of whom is under a legal disability. The trust deed provides that the trustee may make allocations to A and B as they see fit, but that the balance of any unallocated income is to be divided equally between A and B.

Initially, it is assumed that the trust deed does not include capital gains as part of trust distributable income, but many cases below will consider situations where capital gains are included as part of trust income.

This section first considers the proportionate approach prior to the 2011 amendments. The application of the proportionate approach is evaluated in situations where there are differences, and a correspondence, between trust distributable income and taxable income, and where the trustee purports to undertake streaming. Clarity as to the deficiencies (if any) of the proportionate approach is critical to evaluating the effectiveness of the 2011 amendments. It is shown that the proportionate approach meets the fundamental policy objective of ensuring an appropriate nexus between economic entitlements and taxable income, and that it can accommodate at least some, but not all, cases of streaming. An alternative version of the proportionate approach is then suggested which can fully accommodate streaming intentions.

50 Gaal, above n 1, 72. Putting aside the extent to which the 'conduit' theory is in fact observed, for a useful explanation of the rationale for why flow-through taxation regimes should in principle lead to character retention of amounts as they 'flow through' the vehicle, see Alex Evans, 'The Design Elements of Flow-Through Taxation' (2019) 48 *Australian Tax Review* 42, 45-46.

51 EM 2.7-2.9.

3.1 The application of the proportionate approach prior to the 2011 amendments

3.1.1 Where capital gains do not form part of distributable income

Example 1
The facts are as per the core example provided above. Assume that the trustee resolves to distribute 40% of the trust income to A and 60% to B and that there is no provision in the trust deed which allows the trustee to include capital gains as part of distributable income.

In this example, under general law trust principles, the income of the trust comprises only the rental income (ordinary income) of $100,000. The net income for tax purposes under s95 ITAA36 however is $200,000—that is, $100,000 ordinary income plus the net capital gain of $100,000 ($110,000 capital gain minus the $10,000 carry forward capital loss), which is statutory income assessable pursuant to s102-5 ITAA97. If 40% of the trust income of $100,000 is distributed to A (i.e., $40,000) and 60% to B (i.e., $60,000), according to the proportionate approach these same percentages that apply to distributable income are also used to work out each beneficiary's share of the trust taxable income of $200,000—this would be $80,000 to A (40% of $200,000), and $120,000 to B (60% of $200,000).

Here we can note firstly that there is a fairness in the relative division of tax liability between the beneficiaries (the second mentioned criterion above), being consistent with the ratio of their actual trust receipts (40% for A and 60% for B). There is however an apparent hardship in that the beneficiaries' taxable incomes ($80,000 for A and $120,000 for B) exceed their distributable incomes ($40,000 for A and $60,000 for B). This is not directly a consequence of the proportionate approach as such but lies in discrepancies between the concepts of distributable trust income and taxable income. In this case, where the discrepancy is due to a capital gain, the problem can be overcome by an appropriately drafted provision in the trust deed. This variation is now considered in Example 2.

3.1.2 Where capital gains form part of distributable trust income

In the situation where capital gains are included as part of trust distributable income, the application of the proportionate approach is first considered in the context where the trustee shows no intention to differentially allocate ordinary income and capital gains.

No differential allocation of capital gains and other income

Example 2
The core example is now varied such that the trust deed confers a power upon the trustee to include capital gains as part of trust distributable income, and the trustee proceeds to exercise that power. As in Example 1, the trustee resolves to distribute 40% of trust income to A and 60% to B.

Here the distributable trust income and taxable income are both $200,000 ($100,000 rental income and $100,000 net capital gain), and the distributable incomes and taxable incomes of A and B will be 80,000 (40% of $200,000), and $120,000 (60% of $200,000), respectively. The apparent unfairness in the previous scenario has been eliminated. There is a correspondence between economic entitlements and taxable income, the first interest described in the previous section. It is common for trust deeds to specify that the distributable income of the trust corresponds to the trust's net income for tax purposes.[52] This is often framed as a 'default' provision, which is subject to any contrary determination by the trustee.[53] However, as the Commissioner indicates in tax rulings, it is not always possible for the trust deed to remove discrepancies between distributable trust income and net taxable income (e.g., franking credits are not regarded as part of trust income, even where an income equalization clause in the trust deed purports to define trust income by reference to income tax concepts).[54]

The trustee purports to allocate capital gains on a different basis to other income (i.e., shows an intention to stream)

The next example covers the situation where the trustee purports to distribute the capital gain in a different ratio to the ordinary income (and as in the previous example, the trustee exercises a power to include the capital gain in distributable income). This is where the proportionate approach is assumed to lead to an unsatisfactory outcome in that it does not accommodate the streaming intentions of the trustee.

Example 3
As in the previous examples, the trustee resolves to distribute 40% of the rental income to A ($40,000) and 60% to B ($60,000). However, in this example suppose the trustee distributes the capital gain in a different ratio to the rental income, allocating 70% ($70,000) to A and 30% ($30,000) to B. The trustee's motive for allocating 70% of the capital gain to A is to enable A to utilize a large personal capital loss to offset the capital gain.

The Government and the court in *Greenhatch* assumed that the proportionate approach entails that no effect can be given to the trustee's intention to differentially allocate particular classes of trust income.[55] The way in which the proportionate approach is assumed to apply is now outlined and then this assumed operation is critically evaluated.

Assumed consequence of the proportionate approach

In *Bamford* and earlier decisions, judges have indicated that a beneficiary's percentage share or proportion of total distributable income equates to their percentage share of a trust's total taxable income.[56] However, importantly, the Government has assumed (and apparently, the Federal Court in *Greenhatch*), that a necessary consequence of the proportionate approach is that it does not allow for any differential allocation of particular classes of income for tax purposes.

This assumed operation of s97 ITAA36 to the scenario in Example 3, prior to the 2011 amendments, is as follows. Assuming that the trustee is authorized to include capital gains as part of distributable income, A's share of this distributable income is $110,000 ($40,000 ordinary income plus $70,000 of the capital gain) being 55% of $200,000, and B's share is $90,000 ($60,000 ordinary income plus $30,000 of the capital gain) being 45% of $200,000. Applying the proportionate approach confirmed in *Bamford*, A's share of the trust's taxable

52 TR 2012/D1 [102]. For examples, see at [18]-[58] of this ruling.
53 This was the case on the facts of *Bamford.*
54 TR 2012/D1 [15], [24]-[29]. On this point, see also Slater, above n 20, 85.
55 The most direct judicial consideration of the issue at hand arose in *Greenhatch* [2012] FCAFC 84 [26]-[36] (Edmonds, Greenwood and Robertson JJ). The case concerned the pre-2011 law. Generally, as to the proportionate approach, see *Davis v FCT* (1989) 86 ALR 195, 230 (Hill J); *Zeta Force Pty Ltd v Commissioner of Taxation* (1998) 98 ATC 4681 (Sundberg J).
56 *Bamford* (2010) 240 CLR 481, 507; *Zeta Force* (1998) 98 ATC 4681, 4686-4687 (Sundberg J).

income ($200,000) is also 55% ($110,000) and B's share of the trust's taxable income is also 45% ($90,000). It is the next step now described which is argued to be only an assumed consequence of the proportionate approach: namely the assumption that A's 55% allocation of trust taxable income also entails the same proportionate share (55%) of each component of the trust's taxable income, i.e., 55% of the rental income and 55% of the capital gain. This is the assumption upon which the 2011 amendments proceed.[57] Effectively, the trustee's intention to allocate or stream 70% of the capital gain to A is frustrated. The third criterion noted earlier is not met if this assumed consequence of the proportionate approach is correct (whether this is an inevitable interpretation is considered below).

In *Bamford*, while the High Court confirmed that the proportionate approach applied to determine beneficiaries' allocations of taxable trust income, the facts did not actually illustrate a situation where the trustee purported to stream particular classes of income,[58] and the decision does not directly undermine an ability to stream.[59] However, the stated premise of the 2011 amendments is that the proportionate approach implies an inability to differentially allocate (stream) particular kinds of income for tax purposes.[60] The issue arose for direct consideration in the Federal Court's 2012 decision in *Greenhatch*,[61] which concerned the law prior to the 2011 amendments. Here the trustee exercised a power to include a net capital gain as part of distributable income. The taxpayer beneficiary's share of the net income of the trust for tax purposes was $112,340 (this was not a point of contention). Consistent with the trustee's intention, the taxpayer argued that the entire $112,340 was referable to the trust's net capital gain of approximately $225,000, which was included in the trust's taxable income of $598,564. The Administrative Appeals Tribunal accepted that the entire $112,340 trust amount included in the taxpayer's taxable income was referable to the trust's net capital gain, consistent with the streaming intentions of the trustee, stating that:

> [w]here the terms of the trust allow identification of who is entitled to what, in our view the legislature intended that the taxation treatment follow on a differentiated basis among beneficiaries.[62]

However, this result was overturned by the Federal Court. The court took the view that what the taxpayer received in this case was 'a proportionate share of amounts having no single character,'[63] and held that the taxpayer's taxable capital gain was limited to the fraction that the trust's net capital gain represented of the trust's taxable income, being

57 EM 2.9.

58 In *Bamford*, the proportionate approach became relevant where the taxpayer beneficiaries were entitled to a specific monetary amount under the trust deed with the residue going to a third party (the Church of Scientology). Trust assessable income was greater than that assumed at the time distributions were made (the trustee intended that distributable income match trust taxable income). Purportedly applying the proportionate approach, the Commissioner used the ratio of the beneficiaries' actual distributions to total income actually distributed (18%) to determine their liability upon the further portion of trust assessable income. This approach was accepted by the High Court but the application of the proportionate approach in this manner is arguably flawed because the result accepted by the Court led to a liability that the beneficiaries may not have incurred had the trustee computed the correct assessable income in the first place. See Slater above n 20, 83.

59 On this point, see Graeme Cooper, 'Reforming the Taxation of Trusts: Piecing Together the Mosaic' (2013) 35 *Sydney Law Review* 187, 200-201. As Cooper notes at 200, 'it is hard to see how *Bamford* says anything at all about streaming or character retention.'

60 See 2.8-2.9 EM.

61 *FCT v Greenhatch* [2012] FCAFC 84.

62 *Greenhatch and Commissioner of Taxation* [2011] AATA 479 [65].

63 [2012] FCAFC 84 [31] (Edmonds, Greenwood and Robertson JJ).

37.6% ($225,000 trust net capital gain/$598,564 total trust taxable income). On this basis, the taxpayer's taxable capital gain was $42,240 (37.6% of the taxpayer's $112,340 share of taxable trust income).[64] Without providing a detailed explanation, the court held that this was a necessary consequence of the proportionate approach that governs s 97 ITAA36, and considered that the streaming of capital gains was not possible under Division 6 ITAA36.[65]

The notion that the liability to tax should fall homogenously across different classes of income with distinct tax consequences (capital gains, franked distributions) leads to inconvenient results in practice when they are inconsistent with the intentions of the parties to the trust. Further, this inconvenience is not one that the legislature foresaw or intended. The provisions of Division 6 ITAA36 pre-date the regime that introduced the taxation of capital gains, and as Hill J commented in *Davis v FCT*[66] (in a statement also cited in *Bamford*) 'the scheme of Div 6 calls out for legislative clarification,' especially in light of its interaction with the capital gains regime.[67] Before turning to the 'solution' offered by the 2011 amendments, it is considered whether an inability to stream is an inevitable consequence of the proportionate approach as assumed by, and reflected in, *Greenhatch*.

Is a Different Interpretation Possible? Streaming and the Proportionate Approach

It is submitted that there are situations where steaming intentions could be accommodated under the proportionate approach confirmed in *Bamford*. As shown in the next example, one such situation is where trust distributable income and trust taxable income correspond.

Where trust distributable income equals trust taxable income

Example 4

Returning to the situation considered in Example 3, assume that trust distributable income equals trust taxable income and is $200,000 (with the trustee exercising a power to include capital gains as part of distributable income). Assume the trustee resolves to distribute 40% ($40,000) of the $100,000 rental income and 70% ($70,000) of the $100,000 capital gain to A, which totals $110,000 ($40,000 plus $70,000). The trustee distributes the remaining $90,000 (i.e., $200,000 minus $110,000) of distributable income to B, comprising 60% ($60,000) of the rental income and 30% ($30,000) of the capital gain. The proportionate approach requires that A's 55% ($110,000/$200,000) share of distributable income corresponds to the same percentage share of A's taxable income i.e., 55%. But this does not have to mean that A's proportionate share of the capital gain must be 55% or $55,000 (0.55 x $100,000). It *could* be held that A's $110,000 of taxable income comprises rental income of $40,000 and a capital gain of $70,000, consistent with the intention of the trustee.

With reference to this example, while the Government and the court in *Greenhatch* have assumed that the proportionate approach implies that A's percentage share of the capital gain correspond with their global percentage share of trust taxable income and be 55% ($55,000), this does not automatically follow. In *Bamford*, the High Court confirmed only that a beneficiary's percentage share of trust taxable income should correspond with their percentage share of trust distributable income. Here, to abide by the proportionate approach

64 Put another way, as the taxpayer was entitled to approximately 18.8% of the trust's distributable income, it was held that they were also entitled to 18.8% of the trust's net capital gain of $225,000: ibid [11].

65 Ibid [36].

66 (1989) 86 ALR 195.

67 Ibid 230.

(in a global sense), it is not necessary that A's proportionate share of distributable income also determine A's proportionate share of specific classes of income. In other words, where a trust's distributable income equals its taxable income, streaming can be accommodated while respecting the central tenet of the proportionate approach as confirmed in *Bamford*. Here, pursuant to the suggested allocation, A's share of total trust taxable income is 55%, which corresponds to their same percentage share of total distributable income (also 55%), but streaming is also accommodated with individual classes of income being allocated on a differential basis.

Where trust distributable income differs from taxable income

However, in the situation where trust distributable income and taxable income differ, it is not readily possible to abide both by the proportionate approach and fully accommodate streaming intentions.

Example 5

Suppose again that trust distributable income consists of $100,000 rental income and a $100,000 capital gain (after subtracting the capital loss). But assume that the 50% CGT discount applies to reduce the taxable capital gain to $50,000 such that taxable trust income is $150,000. As before, assume the trustee resolves to distribute 70% ($70,000) of the distributable capital gain to A and 30% ($30,000) to B, with the rental income being distributed 40% ($40,000) to A and 60% ($60,000) to B.

Here, A's and B's percentage shares of distributable income are 55% ($110,000) and 45% ($90,000), respectively, as before. To abide by the proportionate approach accepted in *Bamford*, taxable trust income must be split between A and B according to a ratio 55:45, consistent with their shares of distributable trust income: accordingly, their shares of trust taxable income are $82,500 (55% x $150,000) and $67,500 (45% x $150,000), respectively. Consistent with the trustee's streaming intentions, if we were to attribute 70% of the trust's taxable (net) capital gain to A, A's share of taxable income of $82,500 contains a capital gain component of $35,000 (70% x $50,000 trust net capital gain) and B's taxable income of $67,500 contains a capital gain component of $15,000 (30% x $50,000 trust net capital gain). Here we have abided by the proportionate approach (i.e., beneficiaries' percentage share of taxable income corresponds to their percentage share of distributable income) and given effect to the trustee's streaming intentions. However, because of the non-correspondence between trust taxable income and trust distributable income, the remainder of taxable income attributable to rent is split 47.5% to A[68] and 52.5% to B,[69] and not 40:60 as intended. In this particular case, while the parties may only be concerned with whether streaming intentions are respected for the net capital gain (which carries specific tax consequences), it is nonetheless the case that the trustee's intention to differentially allocate particular classes of income cannot be fully given effect (while abiding by the proportionate approach), and this will present a practical problem where it is important that two different categories of income are streamed because of their specific tax consequences (e.g., net capital gains and franked dividends). In this particular example, where the discrepancy between trust distributable income and taxable income is due to the CGT discount, it can be overcome through a trust deed provision that equates

68 A's total taxable trust income is $82,500 from above, and after subtracting $35,000 attributable to A's share of the taxable capital gain, this leaves $47,500 which is 47.5% of the rental income of $100,000.

69 B's total taxable trust income is $67,500 from above, and after subtracting $15,000 attributable to B's share of the taxable capital gain, this leaves $52,500 which is 52.5% of the rental income of $100,000.

distributable income with net tax income, and as noted above, streaming can then be theoretically accommodated.

However, as also noted earlier, there will be situations where it not possible, as a matter of law, to equate the two concepts. Accordingly, it is concluded that the proportionate approach confirmed in *Bamford* (pursuant to which a beneficiary's percentage share of distributable income determines their percentage share of trust taxable income) cannot be reconciled fully with streaming intentions. Before turning to the 'solution' offered by the 2011 amendments, it is now considered whether a different conceptualization of the proportionate approach is possible, which would consistently give effect to streaming intentions.

3.2 A different version of the proportionate approach – 'class of income' basis

As noted earlier, section 97(1) ITAA36 provides that where a beneficiary is 'presently entitled' to '*a share of the income of the trust estate* the assessable income of the beneficiary shall include so much of *that share of the net income of the trust estate*.' (emphasis added) In *Bamford* and earlier court decisions, judges have conceptualized the proportionate approach as referable to a beneficiary's percentage share of total distributable income, which is then used to determine a beneficiary's percentage share of total trust taxable income. This conceptualization appears to represent quite a literal interpretation of the statutory language. Here, a different version of the proportionate approach is suggested, which substantially gives effect to the judicially recognized principle underlying Division 6 ITAA36 that there should be an appropriate nexus between economic entitlements and taxable income.

A proportionate approach *per se* is not unreasonable—indeed, the basic idea that the extent of tax liability should vary in accordance with economic entitlements is both fair and consistent with the central assumption of both Division 6 ITAA36 and key aspects of the income tax legislation (e.g., the progressive rates for the taxation of individuals). However, if a proportionate approach is to be adopted, it should not be applied to total distributable income, but *differentially to distinct classes of income* if the trustee has shown an intention to allocate particular classes of income in different proportions. In practice, it is expected that this would only arise where income has specific tax consequences as in the case of capital gains and franked dividends.[70] For example, if the trustee has shown an intention to stream 70% of a capital gain to a particular beneficiary, that beneficiary is allocated 70% of the trust's taxable capital gain. Pursuant to this approach, the balance income in respect of which streaming intentions have not been expressed is treated as a single class, to which the proportionate approach also applies. The suggested approach is now illustrated by showing its application to the same scenario considered in the previous example where distributable income differs from taxable income.

70 As Boccabella (above n 1, 135) outlines, depending on the 'tax profile of beneficiaries,' there may also be strategic reasons to stream foreign source income and interest income (as differential tax treatment applies depending on whether the beneficiary is an Australian or foreign resident).

The fourth and sixth columns (shaded grey) of the table below show the suggested division of taxable income between A and B where the trustee resolves to distribute 70% of the capital gain to A and 30% to B, with the balance income divided 40:60 as per the trustee's resolution.

	Trust income	**Trust taxable income**	**A's distribution**	**A's taxable income**	**B's distrbution**	**B's taxable income**
Capital gain	$100,000	$50,000	$70,000 (70%)	$35,000 (70%)	$30,000 (30%)	$15,000 (30%)
Other income (rent)	$100,000	$100,000	$40,000 (40%)	$40,000 (40%)	$60,000 (60%)	$60,000 (60%)
Total	$200,000	$150,000	$110,000	$75,000	$90,000	$75,000

For each of A and B, their percentage share of the taxable (discountable) capital gain and other (rental) income equals their percentage share of the distributed amount of the capital gain and other income, respectively. For example, A has 70% of the distributed amount of the capital gain and a 70% share of the taxable capital gain. This would seem to be the division that gives effect to the trustee's intentions. Under this approach, the total taxable amounts for each beneficiary are different compared to applying the proportionate approach in a global sense. Here A has $75,000 of taxable trust income whereas, as noted earlier, A had $82,500 pursuant to the proportionate approach upheld in *Bamford*, which requires that a beneficiary's percentage share of trust taxable income correspond to their percentage share of total trust distributable income. Here, while receiving 55% of trust distributable income ($110,000/$200,000), A's percentage share of taxable income is 50% ($75,000/$150,000)—this outcome reflects the trustee's streaming intentions insofar as the trustee has shown an intention to allocate tax advantages to A. A proportionate approach of this kind is essentially reflected in the 2011 amendments in Subdivision 115-C, but the regime unnecessarily resorts to immense complexity, and certain elements of the approach in the legislation create anomalies.

4 Does the streaming regime introduced in 2011 offer an effective solution?

Following a consultation with relevant stakeholders, amendments to the taxation of trusts were introduced in March 2011.[71] The provisions are effective from the 2010-2011 income year onwards. In the Explanatory Memorandum, the Government makes clear that the amendments are a response to *Bamford*, and states that their 'primary purpose' is 'to ensure that, where permitted by the trust deed, the streaming of capital gains and franked distributions to beneficiaries is effective for tax purposes.'[72] The relevant provisions are described as 'interim changes to improve the taxation of trusts,'[73] and are intended to be re-examined following a broader review of the taxation of trusts (which has not occurred to date). While stating that the amendments do not resolve all 'problems' and 'uncertainties'

71 The changes were affected pursuant to the *Tax Laws Amendment (2011 Measures No. 5) Act 2011*.
72 EM 2.25.
73 This is the title to Chapter 2 of the EM which describes the relevant changes.

(these being unidentified), the Government expressed the view that the amendments 'address key anomalous outcomes' and 'provide certainty in relation to the streaming of capital gains and franked distributions.'[74] The provisions are complex, and a significant time commitment is required grasp the way in which the streaming regime operates, and the way in which the amendments have changed the law.[75]

Division 6 ITAA36 remains of central importance, and is the starting point when considering the taxation of trusts. If the trust does not have any capital gains or franked distributions in an income year, it is only Division 6 that is relevant; the 'net income of the trust' (as defined in s95 ITAA36) is determined as it was prior to the 2011 amendments, and taxed in the hands of beneficiaries or the trustee as the case may be pursuant to relevant provisions, particularly s97, s98, s99A and s99 ITAA36. If the trust does have a net capital gain[76] or franked distribution in an income year (since 2010-2011), and provided the trust has positive taxable income, the amendments are relevant. Division 6E ITAA36 (inserted by the amendments) modifies the operation of Division 6 by excluding capital gains, franked distributions and franking credits from the assessing provisions in Division 6 ITAA36,[77] and these categories are instead assessed under Subdivision 115-C ITAA97 (net capital gains)[78] or Subdivision 207-B ITAA97 (franked distributions). And despite that the main purpose of Subdivision 115-C ITAA97 is to allow for the streaming of capital gains, the approach of the legislation is to assess beneficiaries in respect of net capital gains under Subdivision 115-C, whether or not streaming has been undertaken by the trustee.

4.1 Outline of key concepts

Two concepts are central to the streaming regime:

1. Specific entitlement – the legislative term that describes when streaming is effective for tax purposes; and
2. The 'adjusted Division 6 percentage' – this is a formula that allocates capital gains and franked distributions to which no beneficiary (or the trustee) is specifically entitled.[79] Here, the focus will only be on capital gains.

These key concepts feed into the core provision in section 115-227 ITAA97, which provides that a beneficiary's (or trustee's) 'share' of a capital gain is the sum of the amount of the capital gain to which they are specifically entitled as per (1) above plus their proportionate share of any capital gain to which no entity is specifically entitled, which is calculated using

74 EM 2.18.

75 For useful guidance, see Gaal, above n 1, Chapter 4, especially at 4-480. Some guidance is provided by the 'simplified outline' in s 95AAA ITAA36 of the relationship between Division 6, Division 6E ITAA36 and Subdivisions 115-C and 207-B ITAA97.

76 That is, after applying steps 1-4 of the method statement in s102-5 ITAA97 (i.e. offsetting capital losses, applying applicable CGT discounts): s 102UW (b)(i) ITAA36.

77 Specifically, as stated in section 95AAA ITAA36, Division 6E excludes amounts relevant to capital gains, franked distributions and franking credits 'from the calculations of assessable amounts under sections 97, 98, 99, 99A and 100'.

78 See section 95AAA ITAA36; see also EM 2.26. However, with respect to trustee assessments in respect of net capital gains, Subdivision 115-C ITAA97 (in s115-222 and s115-220) directs the assessment back to s99A or s 99 (where there is trust income to which no beneficiary is presently entitled, or where the trustee has a specific entitlement amount pursuant to s115-230 ITAA97) or s98 (i.e., in a situation where the trustee pays tax on behalf of the beneficiary).

79 Section 115-227(b) ITAA97 is the provision which specifies that the adjusted Division 6 percentage (defined in s 95 ITAA36) applies in respect of capital gains and franked distributions that are not the subject of specific entitlement.

the 'adjusted Division 6 percentage' as per (2) above.[80] As will be shown, only one of these concepts may be relevant in an individual case and they are both relevant where partial streaming is undertaken.

A brief description of these concepts is provided before undertaking a critical examination of their operation.

4.1.1 Streaming – Specific Entitlement

Pursuant to s115-228(1) ITAA97, a beneficiary has a 'specific entitlement' to some or all of a capital gain where the beneficiary 'has received or can reasonably be expected to receive' part or all of the net financial benefit referable to the capital gain, and where the amount 'is recorded, in its character as referable to the capital gain' in the accounts or records of the trust no later than two months from the end of the income year.[81] Clear evidence of an intention to make a beneficiary presently entitled to a capital gain (or part thereof) is sufficient for the purposes of 'specific entitlement.'[82] However, somewhat counter-intuitively, it is possible to make a beneficiary specifically entitled to a capital gain even when capital gains are not part of the distributable income of the trust[83] provided that the trust deed allows the trustee to stream capital gains.[84]

The legislative formula in s115-228(1) ITAA97 for calculating specific entitlement is as follows:

> Capital gain x share of net financial benefit/net financial benefit

As per the core example used in this paper, suppose a $110,000 capital gain is made from the sale of a trust asset, where there is a $10,000 carry forward capital loss that can be applied to reduce the capital gain. The trustee declares that a particular beneficiary is entitled to $70,000 of the capital gain. Here the beneficiary's specific entitlement is as follows:

> $110,000 (capital gain) x $70,000 (share of net financial benefit) /$100,000 (net financial benefit, i.e. after subtracting the capital loss) = $77,000.[85]

As can be seen, the legislative formula calculates specific entitlements by reference to the gross capital gain. This step is later reversed when the beneficiary's taxable capital gain is computed. As will be shown, this two-step process is not necessary and specific entitlements could be calculated directly by reference to the taxable capital gain.

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80 As will be outlined when relevant, a beneficiary's 'share' of the capital gain (represented by the sum of any specific entitlement and the amount obtained by applying the adjusted Division 6 percentage), which is expressed in terms of the trust's gross capital gain, is then used to compute a beneficiary's 'attributable gain' pursuant to s115-225 ITAA97, which is based on the trust's net capital gain. Following this process, the remaining provision to be considered is s115-215 ITAA97, which requires beneficiaries to reverse or 'gross up' the effect of any CGT discounts applied at the trust level. Personal capital losses can then be applied, and if available (as in the case of individuals), the CGT discount can then be claimed.

81 Where proceeds relating to a capital gain have not been applied to a beneficiary within 2 months of the end of the income year, it is possible for a trustee to be specifically entitled to a capital gain under s115-230 ITAA97. If the trustee is specifically entitled, the assessment occurs pursuant to s 99A or s 99 ITAA36.

82 EM 2.45

83 See example 2.8 in the EM.

84 EM 2.35.

85 A similar example is shown in ATO webpages: https://www.ato.gov.au/General/Trusts/In-detail/Distributions/Streaming-trust-capital-gains-and-franked-distributions/?page=9

4.1.2 The Adjusted Division 6 Percentage

As noted above, the 'adjusted Division 6 percentage' is the formula prescribed for allocating capital gains that are not the subject of specific entitlement. Broadly, this is allocated based on beneficiaries' present entitlements to trust income (disregarding specific entitlements). If there is trust income to which no beneficiary is presently entitled, then the trustee has an adjusted Division 6 percentage,[86] and will be liable to tax (under s 99A or s 99 ITAA36).[87] The 'adjusted Division 6 percentage' is central to the operation of subdivision 115-C ITAA97, but its definition is contained in s 95 ITAA36. It is to be contrasted with the 'Division 6 percentage,' also defined in s 95. Both of these terms were introduced by the 2011 amendments.

It is appropriate to begin with the 'Division 6 percentage.' This is defined under s 95 ITAA36 to mean the percentage share of the income of the trust estate to which a beneficiary is presently entitled. It can be expressed as follows:

Beneficiary's share of trust distributable income / Total trust distributable income

It is apparent that this is the key input under the proportionate approach confirmed in *Bamford*, being a beneficiary's percentage share of distributable income, which (pursuant to the proportionate approach) is also treated as corresponding to a beneficiary's percentage share of trust taxable income. Since the 2011 amendments, the proportionate approach has direct and continuing relevance insofar as it is applied to calculate the tax liability of beneficiaries under Division 6 ITAA36 in respect of income excluding capital gains and franked distributions. Curiously and confusingly, while the Division 6 percentage is defined as described in s 95 ITAA36, it is not explicitly referred to in other provisions as a basis for calculations. Its main purpose appears to be as a conceptual construct—which is used to define the 'adjusted Division 6 percentage,' which is used in calculations, as now outlined.

The 'adjusted Division 6' percentage varies the Division 6 percentage by creating a default allocation that disregards specific entitlements (if applicable) as shown below. The formula (defined in s95 ITAA36) is as follows:

$$\frac{\text{Beneficiary's share of trust distributable income – their specific entitlement (if any)}}{\text{Trust distributable income – all specific entitlements (if applicable)}}$$

As the following sections outline, there are several problems with the adjusted Division 6 percentage: its scope of operation is too wide, it gives rise to certain anomalies and sub-optimal outcomes, and also creates unnecessary complexity.

4.2 How has the application of the 'proportionate approach' changed? An analysis of the application of the specific entitlement and 'adjusted division 6 percentage' concepts.

As summarized in Table 2 in the Appendix, the basic philosophy of the regime is that streaming intentions trump the assumed consequences of the proportionate approach, but the proportionate approach applies, or essentially applies, to the extent that there is no streaming.

86 See the EM 2.65.
87 See the EM 2.82.

As a means of analysing how the application of the proportionate approach has changed pursuant to Subdivision 115-C ITAA97, and critically evaluating the central concepts underpinning the streaming regime, it is useful to analyse tax consequences by considering situations where:

i. the capital gain is fully streamed: where only the concept of specific entitlement is relevant;
ii. where the trustee does not undertake any streaming at all: where curiously, the adjusted Division 6 percentage is the basis for allocation of the net capital gain, although it is not needed and produces exactly the same results as the proportionate approach pre-2011;
iii. only part of a capital gain is streamed, where both the concepts of specific entitlement and the adjusted Division 6 percentage apply: the legislative process here is immensely (and unnecessarily) complex and is also associated with outcomes that lack a sound rationale.

The application of Subdivision 115-C to these three categories in situations where capital gains form part of trust distributable income and when they do not is now considered, and a comparison with the previous law is also undertaken. Despite the deficiencies with Subdivision 115-C ITAA97, as noted below, there is one clear benefit compared to the previous law, insofar as penalty rates of tax pursuant to s 99A ITAA95 can be more easily avoided.

4.2.1 The trustee undertakes streaming (entirely) – only specific entitlement concept relevant

In the situation where the trustee fully streams the capital gain, the legislation achieves its objective of enabling streaming, but as argued below, the process is unnecessarily complex.

Capital gains included in trust income

> **Example 6**
> Continuing with the same basic scenario, in this example the trustee allocates the capital gain of $100,000 (which is here assumed to be included as part of distributable income under the deed) as follows: 70% ($70,000) to A and 30% ($30,000) to B, whereas the other (rental) income of $100,000 is distributed 40% ($40,000) to A and 60% ($60,000) to B. Note that the capital gain is fully streamed (there is no capital gain to which no beneficiary is specifically entitled). In this example, assume the capital gain is discountable such that the trust net capital gain is $50,000.

As noted above, under the pre-2011 law, neither the Government nor the Federal Court in *Greenhatch* considered that distinct classes of income could be allocated differently for tax purposes because of the proportionate approach, which was confirmed to apply to s 97 ITAA36 in *Bamford*. The current law removes the perceived impediment to streaming through the mechanism of creating ‘specific entitlements.’ However, a major source of complexity is that specific entitlements (as per the formula stated earlier) are created by reference to the gross capital gain amount.

In this example, where the trustee resolves that A is entitled to $70,000 of the capital gain and that B is entitled to $30,000, the specific entitlement formula must be applied as follows:

For A:	**For B:**
$110,000 (gross capital gain) x $70,000 (share of net financial benefit)/$100,000 (net financial benefit): - A's specific entitlement: $77,000	$110,000 (gross capital gain) x $30,000 (share of net financial benefit)/$100,000 (net financial benefit): - B's specific entitlement: $33,000

Then these specific entitlements are expressed as a fraction of the gross capital gain to give each party's percentage 'share' of the gross capital gain (pursuant to s115-227 ITAA97), which is then multiplied by the trust's net capital gain (here discountable) to give each party's 'attributable gain' (pursuant to s115-225 ITAA97).

For each of A and B the process is as follows:

For A:	**For B:**
A's specific entitlement ($77,000) expressed as a percentage of the gross capital gain ($110,000) gives a 70% share of the gross capital gain • then this 70% is multiplied by the trust's net capital gain of $50,000 to give A a $35,000 attributed part of the taxable capital gain.	B's specific entitlement ($33,000) expressed as a percentage of the gross capital gain ($110,000) gives a 30% share of the gross capital gain • then this 30% is multiplied by the trust's net capital gain of $50,000 to give B a $15,000 attributed part of the taxable capital gain.

A simplified approach is now suggested.

Suggested Improvement

The trustee's streaming intentions can be realized simply by applying the proportionate approach on a 'class of income' basis (outlined earlier), without calculating specific entitlements by reference to gross amounts. The suggested process is as follows:

For A:	**For B:**
As A has been allocated 70% of the trust distributable capital gain, by applying a proportionate approach on a class of income basis this translates to 70% of the trust's net capital gain of $50,000, and A's share is $35,000.	As B has been allocated 30% of the trust distributable capital gain, by applying a proportionate approach on a class of income basis this translates to 30% of the trust's net capital gain of $50,000, and B's share is $15,000.

Compared to the legislative process, the same outcome is achieved in one step rather than two. As shown later, even greater improvements are possible in the case of partial streaming.

Where capital gains not included in trust income - advantages compared to the pre-2011 law

Even in the situation where the trust deed does not specify that capital gains can be included as part of trust distributable income,[88] the legislation allows for specific entitlements to be created in respect of capital gains.[89] The trustee could, consistently with Subdivision 115-C ITAA97, take steps to ensure that capital gain amounts become the subject of specific entitlement to beneficiaries. Importantly, under s 115-228(1) ITAA97, an effective specific entitlement in respect of a capital gain only arises if the relevant allocation proceeds 'in accordance with the terms of the trust,' and s 115-228(2)(a) further provides that 'something is done in accordance with the terms of the trust' if it is done in accordance with 'the exercise of a power conferred by the terms of the trust.'[90] Accordingly, as emphasized by Gaal, in practice this means that effective specific entitlements can only be created if the trustee has an adequate power to distribute capital gains under the relevant trust deed (albeit that capital gains are not included in the income of the trust estate).[91]

Compared to the pre-2011 law, the current law confers a definite advantage insofar as it enables the trustee to pass on the tax consequences associated with capital gains to beneficiaries *even if capital gains are not part of trust income.*

Example 7

Continuing with the same basic scenario, assume that a trust has rental income of $100,000 and a capital gain of $100,000 (assumed to be discountable here). Trust taxable income is $150,000 comprising the rental income of $100,000 plus the net capital gain of $50,000. But assume here that trust income under the general law is only $100,000 as capital gains are not included as part of trust income under the deed.

The trustee resolves to allocate the rental income 40:60 between A and B as before. The trust deed enables the trustee to stream capital gains. Again assume there are strategic reasons for allocating a greater share of the capital gain to A, such that the trustee allocates 70% of the capital gain to A and 30% to B as before. A's economic entitlement to what might be termed the trust 'proceeds' is then $110,000 ($40,000 share of rental income plus a $70,000 share of the distributed capital gain). B's economic entitlement to trust proceeds is $90,000 ($60,000 share of rental income plus a $30,000 share of the distributed capital gain).

An advantage conferred by Subdivision 115-C ITAA97 here (compared to the previous law) is that it easily allows a trustee to strategically allocate capital gains among beneficiaries for tax purposes. In this example, once the trustee has streamed $70,000 of the capital gain to A, this is also effective for tax purposes in the sense that A can recognize a $70,000

88 For example, as pointed out in 2.169 of the EM, where a trust deed does not define 'income', trust distributable income would take its ordinary meaning under trusts law and would not include capital gains.

89 This is made clear in the EM, which states at 2.87 that a beneficiary who receives (or is reasonably expected to receive) amounts referable to capital gains will be assessed in respect of those capital gains, and that '[i]t does not matter whether all or part of that amount is part of the income of the trust estate'. Several examples (referred to below) in the EM also show the application of the specific entitlement mechanism to situations where capital gains are not included in the income of the trust estate.

90 In addition, it is noted that s115-228(2) also provides (in para (b)) that something is done 'in accordance with the terms of the trust' if it is in accordance with both the terms of an applicable trust deed and 'terms applicable to the trust because of the operation of legislation, the common law or the rules of equity'.

91 Gaal, above n 1, 13 and 82. To similar effect, see the EM at 2.35.

(grossed-up) capital gain at the individual level which can be offset by A's personal capital losses.[92]

By comparison, under the pre-2011 law, the trustee did not readily have the flexibility to determine the relative division of the taxable capital gain among the beneficiaries. According to the assumed operation of the proportionate approach, the beneficiaries' respective shares of the taxable capital gain were determined by their percentage shares of distributable trust income: in the scenario above (under the pre-2011 law), with respect to the $50,000 net capital gain, A would have been attributed $20,000 (40% of $50,000 trust net capital gain; $40,000 grossed up) and B would have been attributed $30,000 (60% of $50,000 trust net capital gain; $60,000 grossed up), corresponding to the percentage shares applicable to distributable trust income (the rental income). While the trustee could have made a capital distribution (if permitted by the trust deed) to financially assist the beneficiaries in meeting their tax liabilities, this action did not affect their tax liability upon capital gains, which was determined entirely by their proportionate entitlements to trust distributable income. Through a convoluted process, there would still have been some scope to strategically ensure that capital gains were allocated to a particular beneficiary; this was only through the mechanism of setting the proportionate entitlement to trust distributable income at the same percentage which was considered optimal for the capital gain e.g., under the pre-2011 law, to ensure that 70% of the capital gain was attributed to A for tax purposes, this could only have been done by the trustee also allocating 70% of trust distributable (rental) income to A. The current law is a definite improvement with the trustee being able to directly allocate the desired quantum of capital gains to beneficiaries for tax purposes (via the specific entitlement mechanism), without any constraint that this correspond to proportionate entitlements to trust distributable income.

As shown in the example below, the current law achieves a significant advantage compared to the pre-2011 law in the situation where trust taxable income consists only of a net capital gain and trust income (under the deed) does not include capital gains.

Advantage where trust's only taxable income consists of a net capital gain.

Example 8

Now suppose that the trust has no rental income, but has a $100,000 capital gain (after subtracting a $10,000 capital loss), which is further reduced by the 50% discount, leaving a $50,000 net capital gain for tax purposes. The trust deed contains no definition of income and therefore there is no trust income under the general law. Assume the trust deed enables the trustee to stream capital gains.

The specific entitlement mechanism in Subdivision 115-C will be very useful here where the trust has positive taxable income (a net capital gain) but no trust income under the general law. Prior to 2011, the trust faced the prospect of penalty rates of tax under s 99A ITAA36 here—since it was necessarily not possible to make beneficiaries presently entitled to any trust income (in the situation where the trust deed did not include capital gains

92 Example 7 in the text follows the same process as examples in the EM to the 2011 amendments at 2.88 to 2.91 (Example 2.8, and also Examples 2.9 and 2.10, which are related) in the materially identical setting where capital gains are not included in the income of the trust estate but the trustee streams capital gains to beneficiaries in exercise of a streaming power in the deed. The EM makes clear through these examples that a trustee's streaming intentions in respect of capital gains are given effect for tax purposes (even where capital gains are not included in trust income under the deed). This is also illustrated in the more complex example at 2.169 of the EM where capital gains are not included in trust income (Example 2.27), which is relied on in Gaal, above n 1, 256-257.

as income).[93] Since 2011, this undesirable consequence can be avoided by invoking the specific entitlement procedure. If the trustee chooses to exercise the streaming power in the trust deed to distribute $70,000 of the $100,000 distributable capital gain to A (70%) and $30,000 to B (30%), then as a result of the application of the specific entitlement formula in Subdivision 115-C ITAA97 (outlined earlier), the beneficiaries' shares of the taxable capital gain are computed in accordance with their proportionate entitlements to the streamed capital gain, and are $35,000 and $15,000 for A and B, respectively.

4.2.2 Trustee does not undertake streaming — adjusted Division 6 percentage applies – but outcomes are the same as the proportionate approach

Where the trustee does not undertake streaming of a capital gain, the same outcomes are achieved as under the proportionate approach (as the 2011 EM acknowledges[94]), but the legislation still analyses the situation using streaming regime concepts – the 'adjusted Division 6 percentage' is utilized when it is not needed, adding unnecessary complexity to the law.

Capital gains are part of trust income

Example 9

The basic scenario is as considered earlier, where a trust has $100,000 rental income and a $100,000 capital gain (after reducing by a $10,000 capital loss). Here the $100,000 capital gain is assumed to be included in distributable income under the trust deed i.e., the distributable income of the trust estate comprises $200,000. Suppose the trustee declares that 40% of trust income is to be distributed to A ($80,000) and 60% to B ($120,000). Here, assume that the 50% CGT discount applies to the capital gain so that the trust's total taxable income is $150,000 (i.e., a $50,000 net capital gain plus $100,000 rental income). Assume the trustee has made no attempt to stream any part of the capital gain (i.e., there are no specific entitlements).

Here the assessable amounts will be the same as the pre-2011 law *but the relevant process and provisions are different*.[95] Division 6E ITAA36 takes the net capital gain out of the assessing provisions of Division 6 (which only assesses the other (rental) income). The net capital gain is assessed under Subdivision 115-C ITAA97. The adjusted Division 6 percentage is used to determine each beneficiary's proportionate share of the capital gain to which no beneficiary is specifically entitled. Here, application of the formula yields the same results as the proportionate approach confirmed in *Bamford*, as there are no specific entitlements at all.

For example, for A:

$$\frac{\text{\$80,000 (A's present entitlement to trust income)} - 0 \text{ (A has no specific entitlement)}}{\text{\$200,000 (total distributable income)} - 0 \text{ (no beneficiary has any specific entitlements)}}$$

i.e., this is $80,000/$200,000, which is 40%, and is applied to the net capital gain of $50,000 to obtain the part of the capital gain attributed to A, which is $20,000 (40% x $50,000). Applying the same formula, B's share is $30,000. Combining each beneficiary's Division 6 amount with their assessable capital gain under Subdivision 115-C gives $60,000 for A

93 On this point, see Gaal, above n 1, 54.
94 See the EM at 2.2 and 2.29.
95 See the EM 2.29.

($40,000 rental income and a $20,000 capital gain) and $90,000 for B ($60,000 rental income and a $30,000 capital gain)—being the same results as under the pre-2011 proportionate approach.[96] The use of the adjusted Division 6 mechanism in situations where no streaming has been undertaken introduces unnecessary complexity into the law. It is quite artificial to view this scenario through the lens of 'specific entitlement', since there is necessarily a complete absence of specific entitlement in this situation (zero will always be inputted into the formula for specific entitlement where the trustee has not undertaken streaming).

If capital gains are not part of trust income

Example 10
Continuing with the same basic scenario, assume that the trust has rental income of $100,000 and a capital gain of $100,000 (after subtracting the capital loss) but that the trust deed does not define income, such that pursuant to ordinary trust law principles, the capital gain is not part of the distributable income of the trust. The trust's total distributable income comprises the rental income of $100,000. The trustee resolves to distribute 40% of the trust's income ($40,000) to A and 60% to B ($60,000).

Here A and B will be liable to tax on the trust's net capital gain in accordance with their proportionate entitlements to distributable trust income (here rental income) and the result is again the same as the pre-2011 law, although the basis of assessment is Subdivision 115-C ITAA97,[97] with the adjusted Division 6 formula being used to allocate the net capital gain as follows:

For A:	**For B:**
$40,000 (A's present entitlement to trust income) – 0 (A has no specific entitlement)	$60,000 (B's present entitlement to trust income) – 0 (B has no specific entitlement)
$100,000 (total distributable income) - 0 (no specific entitlements)	$100,000 (total distributable income) - 0 (no specific entitlements)
= 40%	= 60%

As in the previous example, A's total trust taxable income is $60,000 ($40,000 share of rental income and $20,000 share of net capital gain) and B's taxable income is $90,000 ($60,000 share of rental income and $30,000 share of the net capital gain). Here, the taxable income for each exceeds their distributable trust income (from above, $40,000 for A and $60,000 for B) but as noted with respect to the previous law, the apparent hardship of beneficiaries facing a tax liability in respect of income that they will not receive can be overcome by including capital gains as part of trust income under the relevant deed. Again, the main critique point here is the artificiality of having to utilize the adjusted Division 6 percentage formula, which relies on the concept of specific entitlement, to allocate the capital gain among beneficiaries when there are no specific entitlements at all. The application of Subdivision 115-C ITAA97 here leads to exactly the same results as the proportionate approach confirmed in *Bamford*.

96 See TR 2012/D1 Example 4 at para 36 for a longer example which is materially similar.
97 See Gaal, above n1, 238 (Example 1) for a further example which is similar in key respects (the trust contains no definition of income such that capital gains are not included in trust income, the trust has positive income which is fully distributed, and there is a net capital gain which is not the subject of streaming).

4.2.3 Partial streaming: the interaction of specific entitlement and the adjusted Division 6 percentage[98]

When only part of the capital gain is streamed, both the specific entitlement and the adjusted Division 6 percentage concepts are required to calculate beneficiaries' attributable portion of the trust's net capital gain. The process is immensely and unnecessarily complex, and the actual allocation that results from the legislative process also lacks a sound rationale, particularly in the case where capital gains are not included in trust distributable income. The legislative steps[99] are as follows:

1. Apply the specific entitlement formula to determine specific entitlements of any parties to the gross capital gain;
2. Subtract the total specific entitlement(s) from the gross capital gain to leave the gross capital gain to which no beneficiary is specifically entitled;
3. Use the adjusted Division 6 percentage formula to work out the parties' proportionate share of the gross capital gain to which no beneficiary is specifically entitled;
4. Then sum each beneficiary's specific entitlement plus their share of the capital gain to which no beneficiary is specifically entitled to get each beneficiary's percentage share of the gross capital gain;
5. Then multiply each beneficiary's percentage share of the gross capital gain by the net capital gain amount to work out each beneficiary's 'attributable gain.'[100]

As argued, neither the specific entitlement formula nor the adjusted Division 6 percentage are needed to achieve streaming in a principled and equitable way. The application of the above steps is now considered separately to the situation where capital gains are included in trust income and when they are not. In each case, a simpler and more equitable approach based on the proportionate approach on a class of income basis (outlined earlier), is also shown.

Capital gains included as part of trust income

Example 11
Continuing with the same basic scenario, suppose a trust has $100,000 in rental income and a $100,000 capital gain (after subtracting the $10,000 capital loss), and here assume that capital gains are included in trust income under the deed such that trust income is $200,000. Pursuant to a power in the trust deed, assume the trustee streams the capital gain, but only part of it: 70% is allocated to A by an appropriate resolution, but the remainder ($30,000) is not explicitly allocated. According to the trust deed, any distributable income that is not explicitly allocated by the trustee is divided 50:50 between A and B. Assume here that the capital gain is discountable such that the trust's net capital gain is $50,000 with total trust taxable income being $150,000 ($100,000 rental income plus the net capital gain of $50,000).

98 ATO webpages contain a similar example to that outlined in this section at: https://www.ato.gov.au/General/Trusts/In-detail/Distributions/Streaming-trust-capital-gains-and-franked-distributions/?page=9

99 Within Subdivision 115-C ITAA97, these steps are discerned from s115-228 (which defines how specific entitlements are calculated), s115-227 (which specifies how a beneficiary's 'share' of a capital gain is calculated) and s115-225 (which specifies how a beneficiary's 'attributable gain' is calculated).

100 At the individual level, this amount is grossed up if any discount was applied at the trust level; personal capital losses (if any) are then applied; if any capital gain remains, then it is reduced by the CGT discount if applicable.

Applying the first step above, A has a specific entitlement to the capital gain, which is calculated as follows:

> $110,000 (gross capital gain) x 70% ($70,000 (share of net financial benefit)/$100,000 (net financial benefit)) = $77,000.

Then applying the second step above, the capital gain to which no beneficiary is specifically entitled is $33,000 ($110,000 (gross capital gain) - $77,000 (A's specific entitlement from above).

Then applying the third step above, the capital gain to which no beneficiary is specifically entitled ($33,000) is allocated to beneficiaries based on their 'adjusted Division 6 percentage.' To input into this formula, we need A's present entitlement to trust income, which is $135,000 ($70,000 capital gain explicitly allocated plus $65,000, being a 50% share in the balance trust income of $130,000), and B's present entitlement to trust income, which is $65,000 (50% of the balance of trust income of $130,000).

A's and B's adjusted Division 6 percentages are shown below and this is then used to work out each party's share of the $33,000 capital gain to which no beneficiary is specifically entitled:

For A:	**For B:**
$135,000 (A's present entitlement to trust income) - $77,000 (A's specific entitlement)	$65,000 (B's present entitlement to trust income) – 0 (B's specific entitlement)
$200,000 (total distributable income) - $77,000 (any specific entitlements)	$200,000 (total distributable income) - $77,000 (any specific entitlements)
$58,000/ $123,000	$65,000 / $123,000
= 47.154%	= 52.846%
47.154% x $33,000 = $15,560.82 - A's share of the capital gain to which no beneficiary is specifically entitled	52.846% x $33,000 = $17,439.18 - B's share of the capital gain to which no beneficiary is specifically entitled

Applying the fourth step above, A's share of the (gross) capital gain of $110,000 comprises $77,000 (to which they are specifically entitled) plus $15,560.82 (as per the table above, being their share of the capital gain to which no beneficiary is specifically entitled), which totals $92,560.82 or 84.15% ($92,560.82/$110,000). B's share of the gross capital gain is $17,439.18 (comprised exclusively of their share of the capital gain to which no beneficiary is specifically entitled, as per the table above) or 15.85% ($17,439.18/$110,000).

Applying the fifth step, each beneficiary's percentage share of the gross capital gain (computed in the fourth step above) is applied to the trust's net capital gain to work out A's and B's attributable gain. This is $42,075 for A (84.15% x $50,000) and $7,925 for B (15.85% x $50,000).

As per the trust deed, A and B is each presently entitled to the balance of trust income on a 50:50 basis respectively. Given all of the rent (of $100,000) is in balance trust income, it means that their present entitlement to rental income is also shared on a 50:50 basis, $50,000 to A and $50,000 to B. The proportionate approach continues to apply to income (here the rental income) that is assessable pursuant to Division 6 ITAA36, and each of A's and B's share of taxable rental income is also $50,000 each.

A suggested improvement to the legislative process is outlined below, which is both much simpler and also more closely gives effect to the policy goal of achieving an alignment between economic entitlements and taxable income. Importantly, as shown below, it is argued that the adjusted Division 6 formula is both unnecessary and does not appear to have a sound rationale as a default rule.

Suggested Improvement

The trustee's streaming intentions can be realized simply by applying the proportionate approach on a 'class of income' basis (outlined earlier), without calculating specific entitlements by reference to gross amounts and without resorting to a formula in terms of the adjusted Division 6 percentage.

The process is as follows:

1. Applying the proportionate approach on a 'class of income' basis, as A has been allocated 70% of the capital gain of $100,000 (after subtracting the $10,000 capital loss), then A is entitled to 70% of the trust's taxable (discounted) capital gain, which is $35,000 (70% x $50,000).
2. With the remainder of the trust's taxable capital gain of $15,000 (from above, $50,000 minus $35,000), this would be allocated in accordance with the parties' entitlements to the balance of trust distributable income, being 50:50 between A and B as specified in the trust deed, i.e., after discount this translates to a $7,500 allocation each.
3. A's allocation of the capital gain for tax purposes is $35,000 (referable to the specific allocation as per (1) above) plus $7,500 (referable to the balance trust income as per (2) above), totalling $42,500 and B's allocation is $7,500 (referable entirely to balance trust income as per (2) above).

(The approach to the rental income is the same as the legislation with each party being allocated 50%.)

The suggested approach has bypassed both the process of creating specific entitlements in the gross capital gain and the use of the adjusted Division 6 percentage formula for the capital gain not referable to streaming. Neither of these steps are necessary or intuitive for the purpose of giving effect to streaming intentions. Aside from avoiding needless complexity, it is argued that the suggested process is superior to the legislative approach insofar as the tax treatment exactly mirrors the trustee's intentions as to how the capital gain ought to be allocated in an economic sense. A's economic entitlement to the capital gain comprises the $70,000 explicitly allocated plus a further $15,000 (being a 50% share of the remaining $30,000 portion of the capital gain in balance trust income), being 85% of the capital gain ($85,000/$100,000). Pursuant to the suggested approach, A's allocation for tax purposes is $42,500, which is 85% of the taxable capital gain of $50,000. By contrast, the legislative process attributes 84.15% of the taxable capital gain to A – while it is very close to A's economic entitlement, there does not appear to be any sensible reason for the divergence and A's taxable capital gain amount is worked out through a complicated and unintuitive process.

In tabular form, the suggested improvement is as follows:

For A:	**For B:**
As A has been specifically allocated 70% of the trust capital gain, applying the proportionate approach on a 'class of income' basis this translates to 70% of the trust's taxable net capital gain of $50,000, and is $35,000. In addition, as A has a 50% share of the balance of trust income—which includes a $30,000 discountable capital gain—this means that A has a 50% share of the taxable amount of this capital gain ($15,000), which is $7,500 after discount (50% x $15,000). A's total taxable capital gain is $42,500 ($35,000 plus $7,500).	As B has a 50% share of the balance of trust income—which includes a $30,000 discountable capital gain—this means that B has a 50% share of the taxable amount of this capital gain ($15,000), which is $7,500 after discount (50% x $15,000).

Where capital gains not included in trust income - an anomalous outcome

As noted earlier, even in the situation where capital gains are not included in trust income, the legislation contemplates that the trustee may stream capital gains provided the trust deed contains a streaming power.[101] Now the case of partial streaming is considered in this context.[102]

Example 12

As in previous examples, a trust has rental income of $100,000 and a capital gain of $100,000 (after subtracting a $10,000 capital loss). Assume here that capital gains are not included in trust income but that the trust deed contains a streaming power. Assume the capital gain is discountable. The distributable income of the trust as defined in the deed comprises the rental income of $100,000, and this is allocated 50:50 between A and B pursuant to a default allocation under the deed as the trustee has not made any explicit allocation to the contrary. Pursuant to the streaming power, suppose that 70% of the capital gain of $100,000 (after subtracting the $10,000 capital loss) is streamed to A as before, but the remainder is not explicitly allocated.

From before (Example 11), by applying the legislative formula, A's specific entitlement (which is calculated by reference to the gross capital gain) is $77,000.[103]

Therefore, the capital gain to which no beneficiary is specifically entitled is $33,000 ($110,000 (gross capital gain) - $77,000 (A's specific entitlement)). This will be allocated to beneficiaries in accordance with their adjusted Division 6 percentage. The $33,000 to which no beneficiary is specifically entitled is allocated between the parties using the adjusted Division 6 percentage, calculated as follows:

For A:	For B:
$50,000 (Present entitlement to trust distributable income) – 0 (their specific entitlement is zero as capital gains not part of trust income) / $100,000 (Total trust income) - 0 (zero specific entitlements as capital gains not included in trust income) $50,000 / $100,000 = 50%	$50,000 (Present entitlement to trust income) – 0 (B has no specific entitlement) / $100,000 (Total trust income) – 0 (all specific entitlements) $50,000/$100,000 = 50%

Here, A's and B's proportions of the unallocated part of the capital gain (which is not the subject of specific entitlement) are determined by their proportionate entitlements to trust income (as defined in the trust deed) and as shown above this will lead to a 50:50 allocation. Notably, the numerator of the adjusted Division 6 formula inputs beneficiaries' present entitlement to trust income and does not include capital gains even in the case (as here) where the trustee has exercised a streaming power to allocate capital gains. Similarly, the denominator of the legislative formula does not include capital gains as part of specific entitlements even though capital gains have in fact been distributed. The legislation only takes account of specific entitlements to capital gains to the extent that they formed part of trust income in the first place.[104] Each party is allocated a 50% share of the (gross) capital gain to which no beneficiary is specifically entitled, and ultimately, attributed a 50% share of that part of the net capital gain that is not referable to specific entitlement ($15,000[105]). So for B, who has no specific entitlement, their attributable gain is $7,500 ($15,000 x 50%). For A, via an immensely complex process, their attributable gain is the remaining $42,500, of which $7,500 is referable to that part of the net capital gain to which no beneficiary is specifically entitled, and $35,000 is referable to their specific entitlement.[106]

However, in devising a 'default' rule to allocate tax liability in respect of that portion of the net capital gain that is not referable to use of the specific entitlement mechanism (i.e., streaming intentions), it no longer makes sense to rely on the parties' entitlements to 'trust income' under the deed (which does not include capital gains) as the use of the specific entitlement mechanism has in fact varied the economic entitlements of the beneficiaries. Pursuant to the entrenched policy underlying the taxation of trusts outlined earlier, judges have recognized that the liability to taxation of beneficiaries should as far as possible

104 See 2.72 of the EM.

105 i.e., $50,000 net capital gain minus $35,000, which is the amount ultimately referable to A's specific entitlement (full details are given in the next note).

106 This is a simplified explanation. The way that the legislation computes each party's liability is unnecessarily complex, as noted earlier. To begin with B, which is simpler: their share of the gross capital gain is $16,500 (sourced entirely to a 50% share of the $33,000 gross capital gain to which no beneficiary is specifically entitled). Expressed as a fraction of the gross capital gain of $110,000, this is 15% ($16,500/$110,000), which translates to $7,500 of the net capital gain (15% x $50,000). The complexity of the legislative steps tends to obscure the parties' 50:50 shares ($7,500 each) of that part of the net capital gain ($15,000) that is not referable to specific entitlement. For A, their specific entitlement of $77,000 (to the gross capital gain of $110,000) is added to their 50% share ($16,500) of the gross capital gain of $33,000 to which no beneficiary is specifically entitled, giving a $93,500 ($77,000 + $16,500) share of the gross capital gain of $110,000, which is 85% ($93,500/$110,000). Translated into a share of the trust's net capital gain, A's taxable gain is $42,500 (85% x $50,000). This can be decomposed into $35,000 that is referable to A's specific entitlement (70% x $50,000 trust net capital gain) plus $7,500, being a 50% share of that part of the net capital gain that is not referable to specific entitlement (30% x $50,000 trust net capital gain, being $15,000).

match their economic entitlements to trust distributions. A more equitable way to allocate the gain is shown below.

What Should Be the Approach: Suggested Improvement

Firstly, by applying the more simplified suggested method outlined earlier in this section (which bypasses the step of calculating specific entitlements by reference to gross amounts) and the proportionate approach on a 'class of income' basis outlined earlier in the paper, because 70% of the capital gain has been streamed to A, this means they are allocated 70% of the taxable net capital gain, which is $35,000 (70% x $50,000). Then with liability on the remaining portion of the net capital gain that is not referable to specific entitlement ($15,000), it is suggested that the parties' economic entitlements to trust distributions, including streamed capital gains, provides an equitable way to allocate this remaining part of the net capital gain between A and B. On this approach, the denominator should reflect the varied economic reality and be based on the total amount explicitly allocated i.e., $170,000 i.e., not only the $100,000 trust (rental) income but also the $70,000 capital gain that has been distributed (to A). The numerator should reflect each parties' respective economic entitlements. Shown below is the calculation for allocating the remaining $15,000 of the net capital gain (that is not referable to any specific entitlement) based on parties' actual economic entitlements:

For A:	For B:
$120,000 ($50,000 rent plus $70,000 capital gain) / $170,000 (total amount explicitly allocated) =70.6%	$50,000 (rent) / $170,000 (total amount explicitly allocated) =$29.4%

On this approach, A's proportionate liability to the capital gain that is not explicitly allocated is 70.6% and B's is 29.4%. Applying these percentage allocations, A's share of the $15,000 net capital gain (which is not referable to specific entitlement) is $10,590 (70.6% x $15,000) and B's share is $4,410 (29.4% x $15,000). As outlined earlier, the legislative formula divides the liability on the remaining part of the net capital gain of $15,000 (that is not referable to specific entitlement) between A and B on a 50:50 basis ($7,500 each) based on the parties' entitlement to trust income under the deed. This outcome is anomalous given it disregards the fact that the specific entitlement procedure has varied the parties' actual distribution entitlements. As outlined earlier, on the legislative approach, A's total share of the net capital gain is $42,500 and B's is $7,500. By comparison, on the suggested more equitable approach, A's total share of the net capital gain would be $45,590 ($35,000 referable to their specific entitlement plus $10,590 (noted above) of the amount that is not subject to specific entitlement) and B's is $4,410 (as noted above, being entirely a share of the capital gain not subject to specific entitlement).

4.3 What if there is income to which no beneficiary is presently entitled?

If the trustee fails to allocate any of the distributable income, there will be income to which no beneficiary is presently entitled, and as was the case prior to the amendments, the trustee will be liable to tax either under s 99A ITAA36 (at a penalty rate), or s 99 ITAA36 (in limited circumstances). If the income to which no beneficiary is presently entitled includes part or all of a capital gain, Subdivision 115-C ITAA97 will apply to assess the trustee on the capital gain (the trustee will have an adjusted Division 6 percentage), which has the effect of creating (or increasing) the liability of the trustee under s 99A ITAA36 or s 99 ITAA36.[107] It is somewhat disorienting that the legislation here continues to assess the trustee under the ITAA36 (s 99A or s 99 as the case may be) as under the pre-2011 law, whereas the general effect of the amendments has been to transfer the assessment of capital gains to Subdivision 115-C ITAA97. Unless there are particular reasons why the trustee wishes to be assessed, as outlined earlier, the prospect of penalty rates of tax under s 99A ITAA36 can be easily avoided by invoking the specific entitlement procedure.

5 Evaluation of the regime

5.1 Beneficial practical consequences

Putting the complexity aside, the 2011 amendments do achieve the legislature's end purpose of enabling the streaming of capital gains (and franked distributions), and removing the post-*Bamford* uncertainty as to whether streaming was possible. However, as shown earlier, at least some cases of streaming could have been accommodated under the proportionate approach.

In terms of other favourable practical consequences of the amendments, as outlined above, even where capital gains are not included as part of trust income under the trust deed, the trustee can invoke the specific entitlement mechanism to allocate capital gains (provided the trust deed contains a streaming power) among beneficiaries in a tax effective way.[108] Importantly, a definite benefit under the current law is that penalty rates of tax under s 99A ITAA36 can be avoided in the situation where capital gains are not included as part of trust income and trust income is nil. Previously, to avoid s 99A ITAA36, it was essential that the trustee have the power to include capital gains as part of trust distributable income in the situation where the trust's only taxable income consisted of a net capital gain (otherwise, there would necessarily be no income to which a beneficiary could be presently entitled).

5.2 Deficiencies

In the previous section, this paper sought to outline problems in the operation of key elements of Subdivision 115-C ITAA97—the 'specific entitlement' formula and 'the adjusted Division 6 percentage'—which are far more severe in the case of the adjusted Division 6 percentage. That analysis also provided alternative, simpler approaches, which in the case of partial streaming are also argued to be preferable in principle. For the benefit of regulators in particular, the problems and alternative approach are now summarized here.

5.2.1 Legislation Design – Complexity

As the analysis in this paper indicates, the regime introduced by the amendments is exceedingly complex. This paper has aimed to show that streaming can be accommodated without resorting to the complex steps employed by the legislation, which currently impede an understanding of the provisions.

107 See 2.101 of the EM.

108 As outlined earlier, pre-2011, while the trustee could have made capital distributions (if permitted by the trust deed) to financially assist beneficiaries in meeting their tax liability, any capital distributions would not change beneficiaries' tax liability in respect of the net capital gain, which was determined entirely by their proportionate entitlements to distributable trust income (as defined in the deed).

Specific entitlement formula

As argued earlier, the deficiency in the specific entitlement formula is that it unnecessarily calculates specific entitlements to capital gains by reference to gross amounts. Unnecessary complexity is created as streaming intentions can be realized by applying a party's fractional trust economic entitlement immediately to the net capital gain. As outlined earlier, this is so both in cases of full streaming and partial streaming.

Adjusted Division 6 percentage formula

The adjusted Division 6 percentage operates as a default rule for allocating tax liabilities in respect of that portion of the net capital gain which is not referable to any specific entitlement. Its scope of application is too wide. As noted earlier, the adjusted Division 6 percentage is used to allocate the net capital gain among parties even in the situation where the trustee has not undertaken streaming at all. In this situation, parties' specific entitlements will always be zero in the adjusted Division 6 formula and the same outcomes are achieved as under the pre-2011 proportionate approach. As argued above, the use of the adjusted Division 6 percentage here is conceptually unnecessary and needlessly creates complexity in the law.

As outlined in the next section, the complexity associated with the adjusted Division 6 formula is most clearly evident, not in isolation, but when the formula must be used in conjunction with the specific entitlement formula.

Overall Process – interaction of specific entitlement and the adjusted Division 6 percentage

The immense complexity of Subdivision 115-C ITAA97 comes to light when we try to apply the overall process mandated by the legislation to cases where the concepts of specific entitlement and the adjusted Division 6 percentage would both need to be applied—namely, in the case of partial streaming, which would arise often in practice. In the situation of partial streaming, as outlined earlier in the paper, there are five distinct steps that must be completed to arrive at the beneficiary's net capital gain, and the complexity arises, not only because of the number of steps but also because particular individual steps are also complex.

This paper has aimed to show that alternative, simpler processes based on a proportionate approach on a 'class of income' basis can be utilized to give effect to streaming intentions. The alternative approaches also avoid the inequities that sometimes arise from an application of the current provisions. As argued, neither the specific entitlement formula nor the adjusted Division 6 percentage are needed to achieve streaming in a principled and equitable way, and the latter in particular creates substantive problems as summarized below.

5.2.2 Outcomes that lack a sound rationale

As outlined earlier, in the situation of partial streaming of a capital gain, the legislative process in Subdivision 115-C ITAA97 (here utilizing both the specific entitlement and adjusted Division 6 percentage concepts) leads to allocations of the taxable capital gain that lack a sound rationale. Taking first the case where partial steaming occurs where capital gains are included in trust income (as outlined in Example 11 above): as shown, parties' fractional allocations of the trust's net capital gain unnecessarily do not mirror their economic entitlements to the capital gain. While the discrepancy is not large, there is no reason why it should occur; as shown earlier, applying the suggested proportionate approach on a class of income basis is both simpler and does achieve a correspondence between parties' fractional economic entitlements and their respective taxable portions of the capital gain.

When partial streaming occurs in the context where the trust deed does not include capital gains as part of trust income (as outlined in Example 12), as argued earlier, the application of the legislative formula leads to quite a serious anomaly. Here there is the potential for significant discrepancies between economic entitlements and taxable capital gains. As noted, the legislation contemplates that streaming can occur even where capital gains are not included in trust income (provided the trust deed contains a streaming power). The anomaly arises because the application of the adjusted Division 6 percentage nonetheless leads to fractional allocations of the net capital gain (not referable to specific entitlement) that are based on parties' entitlements to trust income excluding capital gains even when capital gains have in fact been distributed pursuant to a streaming power. This does not take account of the fact that the trustee's decision to stream a part of the capital gain has in fact varied the distributional entitlements of the parties. A more equitable method of allocation was outlined in the paper.

6 Conclusion

This paper has sought to critically examine the immensely complex capital gains streaming regime in Subdivision 115-C ITAA97, which was introduced in 2011. Although described as 'interim', more than nine years later, the Government has not proposed any alternative regime. This paper first sought to understand the perceived problem the provisions sought to tackle. As Subdivision 115-C ITAA97 was a response to the 'proportionate approach' confirmed in the High Court's 2010 decision in *Bamford*, a detailed analysis of the proportionate approach and its application to key scenarios of interest was undertaken. The Explanatory Memorandum to the 2011 amendments assumes that the proportionate approach does not allow for the streaming of particular classes of trust income to beneficiaries. However, as outlined, at least where distributable income equals taxable trust income, streaming could be accommodated while respecting the central tenet of the proportionate approach that a beneficiary's percentage share of distributable income also determines their percentage share of the trust's taxable income. However, as also shown, not all cases of streaming can be reconciled with the proportionate approach, and accordingly, a legislative response was necessary given the widely accepted view that trustees ought to be able to strategically pass on the tax consequences of particular classes of income to beneficiaries.

The provisions in Subdivision 115-C ITAA97 do at least achieve the legislative purpose of fully allowing for the streaming of capital gains (and franked distributions) among beneficiaries. As outlined, there is also a distinct benefit compared to pre-2011 in the situation where capital gains are not included as part of trust income under the deed and capital gains are the trust's only taxable income. Whereas the trust faced the prospect of penalty rates of tax under s99A ITAA36 under the pre-2011 law, under the current law the trustee is able to avoid penalty rates of tax under s 99A ITAA36 by invoking the specific entitlement mechanism to stream capital gains (provided the relevant trust deed allows the trustee to stream capital gains).

However, this does not mean the regime is a success. The legislation is far too complex, and as argued, the complexity is in fact unnecessary. In certain cases, it was also shown that the legislative process leads to outcomes that lack a sound rationale, insofar as unnecessary discrepancies are created between beneficiaries' economic entitlements to trust income and their shares of trust taxable income. The central constructs of the streaming regime – specific entitlement and the adjusted Division 6 percentage – are each associated with problems and in particular, the interaction of these concepts in the case of partial streaming creates immense complexity. As this paper has aimed to show, the alternative, simpler processes based on a proportionate approach on a 'class of income' basis both give effect to streaming intentions, and also ensure a closer correspondence between economic entitlements and taxable income.

Appendix

Table 1 - The Scheme for the Taxation of Trusts

Pre-2011	Post-2011	
Division 6 ITAA36 – determines beneficiaries' share of trust assessable income (including net capital gains and franked distributions) Presently entitled beneficiaries: - S97 ITAA36 (no legal disability) or - s98 ITAA36 (trustee pays tax on behalf of beneficiaries in specified situations) No present entitlement: Trustee taxation s99A ITAA36 (penalty rates) or s99 ITAA36.	Trust has no net capital gains or franked distributions	Trust has net capital gains or franked distributions
	Apply Division 6 ITAA36 (s97, s98, s99A, s99) as before	Division 6 as modified by Division 6E ITAA36: assessing provisions of Division 6 ITAA36 (s97, s98, s99A, s99) apply to net income excluding capital gains and franked distributions ('Division 6E net income'). Net capital gains – assessed under Subdivision 115-C ITAA97 Franked Distributions – assessed under Subdivision 207-B ITAA97

Table 2 - How has the Scope of Application of the Proportionate Approach Changed?

Trust has no net capital gains or franked distributions but positive taxable income	Trust has net capital gains or franked distributions (and positive taxable income)	
	Streaming:	No streaming:
Proportionate approach continues to apply only Division 6 ITAA36 is relevant	**Full streaming**: the specific entitlement formula is used; tax effects match streaming intentions for net capital gains, franked distributions **Partial streaming**: both the specific entitlement formula and the adjusted Division 6 percentage apply Both cases above: proportionate approach applies to balance trust income	**Effectively, the proportionate approach continues to apply to all taxable income** Same outcomes as pre-2011 but capital gains and franked distributions are assessed using streaming regime concepts – the adjusted Division 6 percentage formula is used.