Tax Planning 2022 - Trust

In brief

Date	Changes and actions
Pre 30 June 2022	• Trustee resolutions need to be in place to be able to distribute trust income for the 2021-22 financial year to beneficiaries (at the latest). • Ensure Tax File Numbers have been received from beneficiaries (excluding minors, non-residents and tax-exempt entities) before appointing income to them.
1 July 2022	• The ATO's more stringent stance on trust distributions to adult children, corporate beneficiaries, and entities with losses comes into effect • New arrangements come into effect for unpaid trust distributions to corporate beneficiaries
31 July 2022	• TFN report due for any TFNs received from beneficiaries in the June 2022 quarter.
31 August 2022 (on or before)	• Send written notice of entitlement to distributions to any beneficiaries that are tax-exempt entities.

What's new

The ATOs aggressive stance on trusts and trust distributions

The ATO has released a package of new guidance material that directly targets how trusts distribute income. Many family groups will pay higher taxes (now and potentially retrospectively) as a result of the ATO's more aggressive approach.

Beneficiaries potentially impacted

The ATO's updated guidance focuses primarily on distributions made to:

- adult children
- corporate beneficiaries, and
- entities with losses

but the guidance is not confined to particular situations.

Distributions to beneficiaries who are under a legal disability (e.g., children under 18) are excluded from these rules.

Actions

For those with discretionary trusts it is important to ensure that all trust distribution arrangements are reviewed in light of the ATO's latest guidance to determine the level of risk associated with the arrangements. It is also vital to ensure that appropriate documentation is in place to demonstrate how funds relating to trust distributions are being used or applied for the benefit of beneficiaries.

Family trust beneficiaries at risk

The tax legislation contains an integrity rule, section 100A, which is aimed at situations where income of a trust is appointed in favour of a beneficiary but the economic benefit of the distribution is provided to another individual or entity. If trust distributions are caught by section 100A, then this generally results in the trustee being taxed at penalty rates rather than the beneficiary being taxed at their own marginal tax rates.

The latest guidance suggests that the ATO will be looking to apply section 100A to some arrangements that are commonly used for tax planning purposes by family groups. The result is a much smaller boundary on what is acceptable to the ATO which means that some family trusts are at risk of higher tax liabilities and penalties.

ATO redrawing the boundaries of what is acceptable

Section 100A has been around since 1979 but to date, has rarely been invoked by the ATO except where there is obvious and deliberate trust stripping at play. However, the ATO's latest guidance suggests that the ATO is now willing to use section 100A to attack a wider range of scenarios.

There are some important exceptions to section 100A, including where income is appointed to minor beneficiaries and where the arrangement is part of an ordinary family or commercial dealing. Much of the ATO's recent guidance focuses on whether arrangements form part of an ordinary family or commercial dealing. The ATO notes that this exclusion won't necessarily apply simply because arrangements are commonplace or they involve members of a family group. For example, the ATO suggests that section 100A could apply to some situations where a child gifts money that is attributable to a family trust distribution to their parents.

The ATO's guidance sets out four 'risk zones' – referred to as the white, green, blue and red zones. The risk zone for a particular arrangement will determine the ATO's response:

White zone	Aimed at pre-1 July 2014 arrangements. The ATO will not look into these arrangements unless it is part of an ongoing investigation, for arrangements that continue after this date, or where the trust and beneficiaries failed to lodge tax returns by 1 July 2017.
Green zone	Low risk arrangements unlikely to be reviewed by the ATO, assuming the arrangement is properly documented. For example, when a trust appoints income to an individual but the funds are paid into a joint bank account that the individual holds with their spouse then this would ordinarily be a low-risk scenario. Or, where parents pay for the deposit on an adult child's mortgage using their trust distribution and this is a one-off arrangement.
Blue zone	Arrangements might be reviewed by the ATO. The blue zone is the default zone and covers arrangements that don't fall within one of the other risk zones. The blue zone is likely to include scenarios where funds are retained by the trustee, but the arrangement doesn't fall within the scope of the specific scenarios covered in the green zone.

Section 100A does not automatically apply to blue zone arrangements, it just means that the ATO will need to be satisfied that the arrangement is not subject to section 100A.

Red zone	Arrangements will be reviewed in detail. These are arrangements the ATO suspects are designed to deliberately reduce tax, or where an individual or entity other than the beneficiary is benefiting.

Adult children

High on the ATO's list for the red zone are arrangements where an adult child's entitlement to trust income is paid to a parent or other caregiver to reimburse them for expenses incurred before the adult child turned 18. For example, school fees at a private school. Or, where a loan (debit balance account) is provided by the trust to the adult child for expenses they incurred before they were 18 and the entitlement is used to pay off the loan. These arrangements will be looked at closely and if the ATO determines that section 100A applies, tax will be applied at the top marginal rate to the relevant amount and this could apply across a number of income years.

Entities with losses

Distributions from a trust to an entity with losses could also fall within the red zone unless it is clear that the economic benefit associated with the income is provided to the beneficiary with the losses. If the economic benefit associated with the income that has been appointed to the entity with losses is utilised by the trust or another entity then section 100A could apply.

Circular arrangements

Circular arrangements could also fall within the scope of section 100A. For example, section 100A could be triggered if:

- The trustee resolves to appoint income to a company at the end of year 1.
- The company includes its share of the trust's net income in its assessable income for year 1 and pays tax at the corporate rate.
- The company pays a fully franked dividend to the trustee in year 2, sourced from the trust income, and the dividend forms part of the trust income and net income in year 2.
- The trustee makes the company presently entitled to some or all of the trust income at the end of year 2 (which might include the franked distribution).
- These steps are repeated in subsequent years.

Distributions to companies

As part of the broader package of updated guidance targeting trusts and trust distributions, the ATO has also released a draft determination dealing specifically with unpaid distributions owed by trusts to corporate beneficiaries. If the amount owed by the trust is deemed to be a loan then it can potentially fall within the scope of another integrity provision in the tax law, Division 7A.

Division 7A captures situations where shareholders or their related parties access company profits in the form of loans, payments or forgiven debts. If certain steps are not taken, such as placing the loan under a complying loan agreement, these amounts can be treated as deemed unfranked dividends for tax purposes and taxable at the taxpayer's marginal tax rate.

The latest ATO guidance looks at when an unpaid entitlement to trust income will start being treated as a loan. The treatment of unpaid entitlements to trust income as loans for Division 7A purposes is not new. What is new is the ATO's approach in determining the timing of when these amounts start being treated as loans. Under the new guidance, if a trustee resolves to appoint income to a corporate beneficiary, then the time the unpaid entitlement starts being treated as a loan will depend on how the entitlement is expressed by the trustee (e.g., in trust distribution resolutions etc):

- If the company is entitled to a fixed dollar amount of trust income the unpaid entitlement will generally be treated as a loan for Division 7A purposes in the year the present entitlement arises; or
- If the company is entitled to a percentage of trust income, or some other part of trust income identified in a calculable manner, the unpaid entitlement will generally be treated as a loan from the time the trust income (or the amount the company is entitled to) is calculated, which will often be after the end of the year in which the entitlement arose.

This is relevant in determining when a complying loan agreement needs to be put in place to prevent the full unpaid amount being treated as a deemed dividend for tax purposes and when the trust needs to start making principal and interest repayments to the company.

The ATO's view on "sub-trust arrangements" has also been updated. Basically, the ATO is suggesting that sub-trust arrangements will no longer be effective in preventing an unpaid trust distribution from being treated as a loan for Division 7A purposes if the funds are used by the trust, shareholder of the company or any of their related parties.

The new guidance represents a significant departure from the ATO's previous position in some ways. The upshot is that in some circumstances, the management of unpaid entitlements will need to change. But, unlike the guidance on section 100A, these changes will only apply to trust entitlements arising on or after 1 July 2022.

Cryptocurrency in the ATO spotlight

The ATO has specified that gains from cryptocurrency are an area of focus again this year.

The tax treatment of cryptocurrency depends on a range of factors, including whether the items are acquired with the intention of making a profit on sale or exchange in the short term or whether they are intended to be held for longer term investment purposes.

It is also important to recognise that a taxing event can be triggered when one item of cryptocurrency is exchanged for another item (that is, even if no cash proceeds are received on disposal).

The tax laws can be complex in this area and it's important to ensure that you get the right advice.

It's important to keep records of your cryptocurrency exchanges. The ATO regularly runs data matching projects, and they have access to the data from many crypto platforms and banks.

Trust 'housekeeping'

Payment deferrals

If you are having trouble paying your tax liability, please let us know as soon as possible so we can negotiate a deferral or payment plan with the ATO on your behalf.

Trust split arrangements

A trust split usually involves a family trust. A common reason given for 'splitting' the trust is to allow different parts of the family group to have autonomous control of their own part of the trust fund.

The Tax Commissioner's view is that the split will create a new trust (as the trustee has new personal obligations and new rights have been annexed to property) and trigger a capital gains tax event, which could potentially give rise to a taxable capital gain.

TFN reporting

Has your trust lodged TFN reports for all beneficiaries?

Trustees of closely held trusts have some additional reporting obligations outside the lodgement of the trust tax return each year. The Australian Taxation Office (ATO) is currently reviewing trustees to ensure their compliance with these obligations, particularly the requirement to lodge TFN reports for beneficiaries.

Where TFN provided

Where beneficiaries have quoted their TFN to the trustee, trustees are required to lodge a TFN report for each beneficiary. The TFN report must be lodged by the end of the month following the end of the quarter in which a beneficiary quoted their TFN. For example, if the trustee receives a beneficiary's TFN in April, they must lodge a TFN report by the end of July.

Where TFN not provided

Where a TFN has not been provided by a beneficiary, the trustee is required to withhold tax at a rate of 47% on distributions made to the beneficiary and pay this to the ATO. The trustee must also lodge an annual report of all amounts withheld.

Failure to comply with the TFN reporting and withholding requirements may trigger penalties.

Trust distributions

Timing of resolutions

Trustees (or directors of a trustee company) need to consider and decide on the distributions they plan to make by 30 June 2022 at the latest (the trust deed may actually require this to be done earlier).
Decisions made by the trustees should be documented in writing, preferably by 30 June 2022.

If valid resolutions are not in place by 30 June 2022, the risk is that the taxable income of the trust will be assessed in the hands of a default beneficiary (if the trust deed provides for this) or the trustee (in which case the highest marginal rate of tax would normally apply).

Anti-avoidance and 'round robin' trust distributions

Anti-avoidance measures prevent family trusts engaging in 'round robin' circular trust distributions with other closely held trusts.

The rules impose penalty rates of tax in situations where trust income is distributed to one or more other trusts and ends up being distributed back to the first trust. Before 1 July 2019, trusts that had made a family trust election were excluded from these rules but that is no longer the case.

Distributions to non-resident beneficiaries

In some circumstances, non-resident beneficiaries can be taxed in Australia on gains relating to foreign assets, which would not have been taxed in Australia had they been made by the beneficiary directly.

If a resident discretionary trust makes a capital gain, the ATO expects that this will normally be taxed in Australia, even if the gain is distributed to a non-resident beneficiary, even if the gain does not relate to Taxable Australian Property (TAP) and even if the gain has a foreign source. Given that non-resident beneficiaries will be taxed at non-resident tax rates and may not have access to the full CGT discount, it will be important for trustees to consider this carefully when deciding on distributions for trusts that have a mixture of resident and non-resident beneficiaries.

The ATO's determinations do not take into account the possible application of any double tax agreements. This is another issue that would need to be considered to reach a conclusion on how distributions are likely to be taxed in the hands of non-resident beneficiaries.

Low income tax offset and minors reminder

The low income offset has not been available to minors who only receive 'unearned' income (e.g. distributions from a discretionary trust) since the 2013 income year. Minors who only receive 'unearned' income will normally be subject to penalty rates of tax on income that exceeds $416.

Normal marginal tax rates can potentially still apply to minors who receive distributions from a deceased estate or testamentary trust. However, recent amendments to the rules in this area are aimed at ensuring that minors are only taxed at adult marginal tax rates in respect of the income a testamentary trust generates from assets of the deceased estate (or the proceeds of the disposal or investment of these assets).

Streaming of franked dividends and capital gains

Trustees are only able to stream franked dividends (and the franking credits that are attached to those dividends) to a particular beneficiary for tax purposes if the beneficiary's entitlement to the franked dividends is recorded in writing by 30 June 2022. For streaming of capital gains to be effective for tax purposes, the beneficiary's entitlement must be recorded in writing by 30 June if the capital gains form part of trust income for the year or 31 August if the capital gains do not form part of trust income.

We can assist you with this process if you do wish to stream franked dividends or capital gains to specific beneficiaries.

Tax exempt entities

If a trustee resolves to distribute income to a tax-exempt entity, the trustee will be assessed on that income at the top marginal tax rate unless:

- The trustee actually pays the entire distribution within 2 months of the end of the income year; or
- The trustee notifies the entity in writing of its entitlement within 2 months of the end of the income year.

Also, anti-avoidance rules tax the trustee on a portion of the income distributed to a tax-exempt entity where there is a mismatch between the net financial benefit to be received by the entity and the tax treatment of the distribution.

What we need from you

This is a general list of what to have ready when we next meet with you:

- Accounts data file (MYOB, Quickbooks, access to Xero)
- Debtors & creditors reconciliation
- 30 June bank statements on all relevant loan documents
- Documents on new assets bought or sold, including the date you entered the contract and the date the asset was first used or installed ready for use
- Payroll reconciliation (if applicable)
- Superannuation reconciliation (if applicable)
- Details of any transactions involving cryptocurrency (e.g., Bitcoin)
- 30 June statements on any investment or operating accounts

And, if we are preparing your individual income tax return:

- Income Statement
- Tax statements of managed investment funds
- Interest income from banks and building societies
- Dividend statements for dividends received
- For share sales or purchases, the purchase and sale contract notes
- For real estate sales or purchases, the solicitor's correspondence for the purchase and sale
- Rental property statements from real estate agent and details of other expenditure incurred
- Work related expenses
- Self-education expenses
- Travel expenses
- Donations to charities
- Health insurance and rebate entitlement
- Family Tax Benefits received
- Commonwealth assistance notices
- IAS statements or details of PAYG Instalments paid
- Details of any transactions involving cryptocurrency (e.g., Bitcoin)
- Details of any income derived from participating in the sharing economy (e.g., Uber driving, rent from Airbnb, jobs completed through Airtasker etc.,)

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