Current Issues: Taxation of Trusts

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Discretionary/Family Trusts – Pros and Cons

Pros - Family or discretionary trusts have long been considered to be the “go to” vehicle to run a small business or hold investment assets because of the ability to stream income to various beneficiaries while retaining the character of that income, provide access to the 50% general discount and simply transfer control to other parties by changing the trustee or control of the trustee.

Cons - However they do come with some drawbacks including the fact that:

- the benefits of income distribution flexibility are lost because there is no beneficiary with a low tax rate,
- The streaming of dividend income from a trading company to a corporate beneficiary may result in top-up tax,
- the absence of unitised ownership makes it is difficult to progressively transfer the ownership of the business from the existing owner/controller to new owners and so the only way of receiving consideration for a business is to sell the business out of the trust that may result in renegotiating existing agreements held in the trust’s name,
- a trust cannot get a refund of excess imputation credits, imputation credits received by a trust can waste revenue losses and can get stranded within a trust, and
- not a suitable vehicle if revenue or capital losses are expected in the short or medium term.

- This presentation will highlight a number of features of a discretionary trust that require specific attention including the trust deed, the calculation of the net income of the trust, presently entitled beneficiaries, steaming income of different character to specific beneficiaries, trust losses, family trusts and the potential access to the small business CGT concessions by trusts.

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Existence of a Trust – Trust Deed

- A trust of property or income may be described as a fiduciary obligation imposed on a person (the trustee) to hold property or income for a particular purpose or purposes, or for the benefit of other persons or classes of persons who may or may not include the trustee.
- Although the trustee may hold the legal title to property, etc, the trustee is compelled in equity to deal with it in accordance with the express or implied terms of the trust.
- The executor or administrator of a deceased person's estate is not strictly the trustee of the estate until executorial or administrative functions are completed, but an executor or administrator is expressly made a trustee for income tax purposes by the expanded definition of "trustee" in s 6(1) ITAA36.
- The Official Receiver in Bankruptcy of an insolvent deceased estate is a trustee, as is the receiver and manager of the assets of a company appointed by the debenture holders and a mortgagee in possession.
- The operation of a trust is governed by the **trust deed** and naturally reference should be made to it in relation to managing the tax affairs of the trust to identify such matters as – the existence of an appointor or principal – the identity of the beneficiaries – the definition of income – the existence of default beneficiaries – the powers of the trustee – the power to change the trust deed with respect to amending the beneficiaries or appoint a new trustee – These factors may be relevant to satisfying the basic conditions for the small business CGT concession.

Amending the Trust Deed

- When will amending the trust deed result in the resettlement of a trust?
- Taxation Determination TD 2012/21, takes the view that the approach adopted by the Full Federal Court in Commercial Nominees 2001 ATC 4336 is authority for the proposition that assuming there is some continuity of property and membership of the trust, an amendment to the trust that is made in proper exercise of a power of amendment contained under the deed will not have the result of terminating the trust, irrespective of the extent of the amendments so made so long as the amendments are properly supported by the power of amendment.
- Amendments validly made pursuant to a power of amendment that will not lead to the creation of a new trust include amendments adding to, or deleting, beneficiaries, the extension of the vesting day, amendments to the definition of income and amendments to permit the "streaming" of different classes of income.
- Depending on the facts, the Commissioner considers that the effect of a particular amendment might be such as to lead to the conclusion that a particular asset has been settled on terms of a different trust by reason of being made subject to a charter of rights and obligations separate from those pertaining to the remaining assets of the trust.

- **Vesting day issues** - There are, potential CGT and income tax issues where the vesting day of a trust passes which will mean that all of the interests in the trust as to income and capital become vested in interest and possession, see TR 2018/6.
- Once the vesting date of a trust has passed, it will not be able to be extended by amendment to the trust deed, even if this could have been validly done before the vesting day arrived (TR 2018/6).

- **Splitting a trust** - A trust split constituted by an arrangement where the parties to an existing trust functionally split the operation of the trust so that some trust assets are controlled by and held for the benefit of a subset of beneficiaries, and other trust assets are controlled and held for the benefit of others, will result in the creation of a trust by declaration or settlement and CGT event E1 will happen (TD 2019/14).

Deceased Estates (1)

- An annual return must be lodged for a trust, irrespective of the amount of income derived by the trust.

- **Trustee of deceased estate** - For the year in which a taxpayer died, the trustee of the deceased estate is generally required to lodge an individual tax return of the deceased's income up to the date of death. The trustee is also generally required to lodge a deceased estate trust return for the remainder of the income year for the income received or derived after death by the deceased estate.
- PCG 2018/4 applies to smaller and less complex estates to enable the trustee to wind up the estate without concern that they may have to fund any of the deceased's pre-death liabilities from their own assets.
- In certain simple deceased estates an executor does not need to lodge a return.

This Guideline applies to an LPR who has obtained probate of a deceased person's will, or letters of administration of a deceased estate provided that in the four years before the person's death

- the deceased did not carry on a business
- the deceased was not assessable on a share of the net income of a discretionary trust
- the deceased was not a member of a self-managed superannuation fund

The estate assets consist only of

- public company shares or other interests in widely-held entities
- death benefit superannuation
- Australian real property
- cash and personal assets such as cars and jewellery, and

the total market value of the estate assets at the date of death was less than $5 million and none of the estate assets are intended to pass to a foreign resident, a tax exempt entity or a complying superannuation entity.

Deceased Estates (2)

- PCG 2018/4 - It is a question of fact whether the LPR has notice of a claim by the ATO. Paragraphs 9 to 29 of the Guideline set out the situations when the ATO consider the LPR has such notice and those when the ATO will treat an LPR as not having notice.

- Notice of amounts owing at time of death – having notice
- Notice of liabilities from outstanding assessments – having notice
- Notice of liabilities arising in respect of outstanding returns – having notice
- Notice of liabilities arising from amendments or other changes – having notice
- Notice of liabilities where further assets discovered – having notice – liability limited to the further assets

- Lodgements and advice of no lodgements necessary by the deceased – subsequent discovery of a material irregularity – not having notice

- Liability of the LPR will extend to all income derived by the deceased to the date of death and so a full inquiry should be undertaken as to the sources of income and whether income deferrals have been undertaken such a farm management deposits or other income elections.

- An LPR takes on the responsibility for the debts of the deceased including Division 7A loans.

Streaming Capital Gains and Franked Dividends

- Where the net income of a trust for an income year does not include a net capital gain or a franked distribution, a beneficiary who is presently entitled to a share (ie a fraction or percentage) of the income of the trust for the income year is taxed on that fraction or percentage of the net income of the trust for that income year as calculated for tax purposes, see the Bamford decision.

- Where the net income of a trust for tax purposes includes a net capital gain or a franked distribution then the capital gains or franked distribution that are reflected in the net income are taken outside the operation of Division 6 (by Division 6E) and are subject to the special rules in Subdiv 115-C (capital gains) and 207-B (franked distributions).

- These special rules enable the trustee to stream capital gains (does not apply where the gain has been calculated using the market value substitution rule) and franked distributions (provided the trust deed confers the necessary power on the trustee) by making beneficiaries "specifically entitled" (an amount equal to the net financial benefit referrable to the capital gain or franked dividend) to amounts of a capital gain or a franked distribution.

- A beneficiary cannot be made entitled to a franking credits separate to the franked dividends.

- To the extent that a capital gain or franked distribution is not attributed to a specifically entitled beneficiary then it is attributed to the beneficiaries of the trust in accordance with their adjusted Division 6 ITAA36 percentages.

- **Tax exempt beneficiaries** - There are two anti-avoidance provisions which may apply (in the absence of notification and payment) to deny the present entitlement of the exempt beneficiary to income of the trust (so that the trustee is assessed on an appropriate share of the net income).

Net Income of a Trust

- The net income of a trust is the total assessable income of the trust calculated as if the trustee were a resident taxpayer in respect of that income, less all allowable deductions, s 95(1) ITAA36.

- The assessable income of a trust includes the whole of the trust's interest in the net income of a partnership of which it is a member, even if that share has not been received. Whether a gain or loss from an investment is made by a trustee is on capital or income account depends on the application of the normal principles (business transaction, isolated profit-making transaction, etc), TD 2011/21.

- In general, all deductions for expenses which would be available if a resident taxpayer had derived the trust's assessable income are taken into account in calculating the net income of a trust. Where the deductions exceed the assessable income, the resulting loss is taken into account in calculating the net income of the trust for succeeding income years, ie the loss is not distributed among the beneficiaries or the trustee as representing corpus. However, under the trust loss measures, a trust may not be able to deduct a prior year loss or certain debt deductions (for bad debts and debt/equity swaps) unless it satisfies certain tests, see later slides.

- Trust losses that are deductible in calculating the net income of the trust for tax purposes are first offset against any exempt income derived by the trust.

- The "refinancing principle" recognised in Roberts & Smith 92 ATC 4380 may allow a trustee to claim interest incurred by a trustee on a loan used to finance the payment of a returnable amount (an amount owing to a beneficiary where the trustee is using the amount to earn assessable income) is deductible. A returnable amount must relate to a realised profit and not internally generated goodwill.

Discretionary Trusts and Present Entitlement

- Where a trustee is given a discretion to pay or apply trust income to or for the benefit of specified beneficiaries, a beneficiary in whose favour the trustee exercises the discretion is deemed to be presently entitled to the amount so paid or applied, s 101 ITAA36.
- For s 101 to apply, there must be an effective exercise by the trustee of the discretion to pay or apply income for the benefit of a beneficiary before the end of the income year in which the income is derived by the trustee (or earlier date if required by the trust deed).
- The fact that a discretionary trust deed may permit the trustee to make a distribution resolution after 30 June will be irrelevant for income tax purposes; for income tax purposes, the present entitlement of a beneficiary must arise by the end of the income year.

- It is essential that the way that a distribution of income is effected complies with any requirements of the trust deed and that there is appropriate evidence of what has been done (eg minutes of any meeting that was in fact held – Trust Resolution).
- Where the trustee is a company, a discretion to pay or apply trust income can be exercised without the company passing a formal resolution to that effect.

- Where there is an ineffective exercise or no exercise by the trustee of the discretion to pay or apply income for the benefit of a beneficiary, but the trust instrument contains a vesting clause that operates before the end of the income year in default of an effective exercise of the discretion, the beneficiary or beneficiaries specified in the default vesting clause will be presently entitled to the trust income.
- A beneficiary may disclaim an entitlement to trust income on it coming to their knowledge but for a disclaimer to be effective, it must be an actual disclaimer of the whole interest and not merely part of the interest.

Non-resident beneficiaries – where a capital gain relating a share that is not taxable Australian property is distributed by a resident trust to a non-resident beneficiary then the gain is not exempt whereas it would be exempt if the share was held directly by an individual.

Tips and Traps – Small Business CGT Concessions (1)

- There are a number of key considerations to be satisfied prior to a discretionary trust being able to access the small business CGT concessions – CGT Small Business entity (aggregated turnover) - Maximum Net Asset Value (value of your, entities connected with you and affiliates asset) – ensuring that an asset is active.

Connected/Controlled - s 328-125(3)(4) ITAA97 - Direct control of a discretionary trust

(3) An entity (the first entity) controls a discretionary trust if a trustee of the trust acts, or could reasonably be expected to act, in accordance with the directions or wishes of the first entity, its * affiliates, or the first entity together with its affiliates.

(4) An entity (the first entity) controls a discretionary trust for an income year if, for any of the 4 income years before that year:
(a) the trustee of the trust paid to, or applied for the benefit of:
(i) the first entity; or
(ii) any of the first entity's * affiliates; or
(iii) the first entity and any of its affiliates;
any of the income or capital of the trust; and
(b) the percentage (the control percentage) of the income or capital paid or applied is at least 40% of the total amount of income or capital paid or applied by the trustee for that year.

- Where the trust did not make a distribution of income or capital because it had a tax loss or no net income in the year then the trustee may nominate up to 4 beneficiaries as being controllers of the trust, s152-78 ITAA97.

A trust will not be an affiliate of yours - s 328-130 ITAA97 - Meaning of affiliate

(1) An individual or a company is an affiliate of yours if the individual or company acts, or could reasonably be expected to act, in accordance with your directions or wishes, or in concert with you, in relation to the affairs of the * business of the individual or company.

Tips and Traps – Small Business CGT Concessions (2)

- There are a number of key considerations to be satisfied prior to a discretionary trust being able to access the small business CGT concessions – providing access to the **15 year Exemption** and the **Small Business Retirement Exemption** – Significant individual – CGT concession stakeholder – Small business participation percentage. s 152-70 ITAA97 Item 3.

A trust (where entities do not have entitlements to all the income and capital of the trust)	This percentage: (a) if the trustee makes distributions of income during the income year (the ***relevant year***) in which that time occurs--the percentage of the distributions to which the entity was beneficially entitled; or (b) if the trustee makes distributions of capital during the relevant year--the percentage of the distributions to which the entity was beneficially entitled; or, if 2 different percentages are applicable, the smaller.

- Trusts with no income/accumulated losses - s 152-70 (4) ITAA97 provides that if the trust does not have any income in a relevant year then treat references to "relevant year" to a distribution in the CGT-event year or the last income year before the CGT event year that the trusted did make a distribution of income or capital.

Tips and Traps – Small Business CGT Concessions (3)

CGT Retirement Exemption - The payment or payments must meet the requirements of s152-325 ITAA97, which are:

(1) Where the payment is made to more than one CGT concession stakeholder the amount of each payment is worked out by reference to the individual's percentage entitlement to the relevant CGT exempt amount.

(2) The percentage entitlement for each CGT concession stakeholder is the amount specified in the written choice to apply the exemption. The percentage can range from nil to 100%, but the total of the percentages must add up to 100%.

(3) If the CGT concession stakeholder is an employee of the entity, the payment must not be of a kind mentioned in s 82-135, which specifies certain types of payments that are not employment termination payments, including a payment that is deemed to be a dividend.

(4) The payment must be made by the later of 7 days after (a) the choice to apply the retirement exemption is made or (b) the entity receives the capital proceeds. However, if CGT event J2, J5 or J6 applies the payment must be made within 7 days of the choice to apply the retirement exemption.

(5) The amount of the payment, or sum of the amounts of the payments, must be equal to the lesser of the capital proceeds received and the relevant CGT exempt amount.

(6) If a CGT concession stakeholder is under the age of 55 just before receiving the payment, the payment must be made into a complying superannuation fund on behalf of the CGT concession stakeholder. Payments may be made indirectly through one or more interposed entities (s 152-325(1)).

Family Trusts

- A family trust for tax purposes is one whose trustee has made a valid family trust election (FTE).
- A trustee only makes a valid FTE where they have satisfied the relevant tests, and made an election in writing in the approved form.
- Once the election has been made, it cannot be varied or revoked except in limited circumstances, see later discussion.
- The FTE entitles the trust to access certain tax concessions. The trade-off is that family trust distribution tax is imposed when distributions are made outside the family group.

There are five main reasons to become a family trust:

- **The trust loss measures** – a non-fixed trust has a carried forward tax loss, or certain debt deductions, but the trust could not satisfy the required trust loss tests to recoup the loss.
- **A company loss tracing concession** – the company loss provisions allow a company that has a non-fixed trust as a shareholder to benefit from a tracing concession where that non-fixed trust is a family trust.
- **The holding period rules regulating access to franking credits** – the holding period rules allow the trustee and beneficiaries of a family trust that receives a franked dividend or franked non-share dividend to benefit from a franking credit concession where the imputation credits are greater than $5,000.
- **Trustee beneficiary reporting (TBR) rules** –Trusts that have made an FTE or an interposed entity election (IEE) (among others) are excluded from having to comply with the TBR rules.
- **Small business restructure roll-over** – to satisfy the ultimate economic ownership requirement for a rollover of active assets involving discretionary trusts it is necessary to have a family trust election in place.

Trust Losses (1)

- Trusts can only deduct tax losses and certain debt deductions in limited circumstances. The restrictions, contained in Sch 2F (s 265-5 to 272-140), apply to:
  - "tax losses" (defined in s 272-140) of an earlier or the current income year, and
  - "debt deductions", ie deductions for bad debts, and debt/equity swap deductions.
- Types of trust - The particular trust loss measures that apply to a trust will depend on the type of trust. The three basic types of trust are:
  - (1) fixed trusts — these include widely held unit trusts
  - (2) non-fixed trusts — these are any trusts that are not fixed trusts and include trusts that have both fixed and non-fixed elements (s 272-70), and
  - (3) excepted trusts — these are family trusts, complying superannuation funds, complying ADFs, PSTs, deceased estates within a reasonable administration period, fixed unit trusts if all of the direct and indirect fixed entitlements to income and capital of the trust are held by exempt entities and designated infrastructure project entities (s 272-100).
- A trust (other than an excepted trust) cannot deduct current year and prior year losses and debt deductions if it fails to satisfy certain tests relating to ownership or control of the trust or if there is abnormal trading in its units (Sch 2F Div 266; 267; ITAA97 s 25-35(5), item 4; 36-25 (tax losses of trusts)).

The relevant test period is generally:

- prior year loss (fixed and non-fixed trusts) — the income year in which the loss was incurred, the income year being examined and all intervening years (if any)
- current year loss (fixed and non-fixed trusts) — the income year being examined
- debt deduction (fixed and non-fixed trusts) — if the debt is incurred in an income year before the deduction arises, from the time the debt is incurred to the end of the income year in which the deduction is available. If the debt is incurred in the income year in which the deduction arises, the test period is the income year.

Trust Losses (Tests) (2)

Type of trust	50% stake test	Business continuity test	Pattern of distributions test	Control test	Income injection test
Fixed trust other than a widely held unit trust	✓(1)				✓
Unlisted widely held trust	✓(2)				✓
Listed widely held trust	✓	✓(3)			✓
Unlisted very widely held trust	✓				✓
Wholesale widely held trust	✓				✓
Non-fixed trust	✓(4)		✓(5)	✓	✓
Family trust					✓(6)
Excepted trust (other than a family trust)					

(1) An alternate test is also available in certain cases where non-fixed trusts directly or indirectly hold fixed entitlements in the fixed trust.
(2) For current year loss purposes, an unlisted widely held trust need only meet the 50% stake test when there is abnormal trading in the trust's units.
(3)This test can be applied if the 50% stake test is failed by a listed widely held trust.
(4)This test applies to a non-fixed trust where individuals have direct or indirect fixed entitlements to more than a 50% share of the income or capital of the trust.
(5)This test does not apply for current year loss purposes or, in the case of a debt deduction, where the debt is incurred in the income year in which the deduction arises.
(6)The income injection test does not apply where entities and individuals within a family group inject income into a family trust with losses.

Family Trust Elections

- A trust is a family trust at any time when a family trust election (FTE) for the trust is in force.
- Generally, an FTE is in force from the beginning of the income year specified in the FTE (the election commencement time).
- The FTE must also specify an individual who forms the point of reference for defining the family group that is taken into account in relation to the election.

- The income year specified in the FTE must have ended before the FTE is made. This is because an FTE can only be made if the trust passes the family control test at the end of the specified income year.
- The FTE can specify an earlier income year from when the election is to commence, provided that from the beginning of the specified income year until 30 June of the income year immediately preceding that in which the election is made:
  - the trust passes the family control test, and
  - any conferrals of present entitlement to income or capital during the period, or actual distributions of such amounts, have been made to the specified individual or members of their family group.

- Generally, an FTE is in force at all times after the 'election commencement time'.
- These rules apply to FTEs specifying the 2004–05 and later income years.
- The ability to make a FTE specifying an earlier year of income can impact on an FTDT liability that would otherwise arise but for that election.

Family Trust Elections - Retrospective Action

- The trustee of Trust A (which has an FTE in force) distributes $50,000 to the trustee of Trust B in the 2020 income year. Trust B is not a member of Trust A's family group, nor has Trust B made an FTE or IEE. Consequently, the trustee of Trust A becomes liable to pay FTDT on the $50,000 distribution to Trust B.
- In the 2019 income year, the trustee of Trust B makes an FTE specifying that the trust be treated as a family trust at all times from the beginning of the 2019 income year. The FTE specifies the same individual named in the FTE of Trust A resulting in Trust B becoming part of the specified individual's family group.
- As Trust B has a FTE in force from 1 July 2018, it is treated as having been a member of the family group in relation to the $50,000 distribution made by the trustee of Trust A in the 2020 income year. Therefore, there is no FTDT liability for the trustee of Trust A.
- The effect of making an FTE that is in force from an earlier year can extend beyond reversing an FTDT liability – it also can allow access to the tax concessions for family trusts mentioned earlier.
- However, whilst an election can operate to reverse a FTDT liability incurred in the 2004–05 or subsequent income year, the ordinary amendment periods limit access to the tax concessions to income years within the applicable amendment period. That is, any retrospective access to the tax concessions is usually limited to either two or four years.

- **2004 or earlier income years** - FTEs for the 2004 or earlier income years could only be made for the earliest year for which a tax return had not yet been lodged. In particular, the election could not be made for the specified income year if it was made after the entity's return for that year has been lodged.

Family Trust Elections – Test (Specified) Individual

- An FTE must specify a person as the individual whose family group is to be taken into account in relation to the election (referred to as the specified individual, primary individual or test individual throughout Schedule 2F).

- The specified individual has no additional rights or responsibilities and doesn't even need to be directly associated with the trust.

- Only one individual can be specified in an FTE.

- Where an FTE is being made in respect of an earlier year of income, the specified individual's date of birth must be on or before the beginning of the income year specified for the commencement of the FTE.

- The specified individual must also be alive at the time the election is made.

- The FTE isn't affected by the death of the individual specified in the FTE – the members of the family group are still determined by reference to that individual.

Family Trust Elections – Revocation

- An FTE can be revoked where the family trust is a fixed trust or where the FTE was not required for recouping tax losses, deducting bad debts or accessing franking credits (subject to the satisfaction of certain conditions).

- Generally, revocations can be made until the end of the fourth income year after the income year that was specified in the original FTE.

- These revocations must be made in the trust's tax return for the income year from which the revocation is to be effective. If the entity isn't required to lodge a tax return for the income year, the revocation must be given to the ATO within two months of the end of that income year, or such later day as the Commissioner of Taxation allows.

- An FTE can't be made for a trust that has previously had an FTE revoked.

- A tax return that has already been lodged can't be amended to include an FTE revocation.

Family Trust Elections – Variation

The specified individual can be varied once, but only once, subject to certain conditions, including that both:

- the new specified individual was a member of the family of the original specified individual at the election commencement time
- there have been no conferrals of present entitlement, or distributions of income or capital, by the trustee of the family trust or an entity that made an IEE in relation to the trust to parties outside the new specified individual's family group during the period in which the election has been in force.

- The specified individual can be varied if, as a result of a family law order, agreement or award arising from a marriage or relationship breakdown, the control of the trust passes to the new specified individual and/or members of their family.

- Generally, variations can be made until the end of the fourth income year after the income year that was specified in the original election. Variations must be made in the trust's tax return for the income year from which the variation is to be effective. If the entity isn't required to lodge a tax return for the income year, the variation must be given to the ATO within two months of the end of the income year, or such later day as the Commissioner allows.

- A tax return that has already been lodged can't be amended to include an FTE variation.

Family Trust Elections – Family Control Test (FCT)

For the purposes of making an FTE or an IEE, a trust passes the family control test (FCT) at a point in time when some or all of the following people control the trust:

- the individual specified in the relevant FTE
- members of the specified individual's family
- a professional legal or financial adviser to the family.

The FCT looks at, among other things, who can control the application of income or capital of the trust.

- This is why a professional legal or financial adviser might be part of the controlling group of a family trust: the adviser might, for example, be one of the directors of the trustee company. However, a person can only be a controller as a professional legal or financial adviser if they became a controller because of their status as such an adviser, rather than in a personal capacity.
- A company or partnership that proposes to make an IEE passes the FCT at a point in time when some, or all, of the specified individual and members of their family beneficially hold between them, directly or indirectly, fixed entitlements to more than 50% of the income or capital of the company or partnership.
- Because the FCT for companies and partnerships only looks at who beneficially owns interests in the entity, any control influenced by a professional legal or financial adviser isn't relevant to determining whether the family controls a company or partnership.

Family Trust Elections – Specified Individual's Family

The family of the individual specified in the relevant FTE consists of that person (the test individual) and all of the following (if applicable):

1. any parent, grandparent, brother or sister of the specified individual or the specified individual's spouse
2. any nephew, niece or child of the specified individual or the specified individual's spouse
3. any lineal descendant of a nephew, niece or child referred to in point 2
4. the spouse of the specified individual or of anyone who is a member of the specified individual's family because of points 1, 2 and 3.

- 'Any lineal descendant' includes any descendant (of an individual) in a direct line of relationship flowing downwards. This starts with an individual's child (including an adopted child, stepchild or ex-nuptial child) and extends to include a grandchild, a great-grandchild and so on. They are not restricted to a descendant on either a patriarchal or matriarchal basis.

- A person doesn't cease to be a family member merely because of the death of any other family member.
- The spouse of the deceased specified individual will continue to be a member of the family, provided they were the spouse at the time of death.

- If the individual specified in an FTE is legally married and separated from their spouse, the spouse remains a member of the family. If the specified individual divorces after being legally married, their former spouse won't be a member of the family. However, the former spouse will remain a member of the family group.
- If the spouse of the deceased specified individual or a member of their family becomes the spouse of a person who is not a member of the deceased specified individual's family, the spouse will cease to be a member of the family. Instead, the former spouse of the deceased specified individual or a member of their family becomes a member of the deceased specified individual's family group. This means that the former spouse of the deceased specified individual won't have concessionary treatment under the income injection test.

Family Trust Elections – Family Group

For the purposes of determining whether a conferral or distribution has been made, the following people and entities are generally members of the family group of the individual specified in the FTE:

- the members of the specified individual's family
- former members of the specified individual's family who are no longer members due to a breakdown in a marriage or relationship, or death (including former spouses, former widows/widowers and former stepchildren)
- family controlled or owned trusts, companies or partnerships
- the family trust for which the family trust election has been made
- other family trusts with the same individual specified in their FTE
- trusts, companies or partnerships that have made an IEE (see below) to become a member of the specified individual's family
- trusts, companies or partnerships (other than non-fixed trusts) where certain members of the family group have fixed entitlements directly or indirectly, and for their own benefit, to all of the income and capital of the trust, company or partnership
- deductible gift recipients in Australia
- bodies all of whose income is exempt from income tax.

Family Trust Elections – Interposed Entity Elections

- There are two main reasons to make an interposed entity election (IEE):
- To make an entity a member of the family group of the individual specified in an FTE. This means that the trustee of the family trust can confer present entitlement to, or make distributions of, income or capital of the family trust on or to the entity that made the IEE without the trustee becoming liable for FTDT.
- To exclude a trust from having to comply with the trustee beneficiary reporting rules in Division 6D of Part III ITAA 36.
- An IEE can be made in respect of a trust that has an FTE in force. The interposed entity (company, partnership or trust) can specify an earlier income year from when the election is to commence provided that, from the beginning of the specified income year until 30 June of the income year immediately preceding that in which the election is made, both:
  - the company, partnership or trust passes the family control test
  - any conferrals of present entitlement to income or capital of the trust during the period, or actual distributions of such amounts, have been made on or to the individual specified in the FTE or members of that individual's family group.

- Generally, an IEE is in force at all times after the 'election commencement time' which is usually the beginning of the specified day in the IEE.
- The death of an individual specified in an FTE of a family trust does not prevent any other trust, company or partnership from making an interposed entity election (IEE) to be included in that individual's family group.
- A company, partnership or trust may make more than one IEE provided each family trust in respect of which the entity is making the IEE has the same individual specified in its FTE. A family trust can make an IEE to be included in the family group of an individual who is different from the person specified in the trust's FTE.
- As with an FTE, an IEE may commence from an earlier income year to bring the entity within the family group of the specified individual. This enables the entity to access the corresponding benefits of being in the family group from the earlier income year, providing the IEE can be validly made. These rules apply to IEEs specifying the 2005 and later income years.

Family Trust Elections – IEE Revocation

- An IEE can be revoked where an entity was at the election commencement time, or becomes at a later time, a member of the family group of the specified individual (for instance, where members of the family have fixed entitlements, directly or indirectly, and for their own benefit, to all of the income and capital of the entity or where a family trust has the same specified individual as another family trust in relation to which it makes an IEE).
- In addition to this, an IEE is taken to be automatically revoked if the FTE to which it relates is revoked.
- Generally, revocations can be made until the end of the fourth income year after the income year that was specified in the original election.
- These revocations must be made in the entity's tax return for the income year from which the revocation is to be effective. If the entity isn't required to lodge a return for the income year, the revocation must be given to the ATO within two months of the end of that income year, or such later day as the Commissioner of Taxation allows.
- A tax return that has already been lodged can't be amended to include an IEE revocation.
- An FTE can only be made once for a trust. The trustee of a family trust is required to include the income year specified in the FTE on the trust tax return each year while the FTE remains in force. This is the same for companies, partnerships and trusts with IEEs.

Family Trust Elections – Family Trust Distribution Tax

Family trust distribution tax (FTDT) is payable where:

- a trustee of a trust has made a FTE
- a partnership's partners, a company or the trustee of another trust have made an IEE to be included in the family group of the individual specified in the FTE made by the family trust, and
- the trustee of the FTE trust, the trustee of the IEE trust, the partnership or the company distributes income or capital other than to the specified individual or members of the specified individual's family group.

- FTDT is payable at the top marginal rate of tax applying to individuals plus Medicare levy (currently 47%). It is paid on the amount or value of any such distributions or conferrals made by an electing entity at any time after the election made by the entity becomes effective.
- A reasonable salary, wage or other benefit (such as superannuation contributions or fringe benefits) provided to, or for the benefit of, an employee for work performed is not considered to be a distribution. There is only a distribution, on which a liability to pay FTDT arises, to the extent that it exceeds an amount commensurate with commercial rates for the type of work or services provided by the employee.
- Each payment of FTDT must be accompanied by the Family trust distribution tax payment advice, see NAT 6175.

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Thank you

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