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Monthly Information Newsletter – Tax & Super

May 2022

Further developments on trust distributions

For the many business owners who operate their affairs through discretionary trusts, there have been further developments on the ATO's planned crackdown on certain distributions.

Backstory

To recap, the ATO in February updated its guidance around trust distributions made to adult children, corporate beneficiaries and entities that are carrying losses. Depending on the structure of these arrangements, there is a potential that the ATO make take an unfavourable view on what were previously understood to be legitimate distribution arrangements.

The ATO is chiefly targeting arrangements under section 100A of the Tax Act, specifically where trust distributions are made to a low-rate tax beneficiary but the real benefit of the distribution is transferred or paid to another beneficiary usually with a higher tax rate. In this regard, the ATO's new Taxpayer Alert (TA 2022/1) illustrates how section 100A can apply to the quite common scenario where a parent benefits from a trust distribution to their adult children.

Released at the same time, the ATO's new draft ruling states that for the new guidance to potentially apply, one or more of the parties to the agreement must have entered into it for a purpose (not necessarily a sole, dominant purpose) of securing a tax benefit. This sets the bar quite low and may capture a number of arrangements previously thought to be within the law.

New announcement

No doubt reluctant to upset small business voters during an election campaign, the government has recently tried to take the heat out of this issue by having the ATO 'clarify' that its new guidance material will not apply retrospectively and that "ordinary advice services" for a fee will not be subject to the promoter penalty rules. If necessary, the government has indicated it will change the law "should any adverse retrospective impacts arise".

While this is very welcome news, it only focuses on the application date of the guidance material. It changes nothing going forward, including issues around adult beneficiaries and the limited scope (in the ATO's view) of the "ordinary family dealing" exception."

Past distributions

Given the government's announcement, there is now no need to revisit pre-1 July 2022 distributions to confirm that section 100A does not apply. For its part, Labor's Stephen Jones has been reported as supporting the government's approach on retrospectivity.

Going forward

A conservative approach would be to adopt the "beneficiaries must benefit" approach that underpins the guidance material, as much as that might be a worry for controlling individuals who have in the past benefited from tax optimisation without actually giving their adult children beneficiaries access to their present entitlements. This means the days of controlling individuals taking loans from the trust as they go along and squaring them off through the trust accounts after year-end might soon be over.

Alternatively, one could continue to deal with 2021/22 trust distributions in exactly the same way as in the past. The law has not been changed and the draft ruling is at odds with a recent Federal Court decision. Such an approach would reflect the view that the Commissioner is wrong in his narrow interpretation of what constitutes ordinary family dealings. That could be a brave strategy, however, as we do not know when or how the draft guidance material will be finalised, while the above Federal Court appeal decision is unlikely to be handed down this side of 30 June 2022.

If you have any concerns about your trust distributions and exposed risk to section 100A (including upcoming distributions for 2021/22) you should contact your accountant for a discussion based on your personal circumstances.