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Upcoming trust distribution strategies…the latest developments

If you run your business through a family trust, there's some good news on the distribution front.

In mid-April, the ATO responded to the landmark trust distribution case, namely the Guardian AIT appeal ruling in January by the Full Federal Court, with a decision impact statement that where the ATO concedes that it will have to amend its position on trusts, Section 100A of the Income Tax Act and reimbursement agreements. In the Guardian appeal, the Full Federal Court rejected the ATO's position that a reimbursement agreement existed in the Guardian case and so section 100A did not apply.

To recap, the ATO in February 2022 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, potentially the ATO may take an unfavourable view on what were previously understood to be legitimate trust distribution arrangements. The ATO is chiefly targeting arrangements under section 100A , 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 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.

Moving forward, there are a number of tax-effective strategies that can be employed that will not fall foul of the ATO's interpretations in this area including:

- *Only distribute to Mum and Dad*

This would be quite safe from section 100A scrutiny. No person pays less tax as a result of any agreement, and this is unlikely to be seen as high-risk by the ATO.

- *Continue to distribute to young adult beneficiaries, but hand over the money*

If you are happy to give money to your children, this can be achieved while at the same time optimising tax.

- *Charge board and current university fees*

If adult beneficiaries are living at home, they should pay board (just as if they had a job). This will not add up to large sums, but arm's-length board for a full year could come to about $18,000. This allows for some tax arbitrage without handing the kids any money.

- *Use of bucket company*

Having a private corporate beneficiary caps the tax rate imposed on trust income. Franked dividends can subsequently be flexibly allocated through having a trust structure interposed between the bucket company and the beneficiaries. The present entitlement can be lent back to the trustee for use in the business of the trust, although there are minimum repayment conditions. Avoid having the main trust as a shareholder in the bucket company. The ATO considers circular income flows to be high-risk.

- *Be alert for the "no reimbursement agreement" argument*

If you are contemplating making a gift or an interest-free loan to another person, ask questions about the circumstances behind this plan. If it was not in contemplation at the time of the relevant appointment of trust income (up to two years ago), but has arisen because family circumstances have changed recently, there may not be a reimbursement agreement.

- *If making gifts, go once and go big.*

There are also other slightly bolder strategies.
If you operate your affairs through a discretionary trust, chat with us around your distribution options prior to the 30 June deadline.