Trust loss provisions

Find out information for trustees who want to use a tax loss to reduce the net income of their trust.

Last updated 19 October 2020

Use of tax losses and debt deductions may be restricted where the tax benefits would be transferred to other entities.

This information is for trustees who want to use a tax loss to reduce the net income of their trust.

A tax loss of a trust can be carried forward and used to reduce the trust's net income in a later year, subject to certain tests. These tests are contained in the trust loss provisions in Schedule 2F to the *Income Tax Assessment Act 1936* (ITAA 1936).

These tests restrict the use of tax losses and debt deductions. The tests apply to the following two types of arrangements under which the tax benefit of trust losses and debt deductions could otherwise be transferred to other entities:

- a change in the ownership or control of the trust
- use of an income injection scheme.

Different tests apply to different types of trusts.

The trust loss provisions generally don't apply to trusts that have validly elected to be a family trust. This is except for the income injection test, which applies in certain circumstances.

The trust loss provisions don't apply to capital losses.

See also:

- Family trusts – concessions

Change in ownership or control – consequences

Find out about the consequences of changing ownership or control of a Trust.

Income injection schemes – consequences

Find out about the consequences of income injection schemes.

Which tests to apply

Find out about what a trust needs to consider about all the tests that apply to that type of trust.

How to apply the trust loss tests

Find out how to apply the trust loss tests.

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Change in ownership or control – consequences

Find out about the consequences of changing ownership or control of a Trust.

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The tests dealing with changes in ownership or control include the:

- 50% stake test
- business continuity test
- pattern of distribution test

- control test.

These tests apply so that, if certain events occur, a trust:

- may be prevented from deducting its tax losses from earlier income years
- may have to work out its net income and tax loss for the current income year in a special way
- may be prevented from deducting certain amounts in respect of debts (for example, bad debts) incurred in the current or earlier income years.

This doesn't apply to excepted trusts, including trusts that validly elected to be family trusts.

Fixed trusts

For fixed trusts, the above consequences apply if there is no continuity of majority beneficial ownership in the income and capital of the trust, as determined by the 50% stake test.

Ordinary fixed trusts have to test ownership continuously – that is, on every day of the test period (from the beginning of the loss year until the end of the income year in which the trustee seeks to claim the relevant deduction).

Widely held unit trusts only have to test ownership when there is abnormal trading in their units or, in some cases, when an income year ends.

Where the 50% stake test is failed, listed widely held trusts can still avoid these consequences if they pass the business continuity test.

Non-fixed trusts

The above consequences will also apply to a non-fixed trust if either:

- there is a 50% or greater change in the pattern of distributions of the income or capital of the trust
- control of the trust changes during the test period.

The 50% stake test only applies to a non-fixed trust where, at any time in the test period, individuals have more than a 50% stake in the income or capital (or both) of the trust.

Find out about:

- Income injection schemes – consequences
- Which tests to apply
- How to apply the trust loss tests

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Income injection schemes – consequences

Find out about the consequences of income injection schemes.

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Under these schemes, income is injected into trusts with tax losses or other deductions to reduce the trust's net income under subsection 95(1) of the ITAA 1936.

However, a trust that is involved in such a scheme to take advantage of tax losses or other deductions may be prevented from making full use of them under the income injection test in Division 270 of Schedule 2F to the ITAA 1936.

Find out about:

- Which tests to apply
- How to apply the trust loss tests

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Which tests to apply

Find out about what a trust needs to consider about all the tests that apply to that type of trust.

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In using a tax loss or claiming a debt deduction, a trust needs to consider all the tests that apply to that type of trust, as shown in the following table.

Types of trusts and tests to apply

Type of trust	50% stake test	Business continuity test	Pattern of distributions test	Co tes
Non-fixed trust	Listed widely held trust, yes	Unlisted widely held trust, no	Listed widely held trust, yes	wi he ye
Listed widely held trust	Listed widely held trust, yes.	Listed widely held trust, yes.	Unisted widely held trust, no.	wi he no
Unlisted widely held trust	Unlisted widely held trust, yes.	Unisted widely held trust, no.	Unisted widely held trust, no.	wi he no
Unlisted very widely held trust	Unlisted very widely held trust, yes.	Unisted very widely held trust, no.	Unisted very widely held trust, no.	ve wi he no
Wholesale widely held trust	Wholesale widely held trust, yes.	Wholesale widely held trust, no.	Wholesale widely held trust, no.	Wh wi he no

Fixed trust other than a widely held unit trust	Fixed trust other than a widely held unit trust, yes.	Fixed trust other than a widely held unit trust, no.	Fixed trust other than a widely held unit trust, no.	tru oth tha wi he tru
Excepted trusts	Excepted trusts, no.	Excepted trusts, no.	Excepted trusts, no.	Ex tru
Family trust	Family trust, no.	Family trust, no.	Family trust, no.	tru
Excepted trust (other than a family trust)	Family trust, no.	Family trust, no.	Family trust, no.	tru

Table notes:

- For non-fixed trusts
  - the 50% stake test only applies where, at any time in the test period, individuals have more than a 50% stake in the income or capital (or both) of the trust
  - the pattern of distributions test does not apply for current year loss purposes.
- For listed widely held trusts, the business continuity test can be applied if a listed widely held trust fails the 50% stake test.
- For fixed trusts other than a widely held unit trust, an alternative version to the 50% stake test is also available in certain cases where non-fixed trusts hold fixed entitlements in the fixed trust (section 266-45 of Schedule 2F).
- For family trusts, the income injection test does not apply where entities and individuals within a family group inject income into a family trust with tax losses or other deductions.

- Excepted trusts, other than family trusts include:
  - complying super funds
  - deceased estates within a five-year administration period
  - unit trusts that are a fixed trust where all the unit holders are exempt from income tax.

See also:

- Schedule 2F – Trust Losses and Other Deductions (ITAA 1936)

Find out about:

- How to apply the trust loss tests

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How to apply the trust loss tests

Find out how to apply the trust loss tests.

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The following tests apply for deducting tax losses and debt deductions:

- 50% stake test
- Business continuity test
- Pattern of distributions test
- Control test
- Income injection test

50% stake test

The 50% stake test is contained in Subdivision 269-C of Schedule 2F to the ITAA 1936.

The 50% stake test is used to determine whether there has been a change in the underlying ownership of a trust with fixed entitlements. An alternative version applies where 50% or more of fixed entitlements to the income or capital of an ordinary fixed trust are held by non-fixed trusts – other than family trusts.

The 50% stake test doesn't apply to family trusts and other excepted trusts.

The 50% stake test only applies to a non-fixed trust where, at any time in the test period, individuals have more than a 50% stake in the income or capital (or both) of the trust.

The 50% stake test applies by determining if there are individuals who between them have, directly or indirectly, and for their own benefit, fixed entitlements to:

- a greater than 50% share of the income of the trust
- a greater than 50% share of the capital of the trust.

The individuals with fixed entitlements to income and those with fixed entitlements to capital don't have to be the same individuals.

The 50% stake test applies independently to both income and capital.

50% stake test – alternative version

The alternative version of the 50% stake test applies where 50% or more of fixed entitlements to the income or capital of an ordinary fixed trust (which is governed by Subdivision 266-B of Schedule 2F) are held by non-fixed trusts (other than family trusts).

In this situation, the 50% stake test can't be satisfied by the fixed trust (as it is impossible to trace through to individuals), and an alternative version of the 50% stake test must be applied.

The alternative version of the 50% stake test also applies to an ordinary fixed trust (which is governed by Subdivision 266-B of Schedule 2F). This applies where non-fixed trusts (other than family trusts) hold fixed entitlements to 50% or more of the income or capital of a company or a fixed trust (the holding entity), and the holding entity holds, directly or indirectly, all of the fixed entitlements to income and capital of the ordinary fixed trust that is seeking to pass the 50% stake test.

These fixed entitlements must have been held at all times during the test period (that is, the test period for the 'normal' 50% stake test).

The alternative version of the 50% stake test is passed where:

- interests in the fixed trust are held directly by non-fixed trusts. There are no changes in the individuals directly holding fixed entitlements to the income and capital of the fixed trust or the percentage of their interests
- interests in the fixed trust are held, directly or indirectly, by a holding entity, and there are no changes in the individuals directly holding fixed entitlements to the income and capital of the holding entity
- at the beginning of the test period, individuals have not had more than a 50% stake in the income or capital of the fixed trust
- every non-fixed trust (that is not a family trust or other type of excepted trust) that holds fixed entitlements in the fixed trust, directly or indirectly, satisfies the relevant tests that apply to non-fixed trusts as if they stood in place of the fixed trust that is seeking to deduct a tax loss or other amount.

Business continuity test

The business continuity test is contained in Subdivision 269-F of Schedule 2F to the ITAA 1936.

The business continuity test applies to listed widely held trusts where the 50% stake test in relation to a tax loss or debt deduction has been failed after abnormal trading in a trust's units.

The business continuity test consists of two separate parts:

- same business test
- similar business test.

Same business test

A listed widely held trust passes the business continuity test during a period (the business continuity test period) in relation to a time (the test time) if throughout the business continuity period it carries on the same business as it carried on immediately before the test time.

However, the trust will not pass the business continuity test if any of the following apply:

- at any time during the business continuity test period, it derives assessable income from either
  - a business of a kind that it did not carry on before the test time
  - a transaction of a kind that it had not entered into in the course of its business operations before the test time
- before the test time, it did one of the following for the purpose of being taken to have carried on throughout the business continuity test period the same business as it carried on immediately before the test time, either
  - it began to carry on a business it had not previously carried on
  - in the course of its business operations, it entered into a transaction of a kind that it had not previously entered into
- at any time during the business continuity test period, it incurs expenditure
  - in carrying on a business of a kind that it did not carry on before the test time
  - as a result of a transaction of a kind that it had not entered into in the course of its business operations before the test time.

Similar business test

The similar business test applies to a tax loss or a debt incurred in an income year starting on or after 1 July 2015.

A listed widely held trust passes the business continuity test during a period (the business continuity test period) in relation to a time (the test time) if throughout the business continuity period it carries on a business that is similar to the business it carried on immediately before the test time.

However, the trust does not pass the business continuity test if before the test time, it did one of the following for the purpose of being taken to have carried on throughout the business continuity test period a business that is similar to the business it carried on immediately before the test time:

- it began to carry on a business it had not previously carried on
- in the course of its business operations, it entered into a transaction of a kind that it had not previously entered into.

A trust can pass the business continuity test through the similar business test, even if it fails the same business test, so long as the tax loss or the debt was incurred in an income year starting on or after 1 July 2015.

A trust's business activities may have changed due to COVID-19. For example, a trust may have commenced a new business activity or closed a business. For more information on the business continuity test and the closing of a business or the receipt of the JobKeeper payments, refer to How to claim a tax loss – Companies.

See also:

- LCR 2019/1 *The business continuity test – carrying on a similar business*
- TR 1999/9 *Income tax: the operation of sections 165-13 and 165-210, paragraph 165-35(b), section 165-126 and section 165-132*

Pattern of distributions test

The pattern of distributions test is contained in Subdivision 269-D of Schedule 2F to the ITAA 1936.

The pattern of distributions (POD) test, which applies to non-fixed trusts, is applied independently to both income and capital.

The test applies if the non-fixed trust has distributed income or capital in the income year in which the deduction is claimed (or within two months after its end), and in at least one of the six earlier income years.

If income or capital was not distributed in any one of the six earlier income years, the trust doesn't have to pass the POD test.

A trust passes the POD test for an income year if, within two months after the end of the income year:

- the trust distributed directly or indirectly to the same individuals, for their own benefit, more than 50% of every 'test year distribution of income' (see section 269-65)
- the trust distributed directly or indirectly to the same individuals, for their own benefit, more than 50% of every 'test year distribution of capital' (see section 269-65).

The individuals who meet the test in respect of capital distributions don't have to be the same individuals that satisfy the test in respect of income distributions.

The actual commencement of the period depends on when the trust has distributed income. If the trust distributed income before the loss year, the income year before the loss year that is closest to the loss year will be the commencement of the period, provided this is within the six-year period mentioned above.

Where different percentages are distributed to individuals over the relevant test years, the smallest percentage distributed in any one income year becomes the distribution percentage for the calculation. The total of the minimum distribution percentages of income or capital for each individual over the relevant years must be greater than 50% in order to pass the POD test.

Example: Income distributed during prior six years

A tax loss was incurred by the Ray Non-fixed Trust in the 2014–15 income year. The trust is seeking to deduct the tax loss in the 2015–16 income year. The trustee distributed income in the 2013–14 and 2015–16 income years as follows:

Ray Non-fixed Trust distributions

Trustee	2014	2016	Minimum percentage
Mum	80%	20%	20%
Dad	10%	50%	10%

Ray	10%	30%	10%
Total of minimum test year distributions	na	na	**40%**

As income has been distributed in the income year, and in at least one of the six earlier income years, the condition of having to pass the POD test applies.

The 2013–14 income year is the closest income year before the loss year in which distributions were made. It is also within six years of the 2015–16 income year in which the trust seeks to deduct the tax loss.

The total of the minimum percentage of test year distributions of income is 40%. As this is not greater than 50%, the tax loss incurred in the 2014–15 income year can't be deducted by the trustee of the Ray Non-fixed Trust.

See also:

- section 269-75 of Schedule 2F to the ITAA 1936 – for incomplete distributions where distributions are made to companies, partnerships or trusts that don't distribute the income but in which individuals have fixed entitlements to income and capital of these entities
- section 269-80 of the Schedule 2F of the ITAA 1936 – where an individual dies, or there is a breakdown in the marriage or relationship

Control test

The control test is contained in Subdivision 269-E of Schedule 2F to the ITAA 1936.

The control test applies to non-fixed trusts. Where a group begins to control a trust between the beginning of the loss year and the end of the income year in which it seeks to claim the deduction (the test period), the trust's tax losses and debt deductions can't be deducted.

Whether a group begins to control a trust in the test period is a question of fact, depending on the circumstances of each individual trust – particularly taking into account the powers conferred on various entities under the trust deed.

The following factors should be checked when determining whether there has been a change in the group controlling the trust in the test period:

- changes in trustees
- changes in the appointor or guardian
- changes in the shareholders or directors of the corporate trustee
- the appointment of new beneficiaries
- the amendment of the trust deed
- a change in unit holdings
- other unusual changes.

Special circumstances where control won't be taken to have changed

Where a group (the original group) ceases to control a non-fixed trust only because of the death, incapacitation or breakdown in the marriage or relationship of the individual comprising, or an individual included in, the control group, the control test won't be failed for that reason alone.

Broadly, this special treatment applies where:

- another group (the replacement group) begins to control the non-fixed trust within one year of the death, incapacitation or breakdown in the marriage or relationship, or such longer period as the Commissioner of Taxation determines
- if the original group consisted only of the individual who died, became incapacitated or experienced the breakdown in the marriage or relationship – the replacement group consists of one or more individuals who are members of that individual’s family (as defined in section 272-95 of Schedule 2F to the ITAA 1936)
- if the original group consisted of more than the individual who died, became incapacitated or experienced the breakdown in the marriage or relationship – the replacement group consists of one or

more individuals who are members of that individual’s family (as defined in section 272-95), together with all of the members of the original group (other than the individual who died, became incapacitated or experienced the breakdown in the marriage or relationship)

- the replacement group began to control the trust only because of the death, incapacitation or breakdown in the marriage or relationship of the individual
- there are no changes in the beneficiaries of the trust apart from the individual who died, became incapacitated or experienced the breakdown in the marriage or relationship and one or more individuals who are members of that individual’s family (as defined in section 272-95).

Other circumstances where control won't be taken to have changed

Under subsection 269-95(4) of Schedule 2F to the ITAA 1936, the Commissioner also has the discretion to treat a group as not beginning to control a trust where, having regard to the identity of the beneficiaries of the trust and all other relevant circumstances of the case, the Commissioner considers it reasonable.

This allows tax losses to be deducted where, because of the particular circumstances of the case, it is not fair and reasonable to treat the control of the trust as having changed. For example, it may be appropriate for the discretion to be exercised in some cases of retirement where those who can benefit under the trust have not changed.

Income injection test

The income injection test applies where there is a scheme to take advantage of a deduction that is allowable to a trust.

For this to apply, an 'outsider to the trust' must provide a benefit to the trustee or a beneficiary of the trust, and a return benefit must be given to the outsider. Such benefits must have been provided (or derived) wholly or partly, but not merely incidentally, because the deduction(s) would be allowable.

The income injection test doesn't apply to income injection schemes that take place wholly within the family group of a trust that has made a family trust election.

It also doesn't apply to complying superannuation funds, complying approved deposit funds, pooled superannuation trusts, deceased estates within a five-year administration period, and unit trusts that are a fixed trust where all the unit holders are exempt from income tax.

Conditions for income injection test to be applied

The following conditions need to be met before the income injection test applies:

- The trust must have an allowable deduction, whether a current year deduction or a carried forward loss, for the relevant income year.
- There must be a scheme under which all the following things happen (in any order)
  - the trust must derive 'scheme assessable income'
  - a person not relevantly connected with the trust (an outsider to the trust) must directly or indirectly provide a benefit to the trustee or a beneficiary (or an associate of either)
  - the trustee or a beneficiary (or an associate of either) must directly or indirectly provide a benefit to the outsider to the trust (or an associate of the outsider to the trust). However, if the test is being applied to a family trust and this return benefit is being provided only to an associate who is not an outsider to the trust, this element will not be satisfied. This ensures that the income injection test will not apply where benefits only flow from the family trust to the entities listed in subsection 270-25(1).
- It must be reasonable to conclude that any one or more of the following has happened under the scheme
  - the trust derived the scheme assessable income wholly or partly, but not merely incidentally, because the deduction would be allowable. (Whether a benefit has been provided merely incidentally because a deduction is allowable to the trust depends on the particular facts and circumstances of the scheme)

- the outsider to the trust provided the benefit to the trustee or a beneficiary (or an associate of either) wholly or partly, but not merely incidentally, because the deduction would be allowable
- the trustee or a beneficiary (or an associate of either) provided the benefit wholly or partly, but not merely incidentally, because the deduction would be allowable.

Consequences if test is failed

Where the income injection test is failed, no deduction is allowable in the relevant income year against the scheme assessable income, with the result that the 'net income' of the trust for the income year is increased to equal the full amount of the scheme assessable income. In addition, to the extent the deduction may be related to the derivation of the scheme assessable income, the deduction is not allowable.

However, any deduction not related to the derivation of the scheme assessable income is still allowable to the trust. For example, it can be deducted against other assessable income derived in the same income year or can be deducted in a later year of income in the form of a tax loss.

See also:

- **Explanatory Memorandum to Schedule 2F to the ITAA 1936, which was inserted by the Taxation Laws Amendment (Trust Loss and Other Deductions) Act 1998** (Chapter 10) – for examples of how the income injection test applies

Meaning of terms

- Scheme
- Benefit
- Outsider to a family trust
- Outsider to a non-family trust

Scheme

For the purposes of this test, 'scheme' takes on the same meaning as in Part IVA of the ITAA 1936:

1. any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings, and
2. any scheme, plan, proposal, action, course of action or course of conduct.

See also:

- PS LA 2005/24 *Application of General Anti-Avoidance Rules*

Benefit

'Benefit' includes anything that is a benefit or advantage within the ordinary meaning of these words. However, it is defined to specifically include money, a dividend or property (whether tangible or intangible), a right or entitlement, services, or the extinguishment, forgiveness, release or waiver of a debt or other liability.

The doing of anything that results in the derivation of assessable income is also specifically defined to be a 'benefit'. For example, if the scheme's assessable income is derived by the trustee of the trust as a result of the transfer to, or conferral on, the trustee of an interest from which assessable income will be derived, the person who transferred or conferred that interest to or on the trustee will have provided a benefit to the trustee.

A benefit includes all ways that value is given to the relevant parties.

Outsider to a family trust

An outsider to a trust that has validly elected to be a family trust is any person other than those set out in the table below. This means that the income injection test doesn't inhibit income injection schemes that take place wholly within groups with certain members.

People who are not outsiders to a family trust

Person who is not an outsider	Comments
The trustee of the family trust.	The trustee must be acting in their capacity as trustee of the family trust.

A person with a fixed entitlement to a share of the income or capital of the trust.	Wholesale widely held trust, no.
The individual specified in the trust's family trust election or a member of his or her family.	Wholesale widely held trust, no.
A company, partnership or trust that has made an interposed entity election to be included in the family group of the individual specified in the trust's family trust election.	The interposed entity election must be in force when the scheme commenced. Note that an interposed entity election can be in force before it is actually made.
A fixed trust, company or partnership if some or all of the following have fixed entitlements, directly or indirectly, and for their own benefit, to all the income and capital of the fixed trust, company or partnership: • the individual specified in the family trust election • the members of that individual's family • the trustees of family trusts with the same specified individual.	The family members, etc, must hold the fixed entitlements for their own benefit at all times while the scheme is being carried out. This means the income injection test may operate if the family acquires interests in the trust as part of the scheme.
A trust with the same individual specified in its family trust election.	Wholesale widely held trust, no.

See also:

- Family trusts – concessions

Outsider to a non-family trust

An outsider to a trust that is not a family trust is a person other than either:

- the trustee of the trust acting in their capacity as such

- a person with a fixed entitlement to a share of the income or capital of the trust.

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