Tax Avoidance Taskforce – Trusts

The Tax Avoidance Taskforce - Trusts targets higher risk trust arrangements in privately owned and wealthy groups.

Last updated 8 August 2023

How we targeted known tax scheme promoters, individuals and businesses involved in tax avoidance or evasion using trusts.

Supporting research

The Tax Avoidance Taskforce – Trusts targets higher risk trust arrangements in privately owned and wealthy groups.

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Overview

What you should know about risky arrangements of trusts used for tax avoidance or evasion.

Last updated 8 August 2023

What you should know about risky arrangements of trusts used for tax avoidance or evasion.

In the 2013–14 Budget, the government announced it would provide funding over 4 years for a multi-agency taskforce. This taskforce would take compliance action against taxpayers involved in tax avoidance or evasion using trusts. From 1 July 2017, this work continues under the operational umbrella of the Tax Avoidance Taskforce.

If you're concerned about the implications of your tax planning arrangements, you can seek independent professional advice by contacting us or making a voluntary disclosure.

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Tax Avoidance Taskforce – Trusts: what we do

How the Tax Avoidance Taskforce – Trusts continues the work of the Trusts Taskforce.

Last updated 8 August 2023

How the Tax Avoidance Taskforce – Trusts continues the work of the Trusts Taskforce.

We target higher risk trust arrangements in privately owned and wealthy groups. These are not ordinary trust arrangements or tax planning associated with genuine business or family dealings.

We recognise that most trusts are used appropriately. We will continue to help those who make genuine mistakes or are uncertain about how the law applies to their circumstances.

We have trust risk rules in place to identify higher risk compliance issues. Most trusts do not trigger these risk rules.

Our priorities are to:

- undertake focused compliance activity on privately owned and wealthy groups involved in tax avoidance and evasion arrangements using trust structures
- target known tax scheme designers, promoters, individuals and businesses who participate in such arrangements
- lead cross-agency action to pursue the most serious cases of tax abuse using trusts
- undertake projects to gather intelligence on and deal with specific risks.

We aim to build community confidence and encourage voluntary compliance. We do this by reporting on our activities in relation to trusts and undertaking education projects to improve voluntary compliance.

We focus on the following risks:

- lodgment of trust tax returns
- complex distributions
- trust and taxable income mismatches
- unidentified beneficiaries

- cross border and international risks
- avoidance and evasion.

Agencies involved

As well as the ATO, the Tax Avoidance Taskforce – Trusts works closely with the following agencies:

- Australian Federal Police
- Australian Transaction Reports and Analysis Centre
- Australian Securities and Investments Commission
- Commonwealth Director of Public Prosecutions
- Australian Criminal Intelligence Commission
- Australian Prudential Regulation Authority
- Australian Competition and Consumer Commission
- Australian Government Solicitor
- Attorney-General's Department
- Australian Business Register

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Trust activities that attract our attention

What trust issues and situations attract our attention.

Last updated 8 August 2023

What trust issues and situations attract our attention.

Circular trust distributions

A circular trust distribution exists where a trust (the first trust) makes a distribution to a second trust. Then all or part of that distribution goes back to the first trust as a distribution from either the second or another trust.

We want to ensure that the trustees have complied with their obligations to **trustee beneficiary non-disclosure tax**. This includes trustees of family trusts for income years starting on or after 1 July 2019.

We focus on those circular trust distributions if tax has not been paid on some or all of the distribution because:

- one or more beneficiaries understate the trust amounts included in the beneficiary's assessable income
- there is an unbroken circular trust distribution between 2 or more trusts.

Differences between distributable and net income

We focus on tax-preferred beneficiaries, including private companies, where their distributable income is significantly less than the net income.

Whether or not this behaviour is considered tax avoidance depends on the case.

Situations that attract our attention include where:

- a trust has
  - a small amount of distributable income and a large amount of net income
  - supposedly made a tax-preferred beneficiary entitled to that distributable income
  - a difference between distributable income and net income which was either retained in the trust or extracted from the trust in a tax-concessional form
- steps have been taken to create or increase the difference between distributable and net income, or to include the tax-preferred entity as a beneficiary
- the trust deed has not been followed when calculating distributable income or assigning distributable income to beneficiaries

- the income of the trust includes franked dividends from a private company.

For more information, see:

- TA 2013/1 *Arrangements to exploit mismatches between trust and taxable income*
- TA 2016/12 *Trust income reduction arrangements*
- TD 2018/13 *Income tax: Division 7A: can section 109T of the Income Tax Assessment Act 1936 apply to a payment or loan made by a private company to another entity (the 'first interposed entity') where that payment or loan is an ordinary commercial transaction?*
- Tax issues for trusts – tips and traps.

Distributions of franked dividends

We are concerned that beneficiaries and their advisors are not applying the franking credit integrity rules when making or receiving franked distributions. As a result:

- individual beneficiaries are claiming franking credits when the qualified person rule or small shareholder exemption ($5,000) is not met
- beneficiaries are claiming the franking credit tax offset from franked distributions (for shares acquired post 31 December 1997) received from discretionary trusts when the trust has not made a family trust election (FTE)
- corporate beneficiaries are claiming or converting excess franking credits into losses when the holding period rule is not met.

Distributions to complying superannuation funds

We focus on distributions from trusts to complying superannuation funds, including self-managed super funds (SMSFs). Any non-arm’s length income should be taxed in the superannuation fund at the top marginal tax rate.

We look for complying superannuation funds (generally SMSFs) that receive income distributions from a trust, where the distributions result from:

- the exercise of a discretion of the trustee
- a fixed entitlement with one or more of the following features
  - the fixed entitlement was not acquired on arm's length terms
  - the fixed entitlement was acquired using a loan from a related lender who is not on arm's length terms
  - the acquisition of assets within the trust was facilitated by loans between related parties which are not on arm's length terms
  - the rate of return received from the investments of the superannuation fund is not consistent with an arm's length return.

For more information, see:

- Non-arm’s length income
- SMSF limited recourse borrowing arrangements interest rates
- TR 2006/7 *Income tax: special income derived by a complying superannuation fund, a complying approved deposit fund or a pooled superannuation trust in relation to the year of income*
- TD 2016/16 *Income tax: will the ordinary or statutory income of a self-managed superannuation fund be non-arm's length income under subsection 295-550(1) of the Income Tax Assessment Act 1997 (ITAA 1997) when the parties to a scheme have entered into a limited recourse borrowing arrangement on terms which are not at arm's length?*

Distributions to tax-preferred beneficiaries

We focus on distributions to tax-preferred beneficiaries that may have been used by trustees to attempt to reduce the amount of tax paid on the trust's net income (as calculated under section 95 of the ITAA 1936).

Tax-preferred beneficiaries include:

- tax-exempt entities

- entities that deduct excess deductions and tax losses against their share of the trust's net income
- entities that apply capital losses or carried forward net capital losses against their share of the trust's capital gains
- entities that pay lower or nil rates of tax
- entities that lack the financial means to pay tax
- non-resident beneficiaries that are either entitled to trust amounts that are subject to withholding tax or whose share of trust income is attributed to sources outside Australia.

Situations that attract our attention include where:

- a tax-preferred beneficiary becomes entitled to an amount that is favourably taxed because of their characteristics
- the entitlement of the tax-preferred beneficiary is not paid to them or is applied to someone else
- the tax-preferred beneficiary has been recently introduced into the trust, or has a weak social or economic connection with the persons controlling the trust
- steps were taken to change the character of the trust income so that the income of the tax-preferred beneficiary is favourably taxed
- the tax-preferred beneficiary is not able to pay the tax due on the trust entitlement
- the tax-preferred beneficiary is tax-exempt, whether or not the requirements in sections 100AA and 100AB of the ITAA 1936 have been met.

For more information, see:

- Tax issues for trusts – tips and traps
- TA 2013/1 *Arrangements to exploit mismatches between trust and taxable income*
- TA 2016/12 *Trust income reduction arrangements*.

Family trust distributions tax

We focus on:

- a trust that has a family trust election in place (family trust) which is distributing outside the family group of the specified individual
- distributions to entities outside the family group by a trust, partnership or company which has made an interposed entity election (IEE) to be included in the family group of the specified individual of a family trust
- instances where an individual beneficiary incorrectly returned an amount on which family trust distributions tax (FTDT) has been paid.

For more information, see:

- **Family of the specified individual**
- **Family trust distribution tax.**

Income recharacterisation arrangements

We focus on trusts where revenue activities are mischaracterised or transactions are undertaken for the dominant purpose of changing the character of trust income to:

- achieve lower rates of tax
- obtain access to benefits or concessions not ordinarily available to trusts.

Situations that attract our attention include:

- using special purpose trusts to recharacterise ordinary income as discountable capital gains
- changing the character of trust income to access the withholding tax provisions.

See **TA 2014/1** *Trusts mischaracterising property development receipts as capital gains*.

Loss trust moved into group

Trusts with significant revenue or capital losses that have recently been moved into a group attract our attention.

We focus on the carrying forward and use of revenue losses by a trust, to ensure the trust loss measures restrictions are applied.

In these situations, entities within the new group may attempt to take advantage by distributing capital gains to the capital loss trust.

For more information, see:

- Trust loss provisions
- TD 2001/27 *Income tax: capital gains: how do Part 3-1 and 3-3 of the Income Tax Assessment Act 1997 (ITAA 1997) treat*

1. *a final liquidation distribution, including where all or part of it is deemed by subsection 47(1) of the Income Tax Assessment Act 1936 ('ITAA 1936') to be a dividend, and*
2. *an interim liquidation distribution to the extent it is not deemed to be a dividend by subsection 47(1)*.

Non-lodgment

If a trust has derived income, they will have to lodge a return, irrespective of the amount of income, unless exempted by the Commissioner.

Prompt lodgment of trust returns is integral to the integrity of the tax system. We rely upon the details provided in trust and beneficiary tax returns to satisfy ourselves that the appropriate amount of tax has been paid through the undertaking of tax assurance activities.

We focus on non-lodgment of trust and beneficiary tax returns. We use information matching techniques to identify returns that are overdue or where there is a potential mismatch.

Non-residents' capital gains

We focus on the capital gains of trusts that are attributed to a foreign resident beneficiary's interest in the trust that have not been assessed to the trustee under section 98 of the ITAA 1936.

Situations that attract our attention include trustees and foreign resident beneficiaries who rely on:

- section 855-10 to disregard capital gains made by a resident trustee

- section 855-40 where the trust is not a fixed trust
- source rules in taking the position that capital gains made by a trustee outside of Australia are not assessed to the trustee under section 98.

We focus on these situations because there is a higher risk that tax was avoided.

For more information, see:

- TD 2022/12 *Income tax: is the source concept in Division 6 of Part III of the Income Tax Assessment Act 1936 relevant in determining whether a non-resident beneficiary of a resident trust, or trustee for that trust, is assessed on an amount of trust capital gain arising under Subdivision 115-C of the Income Tax Assessment Act 1997?*
- TD 2022/13 *Income tax: does Subdivision 855-A (or subsection 768-915(1)) of the Income Tax Assessment Act 1997 disregard a capital gain that a foreign resident (or temporary resident) beneficiary of a resident non-fixed trust has because of subsection 115-215(3)?*

Potential reimbursement agreements

We focus on arrangements that may constitute a reimbursement agreement. These agreements involve a trustee making distributions to lower taxed beneficiaries while the economic benefits are directed to another entity. The other entity is often a controller of a privately owned group, close relatives of the controller or an entity within such a group.

We are concerned with these arrangements as they typically exhibit the following features:

- elements of contrivance
- undue complexity
- other features that do not show a commercial or family-based reason
- a motivation to shelter income from higher rates of tax.

Practical Compliance Guideline PCG 2022/2 *Section 100A reimbursement agreements - ATO compliance approach* describes the arrangements that are high risk and to which we will prioritise the allocation of our compliance resources.

An example of an arrangement that is high risk is outlined to Taxpayer Alert **TA 2022/1** *Parents benefitting from the trust entitlements of their children over 18 years of age*.

For more information, see:

- Taxation Ruling **TR 2022/4** *Income tax: section 100A reimbursement agreements*
- **Trust taxation - reimbursement agreement**
- Practical Compliance Guideline **PCG 2022/2** *Section 100A reimbursement agreements - ATO compliance approach*
- **Taxpayer Alert TA 2022/1** *Parents benefitting from the trust entitlements of their children over 18 years of age*.

Unitisation arrangements

We focus on arrangements involving private companies acquiring units in a unit trust. These arrangements may involve either the:

- company making a payment to the unit trust for the units
- unit trust issuing the units to satisfy a UPE, debt or other obligation owed to the company.

We are concerned if the cost of the units is more than what would have been paid had the parties been dealing at arm's length.

The funds representing the UPE are then either:

- retained in the unit trust as working capital
- used to make loans or payments to shareholders or associates of shareholders of the private company.

These arrangements may involve the application of Division 7A, section 100A or Part IVA of the ITAA 1936.

See **Unit trust arrangements and unpaid present entitlements**.

Value extraction and corpus distributions

Capital distributions, or entitlement to corpus, may involve extracting value from a trust in a non-assessable form (subject to the CGT events, section 99B and the specific entitlement rules in Subdivision 115-C of the ITAA1997).

Situations that attract our attention include when the:

- corpus entitlement is satisfied by
  - an unrealised capital gain
  - using an unpaid income entitlement of a tax-preferred beneficiary
  - accessing value in another entity, such as a company or a superannuation entity
- capital distribution is funded from, or causes, a difference between the trust's distributable and net income
- transfer of assets occurs to another trustee who intends both
  - to hold them as a separate trustee on the same trust under a trust splitting arrangement
  - that the transfer should not trigger CGT events E1 and E2
- trustee has borrowed money to satisfy the corpus entitlement and is claiming deductions for the loan interest.

For more information, see:

- Division 6 – Trust income
- Section 100A – Present entitlement arising from reimbursement agreement
- Trust taxation – reimbursement agreement
- TR 2005/12 *Income tax: deductibility of interest expenses incurred by trustees on funds borrowed in connection with the payment of distributions to beneficiaries*
- Taxation Determination TD 2019/14 *Income tax: will a trust split arrangement of the type described in this Determination cause a new trust to be settled over some but not all assets of the original trust with the result that CGT event E1 in subsection 104-55(1) of the Income Tax Assessment Act 1997 happens?*

To find out what behaviours, characteristics and tax issues attract our attention in Privately owned and wealth groups, see **Privately owned and wealth groups – What attracts our attention**.

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Dealing with risky arrangements

Get advice about the implications of trust or tax planning arrangements either in place or contemplated.

Last updated 8 August 2023

Get advice about the implications of trust or tax planning arrangements either in place or contemplated.

If you're unsure about the full implications of trust or tax planning arrangements either in place or contemplated, we recommend:

- you seek independent advice
- review your arrangement
- **contact us** to discuss your situation.

If you need to adjust a tax position you have previously taken, you can make a **voluntary disclosure**.

If you're aware of potential tax avoidance or evasion arrangements involving trusts proposed to you by other taxpayers and advisers, email **TrustRisk@ato.gov.au** (make sure the information you send us has a 'sensitive' protective marking).

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Results and insights – Trusts Taskforce

How we targeted known tax scheme promoters, individuals and businesses involved in tax avoidance or evasion using trusts.

Last updated 8 August 2023

How we targeted known tax scheme promoters, individuals and businesses involved in tax avoidance or evasion using trusts.

In the 2013–14 Budget, the government announced it would provide $67.9 million over 4 years for targeted compliance action against people who have been involved in tax avoidance or evasion using trusts. This measure was estimated to increase revenue by $379 million over the forward estimates period and, in underlying cash terms, increase receipts by $217.1 million.

From 1 July 2013 to 30 June 2017, the Trusts Taskforce raised over $951 million in liabilities and collected more than $283 million. In addition to the cash collected, assets of $55 million were restrained under proceeds of crime legislation.

The Trusts Taskforce targeted known tax scheme promoters, individuals and businesses who participated in such arrangements. It also used our intelligence systems and analysis of tax returns to identify and deal with abusive use of trusts.

In the most serious cases, criminal sanctions were pursued in collaboration with law enforcement authorities, through the Serious Financial Crime Taskforce and collaboration with overseas authorities.

Amongst its achievements, the Trusts Taskforce:

- finalised 62 audits and 864 reviews
- had 2 convictions for serious tax fraud and referred a further 4 matters to law enforcement agencies for criminal investigation
- issued 3 significant Taxpayer alerts with further alerts being issued by the Tax Avoidance Taskforce
  - the first alert concerned artificial arrangements where a deliberate mismatch is created between trust and taxable income (Taxpayer Alert TA 2013/1 *Arrangements to exploit mismatches between trust and taxable income*)
  - the second alert concerned the incorrect claiming of the 50% capital gains tax discount by trusts engaged in property

development activities (**Taxpayer Alert TA 2014/1** *Trusts mischaracterising property development receipts as capital gains*)

- the third alert concerned arrangements to exploit the proportionate approach to trust taxation by deliberately excluding much of the economic benefit that is reflected in the taxable income of the trust (**Taxpayer Alert TA 2016/12** *Trust income reduction arrangements*).

The Trusts Taskforce identified a number of examples of aggressive tax planning and tax evasion using trust structures, including:

- trafficking in losses through the use of trusts
- active exploitation of the lack of transparency associated with trusts
- trusts distributing income to chains of trusts (some sharing the same corporate trustee), but where the beneficiaries fail to lodge income tax returns reporting that income
- documents being falsified to gain a concession or benefit.

This focus on egregious trusts arrangements continues under the operational umbrella of the Tax Avoidance Taskforce – Trusts.

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Supporting research

The Tax Avoidance Taskforce – Trusts targets higher risk trust arrangements in privately owned and wealthy groups.

Last updated 8 August 2023

The Tax Avoidance Taskforce uses a range of sources when developing strategies to address non-compliance.

As part of our ongoing program of work, the ATO commissioned the Royal Melbourne Institute of Technology (RMIT) to conduct independent research and provide an additional perspective on tax issues involving trusts to assist us to develop mitigation strategies to address trust mischief.

For more information, see **Current Issues with Trusts and the Tax System**.

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Our commitment to you

We are committed to providing you with accurate, consistent and clear information to help you understand your rights and entitlements and meet your obligations.

If you follow our information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

Some of the information on this website applies to a specific financial year. This is clearly marked. Make sure you have the information for the right year before making decisions based on that information.

If you feel that our information does not fully cover your circumstances, or you are unsure how it applies to you, contact us or seek professional advice.