



WA Tax Forum

Family Trust Elections

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1. Overview

The concept of a ‘family trust’ and ‘family trust elections’ (FTE) were introduced as part of the trust loss provisions in schedule 2F of the 1936 Tax Act. These provisions first applied in the 1995 tax year.

A number of subsequent amendments have made it a condition in relation to certain trustees accessing concessions in the 1936 Tax Act and 1997 Tax Act that the trustee has lodged an FTE.¹

If a trustee makes an FTE and then subsequently ‘confers a present entitlement to, or distributes, income or capital of the trust’² to someone who is not a member of the ‘family group’ covered by the FTE then the trustee is liable to pay family trust distribution tax pursuant to Division 271 of schedule 2F.

Related companies and trusts who are eligible may elect to become part of the family group of the test individual who is named in the FTE of a trust by lodging an interposed entity election (IEE).³

The implications of lodging an IEE are substantially the same for lodging an FTE.

The rules relating to passing the ‘family control’ test and who is part of the ‘family group’ become more complex when considering a client’s succession plan. This is mainly for the following reasons:

- The mere death of an individual will not result in another individual ceasing to be a member of the test individual’s ‘family’. However, an individual or spouse of an individual in the ‘family’ may commence a new relationship resulting in particular family members ceasing to be part of the ‘family’. This commonly occurs in relation to step-children, although they will generally still be part of the ‘family group’.

Whereas a test individual can be varied if there is a change of control of a trust as a result of an order, agreement or an award being made pursuant to a marriage or relationship breakdown, a test individual cannot be varied because a test individual has died. In this case the avenue for varying the test individual would be if the requirements under sections 272-80(5A) and 272-80(5B) are satisfied (that is, including within 4 years and provided a previous variation has not occurred).

- It is not uncommon for clients to want to choose independent people to control testamentary trusts. If a testamentary trust is required to make an FTE to pass on franking credits to beneficiaries, it will be important to ensure that the trust can satisfy the ‘family control’ test at the end of the relevant year.
- As part of any succession plan it will be important to identify who will control the trusts in the group and the impact which any FTEs have on the flexibility of future distributions (in particular to corporate beneficiaries owned by trusts). This is particularly the case as the Commissioner’s view is that the test individual must be alive at the time which the FTE is made. It may be possible to establish trusts (during an individual’s lifetime) which have made FTEs with particular test

¹ 45 day holding rule, carry forward company losses (section 165-207 of the 1997 Tax Act) and small business restructure rollover (Subdivision 328-G of the 1997 Tax Act)

² Subdivision 272-B of Schedule 2F of the 1936 Tax Act

³ Section 272-90(4) and Section 272-85 of schedule 2F of the 1936 Tax Act

individuals so that the trusts can be used as shareholders of corporate beneficiaries once the test individual has passed away.

As the consequences of lodging an FTE are quite restrictive a trustee should only make an FTE after considering all issues. FTEs should not be made as a matter of course, even where a trust may have losses.

However there are instances where a trust or company is required to make an FTE and/or IEE. This may be to pass on franking credits or to be part of the 'family group' where the entity has previously received distributions. It is important to identify these instances as soon as possible. There are circumstances where FTEs and IEEs can specify an earlier year in which to commence, however this is subject to the trust or company having not made distributions outside the 'family group' of the person who will be chosen as the test individual. As the test individual must be alive at the time the FTE is made, sometimes once the individual has died, it is impossible to be able to satisfy this requirement resulting in:

- distributions being made outside the family group and therefore subject to family trust distribution tax; and/or
- trusts not being able to make a valid FTE to pass on franking credits (resulting in dividends being trapped in companies without franking credits).

In this paper, references to:

- '1997 Tax Act' means the Income Tax Assessment Act 1997 (Cth)
- '1936 Tax Act' means the Income Tax Assessment Act 1936 (Cth)
- 'Tax Acts' means the 1997 Tax Act and 1936 Tax Act
- 'FTE' means Family Trust Election
- 'IEE' means Interposed Entity Election
- 'FTDT' means Family Trust Distribution Tax
- 'test individual' has the same meaning as 'specified individual' and 'primary individual'

2. Fixed trusts, non-fixed trusts and excepted trusts

2.1 Fixed Trust

- There is a common misconception that unit trusts are “fixed trusts”.

In fact, most private unit trusts will not qualify as a fixed trust for the purposes of the Tax Acts.

- This can be quite important as:

- different rules apply under the “loss trust provisions” for fixed and non-fixed trusts;
- a unit trust that holds shares cannot claim the franking credits attaching to dividends unless an FTE has been made or the trust is a fixed trust; and
- for most private unit trusts it will not be practical for the trustee to make an FTE as the effect of making an FTE is that the trustee will be liable for family trust distribution tax on any distributions outside of the family group of the test individual.

This means that it will be important in those circumstances that the unit trust qualifies as a fixed trust.

2.1.1 Definition of a ‘fixed trust’ for the purpose of loss trust provisions?

- A trust will be a fixed trust only “if persons have fixed entitlements to all of the income and capital of the trust”.⁴
- Beneficiaries will have fixed entitlements to the income and capital of a trust if, under a trust instrument they have “a vested and indefeasible interest” in a share of the income and/or capital.⁵
- “Vested” and “Indefeasible”: What does this mean?

Neither of these terms are defined in the Tax Acts, therefore they will take on the ordinary meaning.

- Meaning of vested⁶:
 - A vested interest is one that is bound to take effect in possession at some point in time.
 - A vested interest is to be contrasted with a contingent interest which may never fall into possession. A contingent interest gives no rights at all unless or until some future event (the contingency) takes place. An example of a contingent interest might be a beneficiary’s entitlement to income which is expressed under the deed only to arise if the trustee exercises a power of appointment in favour of the beneficiary.

⁴ Section 272-65 of Schedule 2F of the 1936 Tax Act

⁵ Section 272-5(1) of Schedule 2F of the 1936 Tax Act

⁶ Per the Explanatory Memorandum to the Taxation Laws Amendment (Trust Loss and Other Deductions) Bill 1998 (which introduced the definition of ‘Fixed Trust’ into the trust loss provisions)

- Meaning of Indefeasible:
 - An interest is indefeasible if it is incapable of being terminated, invalidated or annulled.⁷
 - Generally there will be no issue that a unitholder's interest in a share of the income and capital of the trust will be vested.
 - The issue is whether that interest is capable of being terminated, invalidated or annulled.

2.1.2 Indefeasible interest

- If a person holds units in a private unit trust, the mere fact that the units may be redeemable or that further units can be allotted, does not itself prevent them having a fixed and indefeasible interest, provided that units can only be redeemed or allotted at a price determined on the basis of net asset value in accordance with Australian accounting standards.⁸

Few private unit trust deeds will stipulate that the value of units has to be determined in this way.

- *Colonial First State Investments Ltd v FC of T*⁹
 - Colonial First State Investments was the responsible entity and trustee of retail unit trust investment fund. In that capacity it held units in a wholesale unit trust fund. Colonial First State Investments wanted to amend the Constitution of the wholesale fund in respect of the rights attaching to the units on redemption.

Clause 43 of the Constitution permitted the responsible entity to make "any modification, addition or deletion" to the Constitution.

The Commissioner submitted that the terms of clause 43 could allow for the interests in the income and capital of the wholesale fund to be defeated. However, section 601GC(1)(b) of the Corporations Act 2001 provides that the responsible entity can only amend the Constitution if the responsible entity reasonably considers the change will not adversely affect members' rights.

Justice Stone focused on section 601GG(1)(a) of the Corporations Act which empowered members to modify, repeal or replace the Constitution by a special resolution. At [105 and 106]

Although the applicant focused on s 601GC(1)(b), the more telling argument that the right in question is defeasible stems from s 601GC(1)(a), which empowers members to modify, repeal or replace the constitution of a unit trust by special resolution. In ING Funds Management Barrett J's comment that s 601GC(1)(a) is a plenary power vested in the member. As his Honour observed, at [60]:

There is no kind of modification that cannot be made in exercise of the power and by the means it prescribes, although the power is no doubt subject to the implied limitations that generally attend any power enabling a majority to bind a minority.

It follows that the members could vote to terminate the present right to a share of income and capital. Although in some circumstances such an exercise of power might be subject to the implied limitations to which his Honour refers, there is no reason to believe that this would

⁷ *Colonial First State Investments Ltd v FC of T* 2011 FCA 16

⁸ section 272-5(2) of Schedule 2F of the 1936 Tax Act

⁹ 2001 FCA 16

always be so. For that reason it must be concluded that the Wholesale Fund is not a fixed trust

- Following Colonial First State Investments, the ATO issued a Decision Impact Statement (June 2011)

Commissioner's response:

The decision confirms the Commissioner's view that very few trusts satisfy the definition of 'fixed trust' in section 272-65 of Schedule 2F in the absence of the exercise of the Commissioner's discretion (essentially because beneficiary entitlements to income or capital are generally liable to be defeated by the exercise of a power in the deed or by a statutory power).

2.1.3 Current state of play

- The Commissioner has a discretion to deem a beneficiary to have a fixed entitlement.¹⁰ In determining whether to exercise this discretion, the Commissioner must have regard to:
 - the circumstances in which the entitlement is capable of not vesting or the defeasance can happen; and
 - the likelihood of the entitlement not vesting or the defeasance happening; and
 - the nature of the trust.¹¹
- The ATO issued Practical Compliance Guideline PCG 2016/16 on 13 September 2017 which outlined the factors which the Commissioner will consider in deciding whether to exercise its discretion to treat an interest in the income or capital of a trust as being a fixed entitlement. It also outlines a safe harbour approach which allows the trustees to manage the trust's affairs as if the Commissioner had exercised the discretion to treat beneficiaries as having fixed entitlements to income and capital of the trust.

Note: PCG 2016/16 does not apply to former section 60APHL(14) of the 1936 Tax Act (where the Commissioner may determine an interest to be vested and indefeasible for the purpose of the holding period rule for franking credits). That is, it will be necessary to apply to the Commissioner for his discretion).

- In PCG 2016/16, the Commissioner [at paragraph 16] outlines the following powers in trust deeds which cause a beneficiary's interest to be defeasible:
 - Broad powers to amend the trust instrument.
 - Powers to issue new units after the trust is settled, or to redeem existing units.
 - A power to reclassify existing units so that they do not all have equal rights to receive the income and capital of the trust.
 - A power to classify receipts as being on income or capital account where the units that have been issued do not all have the same rights to receive the income and capital of the trust.

¹⁰ Section 272-5(3) of Schedule 2F of the 1936 Tax Act

¹¹ Sections 272-5(1)(b)(i)-(iii) of Schedule 2F of the 1936 Tax Act

- A power to appoint a beneficiary's interest in the income or capital of the trust to another beneficiary.
 - A power to settle or appoint any part of the corpus of the trust to a new trust with different beneficiaries.
 - A power to enforce the forfeiture or cancellation of partly paid units due to the non-payment of a call except where such partly paid units would be void ab initio.
 - For the purposes of working out whether all beneficial interests have the same rights to receive the income and capital of the trust, the Commissioner will disregard the following factors which may otherwise result in a different conclusion [at paragraph 17]
 - Fees or charges imposed by the trustee in relation to the beneficial interests.
 - Issue price and redemption price of the beneficial interests (provided that the savings rule in subsection 272-5(2)).
 - Exposure of the beneficial interests to foreign exchange gains and losses.
 - Satisfaction of the 'savings rule' in subsection 272-5(2) [at paragraphs 18 and 19]
 - The mere fact that a trustee has power to redeem units in a unit trust, or issue further units, for an appropriate value, being:
 - where the units are listed for quotation in the official list of an approved stock exchange — the same price as other units are offered for sale on that exchange at the time of the redemption or issue, or
 - where the units are not so listed — a price determined on the basis of the net asset value of the unit trust at the time of the redemption or issue according to Australian accounting principles
- does not mean that unit holders' interests in the income or capital of the unit trust are defeasible.
- The Commissioner considers that the savings rule is satisfied where further units may be issued or existing units redeemed in any of the following situations:
 - For a price based on a market value of the assets and liabilities of the trust which has been determined by a licensed valuer.
 - For a price based on a market value of the assets and liabilities of the trust which has not been determined by a licensed valuer, but which nevertheless is accurate.
 - For a price determined by reference to a value of the trust which is sufficiently close to its net asset value (allowing an adjustment for transaction costs).
 - For a price determined by reference to a value of the trust which is sufficiently close to its net asset value (allowing an adjustment for transaction costs), including where accrued distributions are excluded from the net asset value based on a 'unit day's pricing model'.
 - For a price based on the volume weighted average price (VWAP) of the units.

- In accordance with ASIC Corporations (Managed investment product consideration) Instrument 2015/847, ASIC Class Order [CO 13/655] and ASIC Class Order [CO 13/657] (if relevant), or any other ASIC guidance or relief on the same subject.
- Commissioner's discretion [at paragraphs 25 to 41]
 - Where a trust is not a fixed trust, because all of the beneficiaries' interests in the income and capital of the trust are not fixed entitlements, and the trust does not satisfy the requirements for a 'safe harbour', the trustee may request that the Commissioner exercise the discretion to treat beneficiaries' interests as being vested and indefeasible.
 - A trust can both rely on the savings rule in relation to some trustee powers in a trust instrument (the power to issue or redeem units), and request that the Commissioner exercise the discretion in the context of other powers that may defeat a beneficiary's interest (such as in relation to a power to amend).
 - Circumstances in which the interest is capable of not vesting or being defeated
 - When examining the circumstances in which a beneficiary's interest is capable of not vesting or being defeated, the Commissioner will have regard to any factor that may affect the defeasance of any beneficiary's interest, including:
 - the number of circumstances of potential defeasance, and
 - the significance of those circumstances.
 - This includes having regard to:
 - any person who is capable of altering the beneficiary's interest;
 - the nature of their relationship to the beneficiary, and
 - any limitation on their capability to so alter that interest.
 - The likelihood of the interest not vesting or the defeasance happening
 - When considering the likelihood of the interest not vesting or being defeated, the Commissioner must form a view as to the probability that the contingency or defeasance will happen. Where the likelihood of the contingency or event of defeasance occurring is low, this will weigh towards a favourable exercise of the discretion.
 - Where the trustee or manager of the trust has a particular power to defeat a beneficiary's interest, it is relevant to consider how often, if at all, they have exercised that power over a relevant period.
 - Any preconditions or caveats that affect the likelihood of a beneficiary's interest not vesting or being defeated are also relevant.
 - The nature of the trust

The nature of the trust refers to its basic legal characteristics and its economic function, both actual and intended. The ability of the trustee or manager of the trust to adversely affect the interests of beneficiaries could be limited where:

- additional responsibilities are placed on the trustee by legislation, most commonly as a registered managed investment scheme under Chapter 5C of the Corporations Act 2001;
 - contractual restrictions limit the trust manager's access to trust assets;
 - the trust is subject to industry regulations, licensing or registration requirements, which are legally enforceable, such as the Australian Securities Exchange (ASX) Listing Rules which are enforceable against listed entities and their associates;
 - commitments are made in a Product Disclosure Statement, Investment Memorandum or other document to exercise powers in a particular (restrictive and/or non-adverse) way;
 - the trust deed restricts the ability of the trustee to issue and redeem units at anything other than market value or other values approximating net asset value, or
 - the unanimous (100%) approval of the beneficiaries is required prior to the exercise of a power capable of defeating a beneficiary's interest by the trustee or manager.
- Other contextual factors
 - Having regard to the subject matter, scope and purpose of the trust loss rules, it is relevant for the Commissioner to consider whether the exercise of the discretion would allow a person to obtain a tax benefit from a trust claiming a deduction for a tax loss, bad debt deduction or debt/equity swap deduction when the person did not bear the economic loss incurred by the trust.
 - The concept of a fixed entitlement is central to the operation of the trust loss rules, the purpose of which is to prevent the transfer of the tax benefit of those losses or deductions. The tax benefit of a loss is transferred when a person who did not bear the economic loss at the time it was incurred by the trust obtains a benefit from the trust being able to deduct the loss.
 - Factors influencing the exercise of the Commissioner's discretion
 - Factors favourable to the exercise of the Commissioner's discretion
 - A trustee or manager has never exercised a power capable of defeating a beneficiary's interest to defeat a beneficiary's interest in the income or capital of the trust.
 - Commitments are made in unit holder agreements, Product Disclosure Statements or other documents with legal consequences that the trustee or manager will not exercise a power capable of defeating a beneficiary's interest at all, or in a way that is adverse to the rights of beneficiaries to receive the income and capital of the trust.
 - All beneficiaries have the same rights to receive the income and capital of the trust.
 - The trust instrument can only be amended with the unanimous (100%) approval of all the beneficiaries.

- Although the trust instrument can be amended without the unanimous approval of beneficiaries, the approval percentage calculated on the current interest or unit holdings of beneficiaries effectively means that all beneficiaries must approve any amendment (for example, where the approval of 75% of unit holders is required to make the amendment and the smallest unit holding is more than 25% of the units).
- The trust instrument has been amended in accordance with section 601GC of the Corporations Act 2001 (so as to assist with the efficient administration of the trust) but no beneficial interests in the income and capital of the trust are adversely affected.
- The beneficiaries whose rights to receive the income and capital of the trust have been adversely affected by the exercise of a power capable of defeating a beneficiary's interest have explicitly consented to that specific act (such as upon the redemption of the interests of an employee not covered by the savings rule upon the cessation of employment).
- The trustee or manager deals with the beneficiaries of the trust on an arm's length basis.
- The trust is governed by a foreign law that is similar to Chapter 5C of the Corporations Act 2001.
- The trust would satisfy the basic and specific conditions (as applicable to the type of trust) for access to a safe harbour.
- Factors adverse to the exercise of the Commissioner's discretion
 - a trustee or manager exercises a power to defeat beneficiaries' interests in the income or capital of the trust, however:
 - the nature of the power that is exercised will be important, for example, compulsorily redeeming units where a unit holder's stake is less than a minimum specified in the trust instrument, and the unit holder receives the redemption price of those units, is unlikely to preclude the exercise of the discretion
 - where external factors (such as those in the Global Financial Crisis) temporarily affect the ability of the trustee or manager to fund distributions or redemptions, this is unlikely to preclude the exercise of the discretion (for example, a temporary wholesale freezing or deferral of interests)
 - there are significantly different beneficiaries of the trust in an income year for which an entity seeks to have a fixed entitlement, than the beneficiaries of the trust in the income year(s) in which the trust made a tax loss, or incurred a bad debt deduction or debt/equity swap deduction
 - an arrangement has been entered into which would result in:
 - section 272-35 having application
 - the trafficking of the tax benefit of a tax loss, bad debt deduction or debt/equity swap deduction, or
 - fraud or evasion.
- In each case the Commissioner will weigh up all factors (favourable and unfavourable) in the context of the facts and circumstances of the case. The

presence of more favourable factors will increase the likelihood that the Commissioner will exercise the discretion.

- However, a single power in a trust instrument may pose such a serious threat to beneficiaries' interests that, in the absence of any mitigating factors, the Commissioner will not exercise the discretion.
 - Conversely, the absence of some or all of the favourable factors does not necessarily preclude the exercise of the discretion.
- "Safe harbours" [at Attachment B]
 - The trustee of a trust that satisfies the conditions for one of the categories below can manage its tax affairs as if the Commissioner had exercised the discretion to treat the beneficiaries as having a fixed entitlement to the income and capital of the trust for the purposes of section 272-5.
 - Accordingly, other than ensuring that a trust satisfies the relevant conditions of the category relied upon, the Commissioner will not allocate compliance resources to determine whether beneficiaries have fixed entitlements in cases where one of the categories below is met. A safe harbour only has application during the period in which the conditions for the relevant category are satisfied. A trustee that requires certainty as to whether or not the beneficiaries of the trust have fixed entitlements in relation to a future time must request the exercise of the Commissioner's discretion.
 - Taxpayers should maintain relevant records that support their claim that they meet the relevant conditions being relied on.
 - Specific single interest holder trusts

The trust complies with all of the following conditions:

- the trust must have a trust instrument
- all beneficial interests in the income and capital of the trust are vested
- all beneficial interests have the same rights to receive the income and capital of the trust
- all beneficial interests in the income and capital of the trust can be expressed as a percentage of the total income and capital of the trust
- the trust is not a discretionary trust or a trust with default income or capital beneficiaries — that is, no beneficial interest in the income or capital of the trust is capable of being defeated, partly or wholly, by the exercise of a power of appointment of income or capital by the trustee or other donee
- one of the following types of entity holds all of the interests, directly or indirectly, in the trust and has the right to receive all of the income and capital of the trust, directly or indirectly, for their own benefit (that is, excluding a nominee, custodian or agent)
 - an individual
 - a listed trust

- a registered managed investment scheme), and
- an arrangement has not been entered into which would result in:
 - section 272-35 having application
 - the trafficking of the tax benefit of a tax loss, bad debt deduction or debt/equity swap deduction, or
 - fraud or evasion.
- Trust (other than listed trusts, registered managed investment schemes that are trusts, unregistered managed investment schemes and certain widely held trust)

The trust complies with all of the following conditions:

- the trust must have a trust instrument
- all beneficial interests in the income and capital of the trust are vested
- all beneficial interests have the same rights to receive the income and capital of the trust
- all beneficial interests in the income and capital of the trust can be expressed as a percentage of the total income and capital of the trust
- the trust is not a discretionary trust or a trust with default income or capital beneficiaries — that is, no beneficial interest in the income or capital of the trust is capable of being defeated, partly or wholly, by the exercise of a power of appointment of income or capital by the trustee or other donee
- a trustee or manager has never exercised a power capable of defeating a beneficiary's interest to defeat a beneficiary's interest in the income or capital of the trust, and
- an arrangement has not been entered into which would result in:
 - section 272-35 having application
 - the trafficking of the tax benefit of a tax loss, bad debt deduction or debt/equity swap deduction, or
 - fraud or evasion.

2.2 Non-Fixed Trust

- A trust is a non-fixed trust if it is not a fixed trust.¹²

¹² Section 272-70 of Schedule 2F of the 1936 Tax Act

2.3 Excepted Trust

- A trust is an excepted trust at a particular time if:
 - it is a family trust at the particular time; or
 - it is a complying superannuation fund, a complying approved deposit fund or a pooled superannuation trust in relation to the income year in which the particular time occurs; or
 - it is the trust of a deceased estate, where the particular time occurs during the period from the death of the individual until the end of the year of income in which the 5th anniversary of the death occurs; or
 - at the particular time it is a fixed trust that is a unit trust, and exempt entities have fixed entitlements, directly or indirectly, and for their own benefit, to all of the income and capital of the trust; or
 - it is a designated infrastructure project entity at the particular time.¹³
- A trust is a family trust at any time when an FTE in respect of the trust is in force.¹⁴
- An excepted trust which is a family trust will need to satisfy the income injection rules.

¹³ Section 272-100 of Schedule 2F of the 1936 Tax Act

¹⁴ Section 272-75 of Schedule 2F of the 1936 Tax Act

3. Why may a trustee need to make an FTE?

3.1 Trust Losses

- A trust (other than an Excepted Trust) will be denied a deduction for prior year tax revenue losses and/or debt deductions if it fails to satisfy certain tests.
- A fixed trust must meet:
 - the 50% stake test; and
 - the income injection test.
- A non-fixed trust must meet:
 - the pattern of distributions test;
 - the 50% stake test;
 - the control test; and
 - the income injection test.
- An 'Excepted Trust' can claim prior year losses and/or debt deductions without having to satisfy the above tests. An Excepted Trust includes:
 - a 'family trust'; and
 - a deceased estate provided that it is during the period of time commencing from the date of the death of the individual to the end of the income year in which the 5th anniversary of the date of death occur.

For example, if the individual died on 1 October 2023, then the deceased estate will be an Excepted Trust from 1 October 2023 until 30 June 2029.

After the end of the income year of the 5th anniversary of the date of death, the estate will need to satisfy the normal rules.

However a 'family trust' will be subject to the 'income injection rules'.

- If the assets pass to a testamentary trust, then to claim prior year revenue losses and/or debt deductions, the testamentary trust will need to satisfy the normal rules depending on whether it is a:
 - Fixed trust;
 - Non-fixed trust; or
 - Family trust.

3.2 Company Loss Provisions

- To carry forward a loss a company must meet either the:
 - continuity of ownership test (COT); or
 - the same business test.
- To satisfy COT, the same persons must beneficially own more than 50% of exactly the same shares in the company from the beginning of the loss year until the end of the year in which the losses are recouped (sections 165-12, 165-155 and 165-165 of the 1997 Act).
- Can the Company satisfy COT where at least 50% of the shares are held by a discretionary trust?
 - At law, a trustee cannot beneficially own shares.
 - However, if the trustee makes an FTE from at least the beginning of the loss year, the shares are taken to be beneficially owned by the family trust from that time which means the company can satisfy the COT.¹⁵
- Where an individual who beneficially owns shares in a company dies, then for the purposes of COT, the deceased is taken to continue to beneficially own the shares provided the shares are owned:
 - by the trustee of the deceased's estate; or
 - beneficially by someone who receives them as a beneficiary of the deceased's estate.¹⁶

3.3 Holding period rule for passing on franking credits

3.3.1 Beneficiaries

- To be able to claim franking credits which are attached to franked dividends from shares acquired on or after 31 December 1997, a beneficiary must be a 'qualified person' (as defined in former section 160 APHD of the 1936 Tax Act).
- A person is a 'qualified person' if they satisfy the holding period rule. Broadly, the holding period rule will be satisfied where a beneficiary has held its interest in shares 'at risk' in respect of which a dividend has been paid, for a period of 45 days (or 90 days for preference shares) commencing on the day after the share is acquired and ending on the day after the shares become ex-dividend.¹⁷
- Beneficiaries of non-fixed trusts (including testamentary trusts)
 - A beneficiary of a non-fixed trust cannot satisfy the holding period rule unless the trustee makes a valid FTE. This is because the beneficiary's fixed interest in the capital of the trust

¹⁵ Section 165-207 of the 1997 Tax Act

¹⁶ Section 165-205 of the 1997 Tax Act

¹⁷ Former section 160APHO of the 1936 Tax Act

will be nil.¹⁸ However, provided that the trustee has a valid FTE in place for the holding period then former section 160 APHL (10) of the 1936 Tax Act does not apply.

- If the trustee of the non-fixed trust does not satisfy the period rule, then if the beneficiary is an individual, the beneficiary will be a ‘qualified person’ provided that individual’s total franking credits for the income year does not exceed \$5,000.¹⁹

3.3.2 Deceased estates

- In determining whether the executor of a deceased estate satisfies the holding period rule, the executor is taken to have acquired the shares at the time when they were acquired by the deceased person.²⁰

3.3.3 Trustees assessed under section 99 or 99A of the 1936 Tax Act

- Where no beneficiary is presently entitled to trust income and the trustee is assessed under section 99 or 99A of the 1936 Tax Act on the franked dividend then the trustee will be entitled to a tax offset that income year equal to its share of the franking credit provided that it is a qualified person [that is, it satisfies the holding period rule] (Sections 207-45(c) and 207-150 of the 1997 Tax Acts). There is no requirement that the trustee has made an FTE. (Private Binding Ruling Authorisation number 1052057572233)

3.4 Small business restructure rollover under Subdivision 328-G of the 1997 Tax Act (SBRR)

- One of the requirements to apply the SBRR is that the transaction must not have the effect of materially changing:
 - which individual has, or which individuals have, the ultimate economic ownership of the assets; and
 - if there is more than one such individual – each such individual’s share of that ultimate economic ownership.²¹
- Special rule for discretionary trusts²²
 - If an asset or interest in an entity is owned by a discretionary trust then it will not be possible to trace through to individual owners as the beneficiaries will only have a contingent interest in the trust. Therefore, there is special rule where the transferor and/or transferee is a non-fixed trust.

¹⁸ Former section 160APHL(10) and (11) of the 1936 Tax Act

¹⁹ Former section 160 APHT of the 1936 Tax Act

²⁰ Former section 160 APHH(4) of the 1936 Tax Act

²¹ Section 328-430(1)(c) of the 1997 Tax Act

²² Section 328-440 of the 1997 Tax Act

- In relation to accessing the SBRRs, a transaction does not have the effect of changing the ultimate economic ownership of an asset, or an individual's share of that ultimate economic ownership, if all of the following are satisfied:
 - Criteria One:
 - Either or both of the following applies
 - Just before the transaction took effect, the asset was included in the property of a non-fixed trust that had made an FTE.
 - Just after the transaction took effect, the asset was included in the property of a non-fixed trust that had made an FTE.
 - Note: This means that either the transferor or transferee (or both) must be a trust which has made an FTE.
 - Criteria Two

Every individual who, just before the transfer took effect, had the ultimate economic ownership of the asset was a member of the family group (within the meaning of Schedule 2F of the 1936 Tax Act) of the individual specified in the FTE.
 - Criteria Three

Every individual who, just after the transfer takes effect, has the ultimate economic ownership of the asset is a member of that family group.

4. Tests for fixed trusts to deduct tax revenue losses and bad debts

- In order for a fixed trust to retain the benefit of its tax losses it must pass either the
 - the 50% Stake Test; or
 - the non-fixed trust stake test.²³
- 50% Stake Test
 - The 50% stake test is met if, at all times during the period (which commences at the beginning of the loss year and finishes at the end of the income year):²⁴
 - the same individuals have more than a 50% stake in the income of a trust; and
 - the same individuals (who may be different to the above) have more than a 50% stake in the capital of the trust.
 - Individuals have more than a 50% stake in the income of a trust if the individuals have (between them), fixed entitlements to a greater than 50% share of the income of a trust.
 - Individuals have more than a 50% stake in the capital of a trust if the individuals have (between them), fixed entitlements to a greater than 50% share of the capital of a trust.
 - For the purpose of this test, other trusts that hold units and have made an FTE will be treated as individuals who hold a fixed stake.²⁵
 - If immediately before an individual dies, they had a fixed entitlement to income or capital, the individual is taken to continue to have the entitlement for so long as:
 - It is held by someone as trustee of the individual's estate; or
 - It is held by someone who received it as a beneficiary of the estate.²⁶
- The non-fixed trust stake test will only apply in limited situations where non-fixed trusts (that have not made FTEs) hold a fixed interest (direct or indirect) of 50% or more in the income and capital of the trust.

Where this test applies each of the non-fixed trusts that hold units must satisfy all of the tests for non-fixed trusts.

²³ Section 266-40 and Section 266-45 of Schedule 2F of the 1936 Tax Act

²⁴ Subdivision 269-C of Schedule 2F of the 1936 Tax Act

²⁵ Section 272-30(2) of Schedule 2F of the 1936 Tax Act

²⁶ Section 272-40 of Schedule 2F of the 1936 Tax Act

5. Tests for non-fixed trusts to deduct tax revenue losses and bad debts

- A non-fixed trust may have to satisfy:

- the pattern of distribution test;
- the control test;
- partially fixed stake test;

whichever are applicable.

5.1 Pattern of distribution test

- In most cases, the relevant test will be the pattern of distribution test²⁷ which applies if:
 - the trust distributed income:
 - in the income year or within two months after its end; and
 - in at least one of the six earlier income years; or
 - the trust distributed capital:
 - in the income year or within two months after its end; and
 - in at least one of the six earlier income years; or
- A trust passes the pattern of distributions test for an income year if the trust distributed directly or indirectly:²⁸
 - a greater than 50% share of all test year distributions of income to the same individuals; and
 - a greater than 50% share of all test year distributions of capital to the same individuals.
- A test year distribution of income is the total of all distributions of income made by the trust in any of the following periods, provided the period does not start more than six years before the start of the income year:
 - paragraph (A) - the period from the start of the income year until two months after its end;
 - paragraph (B) -if the trust distributed income before the loss year – the income year, before the loss year that is closest to the loss year;
 - paragraph (C) - if paragraph (B) does not apply and the trust distributed income in the loss year – the loss year;

²⁷ Section 267-30 of Schedule 2F of the 1936 Tax Act

²⁸ Subdivision 269-D of Schedule 2F of the 1936 Tax Act

- paragraph (D) - if neither paragraph (B) or (C) applies – the income year, closest to the loss year, in which the trust distributed income;
- paragraph (E) - each intervening income year (if any) between the one in paragraph (A) and the one in paragraph (B), (C) or (D).
- A test year distribution of capital applies the same way as the test year distribution of income.
- If the percentage of distributions to an individual differs between years, the smallest percentage that it distributed to the individual is used.

This means that if the same beneficiary received 80% of the income in one year and only 20% of income in another year in the test period, they are taken to have received a maximum of 20% in both years.²⁹

- If the trustee distributes to an entity (for example, a corporate beneficiary) and individuals have fixed interests in income/capital, then the distribution to the corporate beneficiary will be attributed to the individuals for the purpose of the pattern of distribution test (incomplete distributions).³⁰
- However, if the shares in a corporate beneficiary:
 - are held by a discretionary trust; or
 - have discretionary dividend entitlements;

the income distributed to the corporate beneficiary cannot be counted for purpose of the pattern of distribution as there will be no “individual” who receives the distribution.

This means it will be very difficult to pass the test if the trust makes substantial distributions to the corporate beneficiary.

- Caution is required in identifying “distributions” as this concept is defined very broadly³¹ and includes:
 - distributions ‘by way of loan’;
 - allowing a beneficiary to use trust property;
 - release of debt.
- Where there is no distribution to an individual because the individual has died or there is a breakdown in the marriage, no income or capital distributed to that individual by the trust is to be included in any test year distribution.³²

Breakdown in the marriage includes de facto relationships.

²⁹ Section 269-70 of Schedule 2F of the 1936 Tax Act

³⁰ Section 269-75 of Schedule 2F of the 1936 Tax Act

³¹ Section 272-60 of Schedule 2F of the 1936 Tax Act

³² Section 269-80 of Schedule 2F of the 1936 Tax Act

5.2 Control test

- A group must not, during the income year, begin to control the trust directly or indirectly.³³
- A group controls a non-fixed trust if:³⁴
 - the group has the power, by means of the exercise of a power of appointment or revocation or otherwise, to obtain beneficial enjoyment (directly or indirectly) of the capital or income of the trust;
 - the group is able (directly or indirectly) to control the application of the capital or income of the trust;
 - the group is capable, under a scheme of gaining the beneficial enjoyment or the control;
 - the trustee is accustomed, under an obligation or might reasonably be expected, to act in accordance with the directions, instructions or wishes of the group;
 - the group is able to remove or appoint the trustee; or
 - the group acquires more than a 50% stake in the income or capital of the trust.
- A group is:
 - a person; or
 - a person and one or more associates; or
 - two or more associates of a person.
- If a group ceases to control a non-fixed trust because of the death, incapacitation or breakdown in marriage of the individual comprising or an individual included in the group and a replacement group begins to control the trust, then the replacement group is taken to have controlled the trust from the time when the original group controlled it.

There are requirements as to who the replacement group may be.³⁵

5.3 Partially fixed stake test

- This applies where:
 - there is non-fixed trust; and
 - “individuals” have a fixed stake to more than 50% of income or capital.
- The test requires that, in those circumstances, individuals who hold a combined fixed stake of more than 50% at the start of test period must continue to hold more than a 50% fixed stake.

³³ Section 267-45 of Schedule 2F of the 1936 Tax Act

³⁴ Subdivision 269-E of Schedule 2F of the 1936 Tax Act

³⁵ see section 269-95(2) of Schedule 2F of the 1936 Tax Act

6. Income injection rules

- These provisions are contained in Division 270. If a trust fails the income injection test, it does not lose the benefit of carried forward losses (as is the case with the other tests) but cannot apply the losses as a deduction against the “injected income”.
- The effect of the income injection rules is to deny a deduction to the trust where there is a scheme under which:
 - the trustee derives assessable income;
 - an “outsider” to the Trust provides a benefit to the trustee or an associate;
 - the trustee provides a benefit to the outsider or associate; and
 - a reasonable person would conclude that the Trust derived the income or entered into the scheme was wholly or partly because of the deductions; and
 - the trust is not an ‘excepted trust’ under section 272-100(b), 272-100(c) or 272-100(d) (that is, the trust is not a complying superannuation fund, deceased estate within the period ending at the end of the year after the 5th anniversary of the death or a fixed unit trust where exempt entities have all of the fixed entitlements).³⁶
- A benefit is defined to mean:
 - money, a dividend or property; or
 - a right or entitlement (whether or not property); or
 - services; or
 - the extinguishment, forgiveness, release or waiver of a debt or other liability; or
 - the doing of anything that results in the derivation of assessable income; or
 - anything that, disregarding the above, is a benefit or advantage.
- If the trust is not a family trust, an outsider to the trust is a person other than:
 - the trustee of the trust; or
 - a person with a fixed entitlement to a share of the income or capital of the trust.
- If the trust is a family trust, an outsider to the trust is a person other than:
 - the trustee of the trust;
 - a person with a fixed entitlement to a share of the income or capital of the trust;
 - the individual specified in the trust's FTE;
 - a member of the individual's family;

³⁶ Section 270-10 of Schedule 2F of the 1936 Tax Act

- a trust with the same individual specified in its FTE;
- a company, partnership or trust that has made an IEE to be included in the individual's family group, where the election was in force when the scheme commenced; or
 - a fixed trust, company or partnership where, at all times while the scheme was carried out:
 - the individual specified in the trust's FTE; or
 - one or more members of the individual's family; or
 - the trustees of one or more family trusts, provided the individual is specified in the FTE of each of those family trusts; or

or any combination of the above, had fixed entitlements, directly or indirectly, and for their own benefit, to all of the income and capital of the entity.

7. Family trust distribution tax

7.1 Trusts which have made an FTE³⁷

- If:
 - a trustee makes an FTE in relation to a trust; and
 - at any time while the election is in force, the trust confers a present entitlement to, or distributes, income or capital of the trust:
 - upon or to a person who is neither the individual specified in the FTE nor a member of the individual's family group in relation to the conferral or distribution; or
 - upon or to the individual specified in the FTE or a member of the individual's family group, where that person is the trustee of a trust, that is not included in the individual's family group in relation to the conferral or distribution; then
- if:
 - the trustee is an individual – the trustee is liable to family trust distribution tax on the amount or value of the income or capital to which the entitlement relates, or that is distributed; or
 - the trustee is a company - **the trustee, together with each person who was a director of the company at the time of the conferral or distribution is jointly and severally liable** to family trust distribution tax on the amount or value of the income or capital to which the entitlement relates, or that is distributed.

7.2 Trusts which have made an IEE³⁸

- If:
 - a trustee makes an IEE for the trust to be included in the family group of the individual specified in an FTE; and
 - at any time while the election is in force, the trust confers a present entitlement to, or distributes, income or capital of the trust:
 - upon or to a person who is neither the individual specified in the FTE nor a member of the individual's family group in relation to the conferral or distribution; or
 - upon or to the individual specified in the FTE or a member of the individual's family group, where that person is the trustee of a trust, that is not included in the individual's family group in relation to the conferral or distribution; then

³⁷ Section 271-15 of Schedule 2F of the 1936 Tax Act

³⁸ Section 271-20 of Schedule 2F of the 1936 Tax Act

- if:
 - the trustee is an individual – the trustee is liable to family trust distribution tax on the amount or value of the income or capital to which the entitlement relates, or that is distributed; or
 - the trustee is a company - the **trustee, together with each person who was a director of the company at the time of the conferral or distribution is jointly and severally liable** to family trust distribution tax on the amount or value of the income or capital to which the entitlement relates, or that is distributed.

7.3 Partnerships which have made an IEE³⁹

- If:
 - the partners in a partnership make an IEE for the partnership to be included in the family group of the individual specified in an FTE; and
 - at any time while the election is in force, the partnership confers a present entitlement to, or distributes, income or capital:
 - upon or to a person who is neither the individual specified in the FTE nor a member of the individual's family group in relation to the conferral or distribution; or
 - upon or to the individual specified in the FTE or a member of the individual's family group, where that person is the trustee of a trust, that is not included in the individual's family group in relation to the conferral or distribution; then

the **partners, together with each person who at the time of the conferral or distribution was a director of any partners that was company is jointly and severally liable** to family trust distribution tax on the amount or value of the income or capital to which the entitlement relates, or that is distributed.

7.4 Companies which have made an IEE⁴⁰

- If:
 - a company makes a IEE for the company to be included in the family group of the individual specified in an FTE; and
 - at any time while the election is in force, the company confers a present entitlement to, or distributes, income or capital of the company:
 - upon or to a person who is neither the individual specified in the FTE nor a member of the individual's family group in relation to the conferral or distribution; or

³⁹ Section 271-25 of Schedule 2F of the 1936 Tax Act

⁴⁰ Section 271-30 of Schedule 2F of the 1936 Tax Act

- upon or to the individual specified in the FTE or a member of the individual's family group, where that person is the trustee of a trust, that is not included in the individual's family group in relation to the conferral or distribution; then

the **company, together with each person who was a director of the company at the time of the conferral or distribution, is jointly and severally liable** to family trust distribution tax on the amount or value of the income or capital to which the entitlement relates, or that is distributed.

7.5 Payment of family trust distribution tax⁴¹

- Family trust distribution tax is due and payable:
 - in the case where the conferral or distribution was made before the day on which the election was made – at the end of 21 days after the day on which the election was made; and
 - in any other case – at the end of 21 days after the day on which the conferral or distribution was made.
- If any of the family trust distribution tax remains unpaid 60 days after the day by which it is due to be paid, the person is liable to pay general interest charge.
- As it is a debt there is no time limit on when the family trust distribution tax is payable (and interest will continue to accumulate on any unpaid amount). That is, it is not subject to a review period.

7.6 Implications for the recipient

- If:
 - a family trust distribution tax (the tax payable) becomes payable on the amount or value of income or capital of the company, partnership or trust; and
 - a payment (the tax payment amount) of the whole or part of the tax payable is made; and
 - the whole or part of the amount or value of the income or capital is included in the assessable income of the company, partnership or trust or of any other person;

the amount included in the assessable income is reduced by the amount worked out using the following formula:

Tax payment amount/tax payable x original assessment amount.⁴²

- A further issue is that if a trustee who has made an FTE makes a distribution to a beneficiary which is outside the family group and that distribution has franking credits attached:
 - the trustee will be liable for family trust distribution tax;
 - the beneficiary will not include the distribution in their assessable income; and

⁴¹ Section 271-75 of Schedule 2F of the 1936 Tax Act

⁴² Section 271-105 of Schedule 2F of the 1936 Tax Act

- no one will be entitled to a tax offset for the franking credits.
- For example:
 - The trustee received franked dividends from XZY Pty Ltd of \$75,000 with franking credits of \$25,000.
 - The trustee distributes the franked dividends to ABC Bucket Co Pty Ltd. ABC Bucket Co Pty Ltd is not part of the family group of the test individual.
 - The trustee (and directors) will be jointly and severally liable for family trust distribution tax of \$35,250 ($47\% \times \$75,000$).
 - ABC Bucket Co Pty Ltd does not include the \$75,000 in its assessable income but also does not receive the benefit of the franking credit.
 - However, ABC Bucket Co Pty Ltd has received accounting income of \$75,000 which will need to be paid out to shareholders at some point (without the benefit of the franking credits).
 - How much tax is being paid on the original \$100,000 from XYZ Pty Ltd?
 - XYZ Pty Ltd paid tax of \$25,000 on the original \$100,000 (being $\$100,000 \times 25\%$). It then paid the fully franked dividend of \$75,000 to the trustee.
 - The trustee then paid family trust distribution tax of \$35,250 (being $47\% \times \$75,000$).
 - The shareholders of ABC Bucket Co Pty Ltd pay tax on the \$75,000 unfranked dividend, being \$35,250 (assuming 47%).
 - Total tax is \$95,500 (\$25,000 plus \$35,250 plus \$35,250). That is, 95.5% of \$100,000.

7.7 Reversing the family trust distribution tax

- If the entity who has made the FTE or IEE has made a distribution outside of the family group, but the recipient can put in place a valid FTE or IEE (and therefore become part of the family group of the relevant entity) specifying the year in which the distribution was received, then the family trust distribution tax is reversed (ATO publication on Family trusts - concessions).

7.8 Terms of the trust deed

- Even though a trust may have made an FTE does not mean that the distribution to an eligible beneficiary is not valid. The beneficiary is still entitled to call for payment of the full amount (even though the trustee will be required to pay the family trust distribution tax).
- Therefore, we recommend that trust deeds should include a provision that, if the trustee has made an FTE or IEE to anyone outside the 'family group', that distribution is invalid.
- In this situation it is likely that the 'default beneficiaries' will be assessed on the amount of the distribution (or the trustee may be assessed under section 99A of the 1936 Tax Act if there are no default income beneficiaries).

- A practical advantage if the distribution is invalid, is that the Commissioner will have a limited time in which to issue an amended assessment to the default beneficiaries (or trustee if there are no default beneficiaries). This will usually be four years from the date of lodgement of their tax returns.
- On the other hand, the family trust distribution tax is not subject to a review period.

8. Family Trust Elections

8.1 Making an FTE:⁴³

- A trustee may make an FTE that it will be a ‘family trust’ at all time after the beginning of a specified year.
- The election must be in writing and in the approved form.
- The election must specify an individual (“test individual”) as the individual whose family group is to be taken into account in relation to the election.

ATO Interpretative Decision ATO ID 2014/3 – the test individual must be alive when the FTE is made.

- If the trust does not pass the family control test at the end of the specified income year, the trustee must not make the election.
- The ATO publication ‘Family Trusts – Concessions’ states

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

Example of this issue: A new trust is established during the year. The trustee cannot make an FTE in relation to a particular individual until the end of the year as the ‘family control test’ must be passed at the end of the year before the trustee can make the FTE. If the individual dies during the year, then the FTE cannot be made in relation to that particular individual as the test individual must be alive at the time of making the FTE (which cannot be made until after the end of the year).

- The ‘specified year’ can be a year earlier than the one in which the FTE is made provided that at all times from the beginning of the ‘specified year’ until 30 June in the income year before the one during the election is made:
 - the trust passes the ‘family control test’; and
 - any distributions of income or capital of the trust have only been made members of the ‘test individual’s’ family group.

The specified year cannot be a year earlier than the 2005 year.

- Once an FTE has been made, it can only be varied or revoked in limited circumstances.
- Election commencement time
 - If the trust does not pass the ‘family control test’ at all times in the income year specified – the earliest time from which the trust does pass the family control test for the remainder of that income year.

⁴³ Section 272-80 of Schedule 2F of the 1936 Tax Act

- If the trust does pass the ‘family control test’ at all times in the income year specified – the beginning of the income year specified.
- The trustee must not make more than one FTE in relation to the trust.⁴⁴

If the trust has made an FTE and then revokes it, it cannot later make another FTE (ATO *Interpretative Decision ATO ID 2008/73*).

If two FTEs are made, then the trustee will need to determine which was made first.

For example: The ATO portal shows the following FTEs are made for the Jones Family Trust

Income year specified	Election commencement date	Test individual	Date of birth
2010	01/07/2009	Suzi Smith	01/01/1980
2014	01/07/2013	Bob Smith	15/01/1979

The trustee will need to determine which FTE was made first (noting that it may not have been the one with the 2010 year as the income year specified).

8.2 Revocation of an FTE

- The trustee of a trust (other than a fixed trust) may revoke an FTE during the period beginning at the start of the income year specified in the FTE and finishing at the end of the fourth income year after the income year specified in the FTE provided that during that period the trust did not need to have the FTE in force in relation to franking credits, tax losses or bad debts.⁴⁵
- The revocation must be made in the trust’s return for the income year from which the revocation is to be effective.⁴⁶

If the trust’s tax return has been lodged for a year, the Commissioner’s view is that you cannot amend a tax return which has been lodged to include a revocation or variation (ATO publication on Family trusts - concessions).

- If a family trust revokes an FTE, it cannot later make another FTE. This is because a trust must not make more than one FTE⁴⁷ (ATO *Interpretative Decision ATO ID 2008/73*).

8.3 Variation of a test individual

- The trustee of a trust may during the period beginning at the start of the income year specified in the FTE and finishing at the end of the fourth income year after the income year specified in the FTE vary the FTE so that a different individual is specified as the test individual provided that:

⁴⁴ Section 272-80(11) of Schedule 2F of the 1936 Tax Act

⁴⁵ Sections 272-80(6A) and 272-80(6B) of Schedule 2F of the 1936 Tax Act

⁴⁶ Section 272-80(8) of Schedule 2F of the 1936 Tax Act

⁴⁷ Section 272-80(11) of Schedule 2F of the 1936 Tax Act

- the new individual was a member of the family of the original test individual;
- any distributions of income or capital of the trust or entity for which an IEE has been made in relation to the trust have been made to either the new individual or members of the new individual's family group.⁴⁸
- A variation which is made under section 272-80(5A) can only be made once.⁴⁹
- A trustee of a trust may vary an election so that a new individual is specified as a test individual if as a result of a court order or BFA that individual and members of the new individual's family control the trust.⁵⁰
- Whereas a test individual can be varied if there is a change of control of a trust as a result of an order, agreement or an award being made pursuant to a marriage or relationship breakdown, a test individual cannot be varied because a test individual has died. In this case the avenue for varying the test individual would be if the requirements under sections 272-80(5A) and 272-80(5B) are satisfied.
- The variation must be made in the trust's return for the income year from which the variation is to be effective.⁵¹

If an entity's tax return has been lodged for a year, the Commissioner's view is that you cannot amend a tax return which has been lodged to include a revocation or variation (ATO publication on Family trusts - concessions).

- Examples of time periods:

The trustee makes an FTE when it lodges its 2021 income tax return.

- Scenario 1: The trustee specifies the 2021 year. The FTE may be able to be varied or revoked on or before the lodgement of the trust's 2025 year tax return.
- Scenario 2: The trustee specifies the 2018 year. The FTE may be able to be varied or revoked on or before the lodgement of the trust's 2022 year tax return.
- Scenario 3: The trustee specifies the 2015 year. The FTE cannot be varied as the four year period has finished.

⁴⁸ Section 272-80(5A) of Schedule 2F of the 1936 Tax Act

⁴⁹ Section 272-80(6) of Schedule 2F of the 1936 Tax Act

⁵⁰ Sections 272-80(5C) and 272-80(5D) of Schedule 2F of the 1936 Tax Act

⁵¹ Section 272-80(8) of Schedule 2F of the 1936 Tax Act

9. Interposed Entity Elections

9.1 Making an IEE:⁵²

- If a company, partnership or trust makes an IEE in respect of the trust which has made an FTE, that company, partnership or trust will be included in the 'family group' of the test individual specified in the FTE.
- This means that the trust which has made the FTE can distribute to that company, partnership or trust.
- The election must be in writing and in the approved form.
- The company, partnership or trust must pass the family control test at the end of the specified income year.
- The 'specified year' can be a year earlier than the one in which the IEE is made provided that at all times from the beginning of the 'specified year' until 30 June in the income year before the one during the election is made:
 - the company, partnership or trust passes the 'family control test'; and
 - any distributions of income or capital of the trust have only been made members of the 'test individual's' family group.
- Once an IEE has been made, it can only be revoked in limited circumstances.
- An IEE is still in force even if the trust in respect of which the relevant IEE was made ceases to exist (ATO Interpretative Decision ATO ID 2013/21)

9.2 Revocation of an IEE

- Provided that the company, partnership or trust was when the IEE was made or later becomes a member of the family group of the individual specified in the FTE, it may revoke an IEE during the period:
 - beginning at the later of:
 - (A) the beginning of the income year specified in the IEE; and
 - (B) the beginning of the income year in which the entity became a member of the family group; and
 - finishing at the end of the fourth income year after the income year referred to in subparagraph (A) or (B).⁵³
- If the FTE to which the IEE is made is revoked, the IEE is taken to be revoked.⁵⁴

⁵² Section 272-85 of Schedule 2F of the 1936 Tax Act

⁵³ Sections 272-85(5A) and 272-85(5C) of Schedule 2F of the 1936 Tax Act

⁵⁴ Section 272-85(5B) of Schedule 2F of the 1936 Tax Act

- The revocation must be made in the entity's return for the income year from which the revocation is to be effective.⁵⁵
- The company, partners or trustee must not make an IEE to be included in the family group of the individual specified in the FTE in respect of more than one trust, unless the individual specified in each FTE is the same.⁵⁶

However, you can disregard an IEE which has been revoked.⁵⁷

⁵⁵ Section 272-85(5D) of Schedule 2F of the 1936 Tax Act

⁵⁶ Section 272-85(7) of Schedule 2F of the 1936 Tax Act

⁵⁷ Section 272-85(8) of Schedule 2F of the 1936 Tax Act

10. Family control test

10.1 Trusts

- A trust cannot make an FTE or IEE unless it passes the ‘family control test’ at the end of the specified year.
- A trust passes the ‘family control test’ if any one of the following are satisfied:⁵⁸
 - (a) Paragraph (A) - the ‘group’ has the power to obtain beneficial enjoyment (directly or indirectly) of the capital or income of the trust; or
 - (b) Paragraph (B) - the group is able (directly or indirectly) to control the application of the capital or income of the trust; or
 - (c) Paragraph (C) - the group is capable, under a scheme, of gaining the beneficial enjoyment in paragraph (A) or the control in paragraph (B); or
 - (d) Paragraph (D) - the trustee of the trust is accustomed, under an obligation or might reasonably be expected, to act in accordance with the directions or wishes of the group; or
 - (e) Paragraph (E) - the group can remove or appoint the trustee of the trust; or
 - (f) Paragraph (F) - the group has more than a 50% stake in the income or capital of the trust; or
 - (g) Paragraph (G) - persons in the group are the only persons who, under the terms of the trust, can obtain the beneficial enjoyment of the income and capital of the trust.
- Who is the ‘group’?
 - The ‘group’ consists of:
 - the individual (test individual) who is specified in the FTE, or in the case of the IEE, who is specified in the FTE to which the IEE will relate; or
 - one or more members of the test individual’s family; or
 - the test individual and one or more of the members of the test individual’s family.
 - The requirement in any paragraphs (a) to (e) above is satisfied in relation to a group consisting of:
 - a person or persons being, the test individual and/or members of the test individual’s family; and
 - one or more legal or financial advisers to the test individual or to a member of the test individual’s family.

NOTE: To satisfy the ‘family control test’ there will need to be at least one individual who is the test individual or members of the test individual’s family.

⁵⁸ Section 272-87(2) of Schedule 2F of the 1936 Tax Act

- If independent persons are used:
 - must ensure that one of the 'family control tests' can be satisfied; and
 - to be part of the 'group' for determining the control test, they must be legal or financial advisers.
- The requirement in paragraph (f) above is satisfied in relation to a group consisting of the trustees of one or more family trusts, provided the test individual is specified in the FTE of each of those family trusts and/or a person or persons being, the test individual and/or members of the test individual's '**family**'.
- Issues for estates and testamentary trusts passing the 'family control test' when independent persons are in control.
 - To satisfy the 'family control test', there will need to be consideration as to who the 'test individual' will be, as the control test is based around the test individual.

The deceased cannot be the test individual – The Commissioner's view is that the test individual must be alive at the time that the FTE is made.

- The 'family control test' must be satisfied at the end of the year.
 - For an estate:
 - Are the beneficiaries all members of the test individual's family?.
 - Who are the executors?
 - For a testamentary trust
 - Are the only beneficiaries members of the test individual's family?
- If the testamentary trust allows distributions to trusts this is unlikely.
- Who controls the trust?

This can be problematic if independent persons 'control' the trust and can remove the trustee.

- The legal or financial advisers must be advisers of the test individual or a member of their family.

In some cases the advisers may be the advisers to the deceased not the person who will be chosen as the test individual.

In some cases the persons who 'control' the trusts are trusted business associates or family friends of the deceased.

- Who are financial advisers?

Does this include accountants?

- This can be extremely problematic where the individual owns shares in their own name which will have considerable dividends flowing. If the shares pass to a trust it will need to

make an FTE to pass through the franking credits to individuals. If the individual wants the shares to pass to a trust(s) from the Estate but have completely independent people in control (who may not be the legal or financial advisers to their family) would be:

- To limit the beneficiaries of the testamentary trust to members of their family (noting the issues with step-children and step-siblings).
- Individual establishes trust(s) in their lifetime and make FTE with themselves as the test individual. The assets could pass from the estate to these trusts (which already have the FTEs in place). Control of the trust(s) passes to the relevant controllers on death.

Note: For the purpose of determining whether the income will be 'excepted trust income' of minors under section 102AG of the 1936 Tax Act, these trusts will not be testamentary trusts for the purpose of section 102AG(2)(a) (that is, a trust estate that resulted from a will etc) and therefore would have to rely on section 102AG(2)(d)(i) (about property that devolves for the benefit of the beneficiary from the estate of a deceased person). There is however uncertainty as to how section 102AG(d)(i) applies particularly where the trust has other beneficiaries).

This trust(s) should be a special purpose trust to receive the assets from the estate. It should not have other assets.

- Alternatively for a testamentary trust, if the franked dividends are accumulated, then the trustee pays tax on the dividends and franking credits. Trustee pays tax at top marginal rate, but provided that the trustee holds the shares at risk for the 45 days, they will obtain the benefit of the franking credits.
- There is a further issue where shares are held in an individual's name and the company has made an IEE. If the shares pass to a testamentary trust the trustee must be able to make an IEE in relation to the test individual to which the company's IEE relates. If the testamentary trust cannot make an IEE because it does not pass the control test, then the company will be subject to franking deficit tax on every dividend which is paid to the testamentary trust.

10.2 Companies and partnerships

- A company or partnership in respect of which an IEE is proposed to be made passes the family control test if a group consisting of:⁵⁹

 - the individual who is specified in the FTE in relation to the IEE; and/or
 - one or members of the test individual family; and/or
 - the trustees of one or more family trusts, provided the individual is specified in the FTE of each of those family trusts

⁵⁹ Section 272-87(3) of Schedule 2F of the 1936 Tax Act

have between them, directly or indirectly, and for their own benefit, **fixed entitlements to a greater than 50% share of the income or a greater than 50% share of the capital** of the company or partnership.

11. ‘Family’ and ‘Family Group’

11.1 ‘Family’ of the test individual

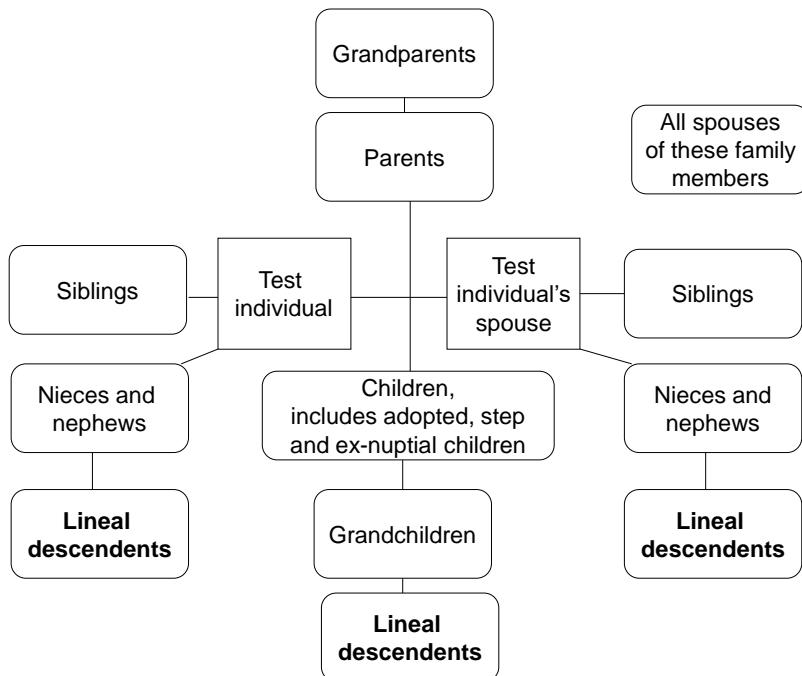
- The ‘family’⁶⁰ of a test individual consists of the test individual and all of the following:
 - any parent, grandparent, brother or sister of the test individual or the test individual’s spouse;
 - any nephew, niece or child or the test individual or the test individual’s spouse;
 - any lineal descendant of a nephew, niece or child of the test individual or the test individual’s spouse;
 - the spouse of the test individual or of anyone who is a member of the test individual’s family because of the above paragraphs.
- Note:
 - ‘Spouse’ is defined in section 995-1(1) of the 1997 Act and includes same sex couples.
 - ‘Child’ is defined in section 995(1) of the 1997 Act to also include the individual’s adopted child, stepchild or ex-nuptial child and a child of the individual’s spouse.
 - A person does not cease to be a family member merely because of the death of any other family member.⁶¹
 - An adopted child, step-child or ex-nuptial child of a person is taken to be a lineal descendant of that person for the purposes of determining the lineal descendants of that person or any other person.⁶²

⁶⁰ Section 272-95(1) of Schedule 2F of the 1936 Tax Act

⁶¹ Section 272-95(2) of Schedule 2F of the 1936 Tax Act

⁶² Section 272-95(3) of Schedule 2F of the 1936 Tax Act

- Diagram from explanatory memorandum to Tax Laws Amendment (2007 Measures No 4) Bill 2007 (which expanded the definition of 'family')



11.2 'Family Group'⁶³

- The section states whether a person is a member of the family group of the test individual in relation to a conferral of a present entitlement to, or a distribution of, income or capital of a company, partnership or trust, upon or to the person.
- A member of the test individual's family is a member of the test individual's family group in relation to the conferral or distribution.
- The following former family members in relation to the conferral or distribution.
 - A person who was a spouse of either the test individual or of a member of the test individual's family before a breakdown in the marriage or relationship.
 - A person:
 - who was the spouse of either the test individual or of a member of the test individual's family before the death of the test individual or of a member of the test individual's family; and
 - who is now the spouse of a person who is not a member of the primary individual's family; and

⁶³ Section 272-90 of Schedule 2F of the 1936 Tax Act

- A person who was a child of the spouse of either the test individual or of a member of the test individual's family before a breakdown in the marriage or relationship of the primary individual or the member of the primary individual's family.

The example in the Explanatory Memorandum below indicates that this would be the case if the breakdown happened because of death. Note, definition of 'breakdown in the marriage or relationship of an individual occurs if the individual is living with another individual on a genuine domestic basis in a relationship as a couple (whether the individuals are the same sex or different sexes and whether legally married or not) and ceases to do so.

- A trust in respect of which the FTE was made is a member of the test individual's family group in relation to the conferral or distribution.
- A trust with the same test individual specified in its FTE is a member of the test individual's family group in relation to the conferral or distribution.
- A company, partnership or trust is a member of the test individual's family group in relation to the conferral or distribution if:
 - the company, partnership or trust has made an IEE to that effect; and
 - the election is in force when the conferral takes place or the distribution is made.
- A company, partnership or trust is a member of the test individual's family group in relation to the conferral or distribution if:
 - the test individual; and/or
 - one or members of the test individual's family; and/or
 - the trustees of one or more family trusts, provided the primary individual is specified in the FTE of each of those family trusts;
 - have fixed entitlements directly or indirectly, and for their own benefit, to all of the income and capital of the company, partnership or trust.
- A fund, authority or institution in Australia covered by Subdivision 30-B of the 1997 Act (about recipients for gift recipients).
- An institution, hospital, trustee, society, association, club or fund, all of whose income is exempt under:
 - section 50-5 (charity, education and science);
 - section 50-10 (community service);
 - Items 6.1 or 6.2 of section 50-30 (public hospital or hospital carried on by a society or association);
 - Items 9.1 or 9.2 of section 50-45 (sports, culture and recreation).

11.3 Interaction of death of an individual on the ‘family’ and the ‘family group’

- The test individual will continue to be the test individual of an FTE once they die.
- As noted previously, whereas a test individual can be varied if there is a change of control of a trust as a result of an order, agreement or an award being made pursuant to a marriage or relationship breakdown, a test individual cannot be varied just because a test individual has died. In this case the avenue for varying the test individual would be if the requirements under sections 272-80(5A) and 272-80(5B) are satisfied (that is, including within 4 years and provided a previous variation has not occurred).
- If the test individual were to pass away then the members of the test individual’s family (as defined prior to their death would remain the same). However, circumstances may change, for example, the test individual or a member of the family’s spouse becomes the spouse of a person outside of the family group.
- Whether an individual is part of a test individual’s:
 - ‘family’ is important for identifying whether the ‘family control’ test is satisfied and whether a company, partnership or trust will be part of the family group of the test individual or can make an IEE to be part of the family group; and
 - ‘family group’ is important for identifying whether the individual can receive distributions without there being family trust distribution tax issues.
- If the spouse of a member of the family (including the test individual’s spouse) just before the death of the test individual becomes the spouse of a person who is not a member of the test individual’s family, that person will cease being a member of the ‘family’ but become a member of the ‘family group’.⁶⁴

In these circumstances the child of a spouse who ceases to be part of the ‘family’ will cease to be part of the ‘family’ but become a member of the family group.⁶⁵

- If the spouse of the test individual passes and the test individual becomes the spouse of an individual who is not a member of the deceased’s family, then:
 - the child of the deceased ceases to be a member of the ‘family’ of the test individual but becomes a member of their ‘family group’;
 - the siblings and other members of the deceased’s family are likely to cease being members of the test individual’s ‘family’ and ‘family group’ (this is because section 272-90(2A) does not specifically provide for these individuals).

For this reason when considering who will be the test individual of particular trusts, there should be careful consideration as to who will benefit from the trust after the death of the controller(s) of the trust.

⁶⁴ Section 272-90(2A) of Schedule 2F of the 1936 Tax Act

⁶⁵ Section 272-90(2A) of Schedule 2F of the 1936 Tax Act

- Examples:

- Tom is the test individual. Tom's brother Jack and Jack's spouse Julie are part of Tom's family. If Jack were to pass away Julie will continue to be a member of Tom's family.

If, however Julie becomes the spouse of a person outside of Tom's family, she would cease being a member of Tom's family but will continue to be a member of Tom's family group.

- Jenny is the test individual. Her husband Bob is part of her family. Bob's brother John is part of her family. Bob's child Samantha is part of her family.
 - If Bob were to pass away then John and Samantha will continue to be part of her family.
 - Assume Jenny then becomes the spouse of Raymond (not related to Bob). At that point:
 - Samantha will cease to be part of Jenny's family. However Samantha will continue to be part of Jenny's family group because she is the child of a former spouse of Jenny (being Bob).
 - John will cease to be part of Jenny's family.

Is John part of Jenny's 'family group'??

Arguably: A way for John to still be part of Jenny's 'family group' is if John were the spouse of someone (say Tracey). Tracey would have been a member of Jenny's family because she is the spouse of John (Bob's sibling). Therefore John was the spouse of a member of Jenny's family before the Bob (a member of Jenny's family) passed away and now that Tracey is not a member of Jenny's family he is now the spouse of someone who is not part of Jenny's family.

- In the above example, if Bob were the test individual, then John and Samantha would continue to be part of his family following his death.
- Example from explanatory memorandum to Tax Laws Amendment (2007 Measures No 4) Bill 2007 (which expanded the definition of 'family') – in relation to step-child
 - The trustee of the Vu Trust has made a family trust election pursuant to section 272-80 and has specified Harry as the test individual.
 - Harry's spouse, Athena has a child, Jasmine, from a previous relationship, Harry's step-child. Since making the family trust election, Athena has died.
 - Harry has not formally adopted Jasmine under any state or territory adoption law.
 - Jasmine remains a step-child of Harry even after the death of Athena. However, she will cease to be a step-child at the time Harry remarries or enters into a de facto relationship. Nonetheless, Jasmine will remain a member of Harry's family group in respect of the Vu Trust, because she will be a former step-child under subsection 272-90(2A). Therefore, any distributions to Jasmine will not be subject to family trust distribution tax.
 - If instead Harry and Athena had divorced, Jasmine would become a former step-child, and while not a family member, would remain a member of the family group. Accordingly, any distribution to Jasmine would not be subject to family trust distribution tax.

- An individual's estate is considered to be a trust. Therefore, for the estate to be part of an individual's 'family group':
 - it will need to either make a valid FTE (which means it will need to pass the 'family control' test at the end of the year); or
 - members of the test individual's 'family' or trusts of which the test individual's is specified in the FTE will need to have fixed entitlements to all of the income and capital at the time of the distribution; or
 - it will need to either make a valid IEE (which means members of the test individual's 'family' or trusts of which the test individual's is specified in the FTE will need to have fixed entitlements to more than 50% of all of the income or capital at the time of the distribution).
- If a testamentary trust must make an FTE who should be the test individual?

Example:

- Tommy owned shares in a private company worth \$10million which receive sizable franked dividends.
- He passed away and under the terms of his Will the shares will pass to one testamentary trust for the benefit of his two children (Sam and Suzie) and future generations.
- Assume that the testamentary trust must make an FTE for the year and that it will pass the 'family control' test at the end of the year.
- Who should be the test individual of the testamentary trust?
 - Cannot be Tommy – this is because the test individual must be alive when the FTE is made.
 - One of Sam's children (say Sonny) or Suzie's children (say Molly)? No
 - If chose one of Sam's children (Sonny), then Suzie (aunt), her spouse (uncle) and her children (cousins) would not be part of Sonny's family or family group.
 - If chose one of Suzie's children (Molly), then Sam (uncle), his spouse (aunt) and his children (cousins) would not be part of Molly's family or family group.
 - Sam or Suzie? Yes
 - Need to choose one of them.
 - The other will then be limited to the family group of the one chosen as the test individual. That is, will not be able to distribute to the parents and siblings of their 'in-law'.
 - Should set up bucket companies owned by a trust which makes an FTE in relation to whoever is chosen so that it can receive distributions from the testamentary trust.

For example, If Sam is the test individual of the testamentary trust:

- Establish Sam Pty Ltd with Sam's Trust (which has made an FTE with Sam as the test individual) as the shareholder.

- Establish Suzie Pty Ltd with Suzie's Trust (which has made an FTE with Sam as the test individual) as the shareholder.
- Alternatives which could have been used:
 - Have two testamentary trusts, one for Sam and one for Suzie. Sam's testamentary trust could have had Sam as the test individual and Suzie's testamentary trust could have had Suzie as the test individual.
 - If Tommy wanted control of the trust which is to hold the shares to be with third parties, Tommy could establish one (or two) trusts during his lifetime which make FTEs with him as the test individual. Under the terms of his Will, the shares pass to these trusts. This avoids the trusts having to pass the 'family control' test as they have already made FTEs.

Additional trusts could be established for Sam and Suzie (which make FTEs in relation to Tommy) which are earmarked to be shareholders of potential corporate beneficiaries. This is discussed later in this paper.

12. Fixed entitlements to a share of income or capital

12.1 Fixed entitlements to the income and capital of a trust⁶⁶

- Beneficiaries will have fixed entitlements to the income and capital of a trust if, under a trust instrument they have "a vested and indefeasible interest" in a share of the income and/or capital.⁶⁷
- When do beneficiaries of a deceased estate have fixed entitlements to income and capital?
 - Note: To be part of the 'family group' of the test individual, members of the test individual's family would need to have fixed entitlements to all income and capital.
 - *Taxation Ruling IT 2622* (about present entitlement during the stages of administration of deceased estates)
 2. On the death of a taxpayer, the property of the deceased taxpayer passes to his or her estate, legal control over which is exercised by an executor or administrator. The executor or administrator, in effect, steps into the shoes of the deceased and winds up the deceased's personal affairs. An executor of a deceased person who leaves a will must obtain probate of the will. This is the official proving of the will and provides the executor with authority to deal with the estate. When probate has been granted, the executor is free to call up the deceased's assets and liabilities, and pay the debts, funeral and testamentary expenses. After these matters have been attended to, the executor distributes the property of the deceased to the beneficiaries of the estate.
 3. A fiduciary obligation is assumed by the executor or administrator, on the death of a taxpayer, in favour of the beneficiaries of the estate. At that time, beneficiaries of the estate have no interest in the assets of the estate, although they do have a beneficial right to see that the estate is properly administered.
 - 13. Until the estate of a testator has been fully administered and the net residue ascertained, a residuary beneficiary has no proprietary interest in any specific investment forming part of the estate or in the income from any such investment. Both corpus and income are the property of the executors or administrators: *Lord Sudeley v. Attorney-General* [1897] A.C. 11; *Dr Barnardo's Homes National Incorporated Association v. Commissioners for Special Purposes* [1921] 2 A.C. 1. See also *Pajels v. MacDonald* (1936) 54 CLR 519 at 526; *Corbett v. I.R.C.* (1937) 4 All E.R. 700 at 707 and *C.S.D. (Qld) v. Livingston* (1964) 112 CLR 12.
 - 16. The administration of the estate does not have to reach the stage where the estate is wound up for beneficiaries to enjoy present entitlement to the income of the estate. Once the executor has provided for all debts incurred by the deceased before his or her death and for debts incurred in administering the estate (e.g. funeral expenses) and provided for distributions of specific assets or legacies, it will be possible to ascertain the residue with certainty, even though the executor may not have actually made all the transfers necessary to satisfy these demands on the estate.

⁶⁶ Section 272-5(1) of Schedule 2F of the 1936 Tax Act

⁶⁷ Section 272-5(1) of Schedule 2F of the 1936 Tax Act

- Private Binding Ruling Authorisation number 1051629761894

As discussed in paragraphs 9 to 14 of IT 2622, until the administration of the estate has been completed, no beneficiaries of the estate are entitled to the income or the assets of the estate.

The High Court of Australia in F.C. of T. v. Whiting (1943) 68 CLR 199; 7 ATD 179 held that a beneficiary of a deceased estate cannot be presently entitled to the income of the estate until the estate has been fully administered. In their joint judgment, Latham C J and Williams J stated (CLR at 216; ATD at 184), that numerous authorities had established that:

".... until an estate has been fully administered by payment or provision for the payment of funeral and testamentary expenses, death duties, debts, annuities and legacies and the amount of the residue thereby ascertained, the income of the residuary estate is the income of the executors and not of the residuary beneficiaries."

Until the estate of a testator has been fully administered and the net residue ascertained, a residuary beneficiary has no proprietary interest in any specific investment forming part of the estate or in the income from any such investment. Both corpus and income are the property of the executors or administrators (paragraph 13 of IT 2622).

As the legal dispute over the assets of the Estate continues, the administration of the Estate has not been finalised. Therefore, none of the beneficiaries have fixed entitlements to either the income or the capital of the estate.

As none of the beneficiaries of the Estate have fixed entitlements to the income or capital of the Estate, the Estate is not a member of the family group of Individual 2 pursuant to Subsection 272-90(5) of Schedule 2F to the ITAA 1936.

- Private Binding Ruling Authorisation number 1052059147423

Vested and indefeasible

The term 'vested and indefeasible' is not defined in the taxation legislation. However, its ordinary meaning is provided by the general law, which is reflected in paragraphs 13.3 to 13.9 of the Explanatory Memorandum to the Taxation Laws Amendment (Trust Loss and Other Deductions) Bill 1997 which states in discussing what constitutes a fixed entitlement to income or capital of a trust:

What is a vested interest?

13.4 A person has a vested interest in something if the person has a present right relating to the thing. Stated simply, a vested interest is one that is bound to take effect in possession at some point in time. A vested interest is to be contrasted with a 'contingent' interest which may never fall into possession. If an interest of a beneficiary in income or capital is the subject of a condition precedent, so that an event must occur before the interest becomes vested, the beneficiary does not have a vested interest to the income or capital since such an interest is instead 'contingent' upon the event occurring.

13.5 In traditional legal analysis, a person can be said to be either 'vested in possession' or 'vested in interest'. A present interest, i.e. one that is being enjoyed, is said to be 'vested in possession'; a future interest, i.e. one which gives its holder a present right to future enjoyment, is said to be 'vested in interest'. A person is vested in possession where the person has a right to immediate possession or enjoyment of the thing in question. In the definition of fixed entitlement, 'vested' includes both vested in possession and vested in interest.

13.6 Because vested interests include future interests, a person can have a vested interest in a thing even though the person's actual possession and enjoyment of the thing is delayed until some time in the future.

When is a vested interest indefeasible?

13.7 A vested interest is indefeasible where, in effect, it is not able to be lost. A vested interest is defeasible where it is subject to a condition subsequent that may lead to the entitlement being divested. A condition subsequent is an event that could occur after the interest is vested that would result in the entitlement being defeated, for example, on the occurrence of an event or the exercise of a power. For example, where a beneficiary's vested interest is able to be taken away by the exercise of a power by the trustee or any other person, the interest will not be a fixed entitlement.

13.8 Where the trustee exercises a power to accumulate income or capital of the trust in accordance with the trust deed, the accumulation does not result in a beneficiary's interest being taken away or defeated as long as the beneficiary nevertheless remains entitled at some future time to enjoy his or her share of the income or capital which has been accumulated.

Vested and indefeasible interests and deceased estates

ATO Interpretative Decision ATO ID 2006/279 Income Tax: Trust losses - fixed entitlement - beneficiaries of a deceased estate (ATO ID 2006/279) discusses circumstances in which the residuary beneficiaries of an estate have fixed entitlements to all of the income and capital of the estate for the purposes of determining whether the trust constituted by the estate is a fixed trust. In ATO ID 2006/279 a bequest was made to an individual and subsequently satisfied, with the residue of the estate equally divided between a class of persons. ATO ID 2006/279 explains that the residuary beneficiaries have a vested interest in the income and capital of the estate as they each have a present right to future enjoyment of their equal share in the income and capital. Their interest is indefeasible as there is no condition in the trust instrument, the Will, by which any of the residuary beneficiaries could lose their interest in the estate. The previously satisfied bequest does not affect the determination of whether the trust constituted by the estate is a fixed trust.

Your circumstances

Under the terms of the Will, each of the deceased's beneficiaries R1, R2, R3, R4 have a vested and indefeasible right to an equal share in the available money in the deceased's bank accounts as well as an equal share in Property A. There is no condition in the Will by which any of the beneficiaries could lose their interest in the estate and they all have a fixed entitlement to a share of the income and capital of the estate, in accordance with subsection 272-5(1) of Schedule 2F to the ITAA 1936. Therefore, as the beneficiaries have fixed entitlements to all of the income and capital of the estate, the trust constituted by the estate is a fixed trust under section 272-65 of Schedule 2F to the ITAA 1936 and section 995-1 of the ITAA 1997. The specific items of personal property given to people marked on the property and the fact that one of the beneficiaries is entitled to the residual real and personal property of the estate does not affect the determination of the trust constituted by the estate as a fixed trust.

12.2 Fixed entitlement to a share of income or capital of a company⁶⁸

- If a shareholder in a company holds shares carrying the right to receive:
 - some or all of the dividends that may be paid by the company, the shareholder has a fixed entitlement to a share of the income of the company equal to the percentage of the total dividends represented by the dividends that the shareholder has a right to receive; and
 - the whole or part of any distribution of the paid-up share capital of the company in the event of any return of capital to shareholders, the shareholder has a fixed entitlement to a share of the

⁶⁸ Section 272-10 of Schedule 2F of the 1936 Tax Act

capital of the company equal to the percentage of the total distribution represented by the amount that the shareholder has a right to receive.

- Private Binding Ruling Authorisation number 1051714149928 – company had different class shares which had equal capital rights but discretionary dividend rights. All shares were held by the test individual and members of the test individual's family.

31. Fixed entitlement to a share of income or capital of a company is outlined in subsections 272-10(1) and 272-10(2) of Schedule 2F of the ITAA 1936. Individually, Taxpayer A, Taxpayer B, Taxpayer C and Taxpayer D do not hold shares that have a right to receive some or all of the dividends of Company A because the dividends may, with the exercise of the discretion, be paid to one or more of the other classes of shares to the exclusion of their shares, as outlined in Clause X.Y of the company Constitution.

32. Collectively, all of the dividends must be paid to members of Taxpayer A's family, however, for the purposes of subsections 272-10(1) and 272-10(2) each of the shareholders' entitlements must be fixed (giving them a right to a share of dividends equal to a percentage of the total dividends) and then taken together all of the shareholders who satisfy (a) to (c) in subsection 272-90(5) should add up to all of the income and capital of the company (100%).

12.3 Fixed entitlement to a share of income or capital of a partnership⁶⁹

- If under a partnership agreement, a partnership is entitlement to a share of income that the partnership derives from time to time, or of the capital of the partnership and the share is not able to be varied, the partner has a fixed entitlement to that share of the income or capital.
- If a partner does not have a fixed entitlement to income or capital of the partnership, only because the partner's share is able to be varied, the Commissioner does have a discretion to treat the partners having a fixed entitlement having regard to:
 - the circumstances in which the share is able to be varied;
 - the likelihood of the variation happening; and
 - the nature of the partnership.

12.4 Fixed entitlement to share of income or capital indirectly

- A person holds a fixed entitlement to a share of the income or capital of a company, partnership or trust indirectly if the person holds the entitlement indirectly through fixed entitlements to shares of the income or capital, respectively, of interposed companies, partnerships or trusts.⁷⁰
- Additional special cases of fixed entitlements held directly or indirectly
 - Section 272-30 also affects references to a person or individual having, directly or indirectly, a fixed entitlement to a share of the income or capital of a company, partnership or trust (other than in sections 269-75(b)(ii) or 272-25) at a particular time (test time).

⁶⁹ Section 272-15 of Schedule 2F of the 1936 Tax Act

⁷⁰ Section 272-20 of Schedule 2F of the 1936 Tax Act

- Section 272-30 will not affect a reference to a person or individual having a fixed entitlement where the phrase 'directly or indirectly' is not used.
- If at the test time a family trust has, directly or indirectly, a fixed entitlement to a share of the income or capital of the main entity, it is treated as if it and the fixed entitlement as an individual and for the individual's own benefit.

12.5 Fixed entitlement on death

- If, immediately before an individual dies, he or she has a fixed entitlement to a share of the income or capital of a trust, partnership or company directly or indirectly, and for his or her own benefit, the individual is taken to continue to have the entitlement for so long as:
 - It is held by someone as trustee of the individual's estate; or
 - It is held by someone who received it as a beneficiary of the estate (s 272-40).

13. Distributions of income or capital

- Subdivision 272-B of Schedule 2F of the 1936 Tax Act is relevant to determining whether 'distributions' have been made outside of the family group and also whether the pattern of distribution test is satisfied.

13.1 Trust distribution to a beneficiary⁷¹

- A trust distributes income or capital to a person if it:
 - pays or credits the income or capital in the form of money to the person;
 - transfers the income or capital in the form of property to the person; or
 - reinvests or otherwise deals with the income or capital on behalf of the person or in accordance with the directions of the person; or
 - applies the income or capital for the benefit of the person;
- in the person's capacity as a beneficiary of the trust.

13.2 Company distribution to a shareholder⁷²

- A company distributes income of the company to a person if the company pays a dividend or non-share dividend to the person.
- A company distributes capital of the company to a person if:
 - it pays or credits money, or transfers property, of the company to the person, where the amount paid or credited, or the amount or value of the property, is debited against an amount standing to the credit of the share capital account of the company; and
 - the payment, crediting or transfer is not the payment of the dividend.
- A company distributes capital of the company to a person if the company makes a non-share capital return to the person.

13.3 Partnership distribution to a partner⁷³

- A partnership distributes income or capital of the partnership to a person if it:
 - pays or credits the income or capital in the form of money to the person; or
 - transfers the income or capital in the form of property to the person; or

⁷¹ Section 272-45 of Schedule 2F of the 1936 Tax Act

⁷² Section 272-50 of Schedule 2F of the 1936 Tax Act

⁷³ Section 272-55 of Schedule 2F of the 1936 Tax Act

- reinvests or otherwise deals with the income or capital on behalf of the person or in accordance with the directions of the person; or
- applies the income or capital for the benefit of the person;
in the person's capacity as a partner in the partnership.

13.4 Other distributions of income and capital⁷⁴

- A company, partnership or trust also distributes income or capital to a person if it:
 - pays (including by way of a loan) or credits money of the entity to the person, or reinvestments such money for the person; or
 - transfers property of the entity to, or allows use of the property of the entity by, the person; or
 - deals with money or property of the entity for or on behalf of the person or as the person directs; or
 - applies money or property of the entity for the benefit of the person; or
 - extinguishes, forgives, releases or waives a debt or other liability owed by the person to the entity (section 272-60(1)).
- However, section 272-60(1) only applies if, and to the extent that:
 - the amount paid, credited, reinvested or applied, the value of the property transferred or the value of the other thing done; exceeds
 - the amount or value of any consideration given in return.
- *Taxation Determination TD 2017/20 [at paragraph 20]*

The amount or value of consideration given for a distribution transaction is a question of fact. However, in practice the Commissioner will infer that the amount or value of a benefit provided to a person does not exceed the amount or value of consideration given in return where the relevant transaction:

- occurs on arm's length terms, and
- is an ordinary incident of a business being carried on by the trust.
- Each thing that is a distribution because of section 272-60(1) is a distribution of income unless it is clear that the money or property concerned was capital, or that the debt or liability was attributable to capital, of the entity.
- *Taxation Determination TD 2017/20 [at paragraph 17]*

.... the unqualified reference to 'distributes...to a person' in the extended definition [that is, section 272-60] includes distributions (as defined) to persons who are not beneficiaries of the trust.

⁷⁴ Section 272-60 of Schedule 2F of the 1936 Tax Act

13.5 Distribute indirectly⁷⁵

- A trust distributes income or capital indirectly to an individual if it distributes the income or capital to a company, partnership or trust (the first interposed entity) interposed between the trust and the individual and:
 - the first interposed entity distributes to the individual an amount or property attributable to the income or capital; or
 - another company, partnership or trust (the final interposed entity) distributes to the individual an amount or property that is attributable to the income or capital as a result of:
 - the distribution of an amount or property attributable to the income or capital to the final interposed entity by the first interposed entity; or
 - successive distributions of amounts or property attributable to the income or capital to and by any companies, partnerships or trusts interposed between the first interposed entity and the final interposed entity.

13.6 Examples

- Taken from Taxation Determination TD 2017/20

Example 1 - various business-related transactions

21. The Rhino Family Trust is a discretionary trust. It has made an FTE and Paul Rhino is the specified individual.
22. The trust operates a commercial café and a separate catering business.
23. The trust employs Paul Rhino, his wife Jane and 20 other employees (who are not members of the family group) in the two businesses.
24. Jennifer is a delivery driver in the catering business. She is permitted to take the trust's delivery van home after late afternoon deliveries.
25. Zara is a book-keeper. As there is no office space at the business premises, the trust has given Zara a laptop to facilitate her working from home.
26. Roberto, the chef, recently celebrated his 10 year anniversary working at the café. Paul and Jane (as trustees) gave Roberto a cash bonus for his years of service.
27. Every Friday the café gives a free coffee to the first customer that correctly answers a trivia question written on the café blackboard.
28. The trust conducts each of these four transactions on arm's length terms.
29. Each is the giving of a benefit as described in the extended meaning of 'distributes' in subsection 272-60(1) and none of the employees nor the customer contributes directly to the cost of these transactions.
30. However, in each case it will be inferred that the amount or value of the benefit provided by the trust does not exceed the amount or value of consideration given in return. Each transaction is on arm's length

⁷⁵ Section 272-63 of Schedule 2F of the 1936 Tax Act

terms and is an ordinary incident of a business that the trust carries on. None is a disguised distribution of trust property outside of the family group.

Note: As each benefit to the employees is not taken to be a distribution, the trust may need to consider whether any such benefit is a fringe benefit.

Example 2 - use of holiday home, not an incident of a business

31. The Wonder Family Trust has made an FTE and Diana Prince is the specified individual. The trust owns a holiday home. The holiday home is used by Diana's friends, for no consideration, for four weeks in the year.

32. This transaction is not on arm's length terms nor an ordinary incident of a business being carried on by the trust. As no consideration is given in return for the use of the property, the full value of that use is a distribution within the extended meaning of 'distributes'.

Example 3 - interest-free loans by a business

33. The Phantom Family Trust has made an FTE and Kit Walker is the specified individual. The trust carries on a commercial retail business which sells goods to customers at market value. At no extra cost, a customer can request the business's 'no repayment for 12 months' deal. This results in an interest-free loan from the trust to a customer for a year.

34. The benefit of the interest-free loan is a distribution transaction. However, in the circumstances it will be inferred that the amount or value of the interest-free loan does not exceed the amount or value of consideration given in return. The interest-free loan is on arm's length terms and is an ordinary incident of a retail business carried on by the trust.

Example 4 - entertainment expense for arm's length clients of a business

35. The Jules Family Trust has made an FTE and Ms Julie Slipig is the specified individual. The trust carries on a business. The trust spends approximately \$200,000 per year on entertaining arm's length clients of the business (the expense is non-deductible).

36. The benefit of the entertainment provided is a distribution transaction. However, in the circumstances it will be inferred that the value of the entertainment provided by the trustee does not exceed the amount or value of consideration given in return. The entertainment is provided on arm's length terms and is an ordinary incident of a business that the trust carries on.

Example 5 - discounted fees for services provided by a business

37. The Super Consulting Family Trust has made an FTE and Mr Clark Kent is the specified individual. In respect of one particular transaction, the trust provided \$200,000 worth of services to a client (based on the trust's standard consultation rate). The trust bills the client for the services. The client subsequently requests that the trust reconsider the price charged due to their longstanding relationship. As an act of goodwill, the trust discounts the fee by \$25,000.

38. The \$25,000 reduction is a distribution transaction. However, it will be inferred that the value of the services provided does not exceed the amount of value of consideration given in return. The reduced fee, although less than would be payable at the trust's standard rate, is nonetheless genuine consideration for the services provided and agreed upon as a result of an arm's length dealing. The discounted fee is provided on arm's length terms and is an ordinary incident of the business that the trust carries on.

Example 6 - written-off bad trade debts

39. The Greener Family Trust has made an FTE and Mr Bruce Banner is the specified individual. The trust operates as an industrial property trust and writes-off a bad trade debt owed by a debtor who is not a beneficiary of the trust.

40. The mere writing-off of a debt does not cause the debt to be extinguished, forgiven, released or waived. It is therefore, of itself, not a distribution transaction.
41. However, to the extent that a debt has, on a bona fide assessment (based on sound commercial considerations) gone bad, the debt is of no value. Accordingly, the value of the distribution transaction that is a genuine extinguishment, forgiveness, release or waiver of a bad debt is nil. Because nothing of value is transferred or given by the trust to the debtor and commensurate consideration (nil) has been given in return by the debtor, a genuine extinguishment, forgiveness, release or waiver of a bad debt is not within the extended meaning of 'distributes'.

- ATO Interpretative Decision ATO ID 2004/162

Issue: Is the trustee of a family trust liable for Family Trust Distribution Tax (FTDT) pursuant to section 271-15 of Schedule 2F to the Income Tax Assessment Act 1936 (ITAA 1936) on a payment made in respect of the redemption of units, where the amount paid exceeds the value of any consideration given in return?

Decision: Yes. The trustee of a family trust is liable for FTDT pursuant to Division 271 of Schedule 2F to the ITAA 1936 to the extent that the payment made in respect of the redemption exceeds the value of any consideration given in return.

Reasons for Decision: The redemption of units in a unit trust would be a distribution pursuant to subsection 272-60(1) of Schedule 2F to the ITAA 1936. Section 272-60 gives an extended meaning of distributions of income and capital.

ABC Family Trust (who is controlled by Tom and Jane Smith) and has made an FTE owns shares in XYZ Pty Ltd. Tom and Jane want to bring their son Jack into the company. ABC Family Trust gifts 50% of its shares to ABC Jr Family Trust.

- The transfer of shares at less than market value will be considered to be a distribution for the purpose of section 272-60(1).

Example:

- DEF Pty Ltd has made an IEE in relation to the DEF Family Trust. DEF Family Trust sells its shares to a third party, Unfortunate Family Trust. DEF Pty Ltd pays dividends to Unfortunate Family Trust.

The dividends will be distributions (section 272-50).

- The client now realises that DEF Pty Ltd has made an IEE, but is out of time to revoke the IEE. DEF Pty Ltd decides to transfer the business assets to NewCo Pty Ltd (the shares of which are owned by Unfortunate Family Trust) for \$50,000 (however, the market value of business assets is \$1 million).

The transfer of the business assets will be a distribution (\$950,000) (section 272-60).

- DEF Pty Ltd forgives the \$50,000 owed by NewCo Pty Ltd for the transfer of the business assets.

The release of the debt will be a distribution (\$50,000) (section 272-60).

14. FTEs and passing control of trusts

- Where a trustee has made an FTE in relation to a particular individual, the entities to which distributions can be made is limited. This is particularly the case when control of trusts are passed to the next generation who may then want to make distributions to corporate entities which they control.
- The issue is compounded because:
 - the test individual cannot be changed as a result of the death of that individual; and
 - a trustee can only make an FTE in relation to someone who is alive.
- To overcome this issue, a strategy may be to establish trusts and have the trustee make FTE's in relation to the test individual of the existing trust with the FTE. Control of these trusts will pass to the individuals who will control the existing trust.
- Example:
 - Background
 - Brian and Louise have a trust which holds the farming land and conducts the primary production operations.
 - Their intention is that, on the death of the survivor, their children, Michael and John will jointly control the trust and the anticipation is that both Michael and John will want to establish corporate beneficiaries which can receive income distributions from this trust.
 - The trust has made an FTE with Brian as the test individual.
 - There may be a problem if corporate beneficiaries are established after the death of Brian and the trust makes income distributions to those corporate beneficiaries.
 - Issue
 - As each of the trust has made an FTE in relation to Brian, this will restrict all future distributions to:
 - individuals who are part of Brian's family;
 - trusts that have made IEE's in relation to the relevant trust;
 - companies that are wholly owned by individuals who are part of Brian's family (but there cannot be any discretionary shares);
 - companies that are wholly owned by trusts that have made an FTE with Brian as the test individual; or
 - companies that have made an IEE to be part of Brian's family group.
 - If a company is established after Brian's death with the shares held by a trust that has not made an FTE while Brian was alive, that company will not be able to make an IEE because it will not satisfy the 'control test' in section 272-87(3) of Schedule 2F of the 1936 Tax Act, which requires that:

- Brian; and
- members of Brian's family; and
- trusts which have made an FTE with Brian as the test individual

must between them have fixed entitlements to more than 50% of the income or capital of the company.

- This means that if Michael and John want to distribute to corporate beneficiaries after Brian's death, the shareholders of those companies can only be:
 - trusts which made an FTE with Brian as the test individual; or
 - individuals who were part of Brian's family.
- A trust can only make an FTE in relation to an individual who is alive at the time the election is made.
- Possible solution (before the death of Brian)
 - Brian and Louise could establish trusts while Brian is alive (New Trusts) which make FTE's with Brian as the test individual.

Note: The Commissioner's view is that the trustee cannot make an FTE unless it passes the 'family control test' at the end of the year.

- The New Trusts and any future companies in which they hold shares will be in Brian's family group because they will:
 - have made FTEs with Brian as the test individual; or
 - be wholly owned by trusts that have made FTEs in relation to Brian.
- After Brian's death, the trustee of the trust could then distribute to:
 - the New Trusts; or
 - corporate beneficiaries in which the New Trusts own all shares.
- It is not necessary that these corporate beneficiaries are in existence prior to Brian's death.

- Possible solution (after the death of Brian)
 - Michael and John could each establish a company which have shares which have:
 - rights to 100% of the capital and voting held by individuals (who are part of Brian's family); and
 - rights to 100% of the income held by a trust of which they are the test individual.

For example, Michael's company could be established with him owning shares which have 100% of capital and voting rights and his trust (Michael Trust) will own shares which have 100% of the income rights.

John's company could be established with him owning shares which have 100% of capital and voting rights and his trust (John Trust) will own shares which have 100% of the income rights.

- Michael's company and John's company could make an IEE in relation to each of the trusts of which Brian is the test individual that make distributions to the relevant companies. The companies can do this as members of Brian's family own more than 50% of the rights to capital.
- Michael Trust and John Trust will need to make an IEE in relation to each of the trusts which distribute to the relevant companies. Otherwise the relevant companies will be liable to family trust distributions tax on the dividends to the trusts. They will also need to make FTE's to pass on the franking credits. For example, Michael could be the test individual of the Michal Trust and John the test individual of the John Trust.
- Michael Trust will need to ensure that distributions are only made to entities within both Brian's and Michael's family group.
- John Trust will need to ensure that distributions are only made to entities within both Brian's and John's family group.

15. Case Study

15.1 Facts

The Royal Group have three entities from which their operations are conducted, being:

- Royal Gems Pty Ltd which operates a souvenir business specialising in all things 'royal'.
- Royal Farming Trust which operates an agricultural business.
- Royal Land Holdings Trust which has extensive land holdings.

Royal Gems Pty Ltd

- Royal Gems was established on 1 July 2013 with Tiggy Holdings Pty Ltd as the trustee of the Tiggy Discretionary Trust as its sole shareholder.
- Tiggy Discretionary Trust made an FTE when it lodged its 2014 tax return commencing on 1 July 2013 with Tiggy as the test individual.
- Royal Gems Pty Ltd made an IEE when it lodged its 2014 tax return commencing on 1 July 2013 in relation to the Tiggy Family Trust.
- On 1 July 2018 the trustee of the Tiggy Discretionary Trust sold its shares in Royal Gems to Sussex Pty Ltd as the trustee of the Sussex Family Trust.
- Harry and his wife (Meghan) became the directors of Royal Gems on 1 July 2018.
- Tiggy (who is Harry's former nanny) is not related to either Harry or Meghan.
- Royal Gems Pty Ltd has done extremely well and the business is now valued at \$5 million.
- Since 1 July 2018 Royal Gems has paid the following fully franked dividends:
 - 2021 year - \$400,000;
 - 2022 year – \$1 million; and
 - 2023 year - \$2 million.

Sussex Family Trust

- Harry and Meghan are the directors and shareholders of Sussex Pty Ltd.
- Sussex Family Trust made a FTE when it lodged its 2019 tax return commencing on 1 July 2018 with Harry as the test individual.
- For the years 2021, 2022 and 2023
 - the 'net income' of the Sussex Family Trust has been defined on the basis of 'accounting concepts'; and
 - the 'net income' has been distributed to Sussex Royal Pty Ltd (which is owned by Harry and Meghan).

Royal Farming Trust

- The trustee of the Royal Farming Trust is Royal Farming Co Pty Ltd.
- Elizabeth and Phillip are the directors and shareholders of Royal Farming Co Pty Ltd.
- Royal Farming Trust made an FTE commencing on 1 July 2001 with Elizabeth as the test individual.
- For the 2002 to 2018 years, the distributions have been made to the following members of Elizabeth's family and entities:
 - Her children – Charles, Anne, Andrew and Edward (\$100,000 each).
 - Her grandchildren – Peter, Zara, William, Harry, Beatrice, Eugenie, Louise and James (\$50,000 each).
 - Her cousins – Alexandra and Michael (\$20,000 each).
 - Blue Ribbon Holdings Pty Ltd - \$1 million (the shares of which are owned by Royal Investment Trust (a discretionary trust which made a FTE commencing on 1 July 2001 with Philip as the test individual)).
 - Elizabeth and Phillip – the balance equally.
- For the 2019 to 2023 years, the distributions have been made as follows:
 - Charles Pty Ltd as trustee of Charles Family Trust – 25%;
 - Anne Pty Ltd as trustee of Anne Family Trust – 25%;
 - Andrew Pty Ltd as trustee of Andrew Family Trust – 25%; and
 - Edward Pty Ltd as trustee of Edward Family Trust – 25%.
- On 1 July 2002 the trustee forgave a loan of \$900,000 which was owing to it by Alexandra.
- FTE's and IEE's of trust beneficiaries:
 - Charles Pty Ltd as the trustee of Charles Family Trust:
 - has made a FTE commencing on 1 July 2010 with Charles as the test individual; and
 - an IEE commencing on 1 July 2010 in relation to the Camilla Family Trust (of which Camilla is the test individual).

Charles is the sole director and shareholder of Charles Pty Ltd.

- Anne Pty Ltd as trustee of Anne Family Trust:
 - has made a FTE commencing on 1 July 2016 with Anne as the test individual; and
 - an IEE commencing on 1 July 2019 in relation to the Royal Farming Trust (of which Elizabeth is the test individual).

Anne is the sole director and shareholder of Anne Pty Ltd.

- Andrew Pty Ltd as trustee of Andrew Family Trust has made a FTE commencing on 1 July 2010 with Andrew as the test individual.
- Andrew is the sole director and shareholder of Andrew Pty Ltd.
- Edward Pty Ltd as trustee for the Edward Family Trust has not made a FTE or IEE.
Edward is the sole director and shareholder of Edward Pty Ltd.

Royal Land Holdings Trust

- The trustee of Royal Land Holdings Trust is Royal Land Holdings Pty Ltd.
- Elizabeth is the sole director and shareholder of Royal Land Holdings Pty Ltd.
- Royal Land Holdings Trust has made a FTE commencing 1 July 2001 with Elizabeth as the test individual.
- The distributions have always been made to Royal Coffers Pty Ltd.
Royal Coffers Pty Ltd is owned by Windsor Family Trust (which has a FTE commencing 1 July 2001 with Elizabeth as the test individual)
- Elizabeth passed away in September 2022. Control of the Royal Land Holdings Trust and Windsor Family Trust passed to her four children. Elizabeth's children want to establish corporate beneficiaries which can receive income distributions from these trusts.

Assumption

Assume all FTE's and IEE's have been validly made.

15.2 Questions

Royal Gems Pty Ltd

- What are the implications under Schedule 2F of the 1936 Tax Act for Royal Gems in relation to the dividends paid since 1 July 2018?
- Who is liable for any family trust distributions tax?
- How are the distributions made to Sussex Royal Pty Ltd treated?
- Would there be any issues under Schedule 2F of the 1936 Tax Act if the business assets were transferred to a new company (which was owned by Sussex Family Trust) for \$10,000?
- Can the IEE be revoked?

Royal Farming Trust

- Have any distributions made in the 2002 to 2023 years been to individuals or entities outside of Elizabeth's family group?
- Are there any implications under Schedule 2F of the 1936 Tax Act in relation to the trustee forgiving the loan owed by Alexandra?
- Who is liable for any family trust distributions tax?
- Can any of the trusts make FTEs or IEEs to be included in Elizabeth's family group.

Windsor Land Holdings Trust

- Who will the shareholders of the corporate beneficiary need to be for them to be in Elizabeth's family group?
- Are there any measures which could have been put in place to provide flexibility for Elizabeth's children during her lifetime?

Safeguards

Are there any terms which can be inserted into trust deeds to safeguard from distributions being made outside the family group?

15.3 Answers

15.3.1 Royal Gems Pty Ltd

What are the implications under Schedule 2F of the 1936 Tax Act for Royal Gems in relation to the dividends paid since 1 July 2018?

- As Royal Gems Pty Ltd has made an IEE in relation to the Tiggy Discretionary Trust commencing on 1 July 2013 then any distributions made outside of the family group of Tiggy (the individual specified in the FTE of Tiggy Discretionary Trust) will be subject to family trust distribution tax.⁷⁶
- Since 1 July 2018 Royal Gems Pty Ltd has paid the following dividends to Sussex Family Trust (which has made a FTE commencing on 1 July 2018 with Harry as the test individual).
 - 2021 year - \$400,000;
 - 2022 year – \$1 million;
 - 2023 year - \$2 million.
- Are the dividends ‘distributions’ for the purpose of Schedule 2F?
 - A company distributes income of the company to a person if the company pays a dividend or non-share dividend to the person.⁷⁷
 - Therefore, the dividends are ‘distributions’ for the purpose of Schedule 2F.
- Is Sussex Family Trust part of Tiggy’s family group (which is defined in section 272-90)?

The Sussex Family Trust will be part of Tiggy’s family group in the following circumstances:

 - Sussex Family Trust has the same test individual as Tiggy Discretionary Trust.
This is not satisfied as they have different test individuals.
 - The following individuals and entities have fixed entitlements directly or indirectly, and for their own benefit, to all of the income and capital of the Sussex Family Trust.
 - Tiggy (being the test individual); and/or
 - one or more members of Tiggy’s family; and/or
 - the trustees of one or more family trusts, provided that Tiggy is the individual specified in the FTE of each of those family trusts.

This is not satisfied as Sussex Family Trust is not a fixed trust (in any case the beneficiaries will be Harry and Meghan and their family and entities).

⁷⁶ Section 271-30(1) of schedule 2F of the 1936 Tax Act

⁷⁷ Section 272-50(1) of schedule 2F of the 1936 Tax Act

- If Sussex Family Trust made an IEE to be in Tiggy's family and the election was in force when the distribution was made.
- For the trustee of Sussex Family Trust to be able to make an IEE it would have to the 'family control test' at the end of the specified income year.⁷⁸
- A trust passes the 'family control test' if any one of the following are satisfied:⁷⁹
 - Paragraph (A) - the 'group' has the power to obtain beneficial enjoyment (directly or indirectly) of the capital or income of the trust; or
 - Paragraph (B) - the group is able (directly or indirectly) to control the application of the capital or income of the trust; or
 - Paragraph (C) - the group is capable, under a scheme, of gaining the beneficial enjoyment in paragraph (A) or the control in paragraph (B); or
 - Paragraph (D) - the trustee of the trust is accustomed, under an obligation or might reasonably be expected, to act in accordance with the directions or wishes of the group; or
 - Paragraph (E) - the group can remove or appoint the trustee of the trust; or
 - Paragraph (F) - the group has more than a 50% stake in the income or capital of the trust; or
 - Paragraph (G) - persons in the group are the only persons who, under the terms of the trust, can obtain the beneficial enjoyment of the income and capital of the trust.

The 'group' consists of Tiggy and/or one or more members of Tiggy's family.

This is not satisfied as Sussex Family Trust will be controlled by Harry and Meghan and not Tiggy. In any case, even if Sussex Family Trust could make an IEE, the trustee would be liable for family trust distribution tax if it distributed outside Tiggy's family group.

Therefore, Sussex Family Trust is not part of Tiggy's family group.

- This means that Royal Gems Pty Ltd is liable for family trust distribution tax on the dividends paid to Sussex Family Trust to date and any future dividends paid to it and any other entity outside Tiggy's family group.
- The dividends paid to date total \$3.4 million. The family trust distribution tax currently owing by Royal Gems (excluding interest) is calculated as follows:

Year	Dividend	Family Trust Distribution Tax
2021	\$ 400,000	\$188,000 (47%)
2022	\$1,000,000	\$470,000 (47%)
2023	\$2,000,000	\$940,000 (47%)
TOTAL	\$3,400,000	\$1,598,000

⁷⁸ Section 272-85(4) of schedule 2F of the 1936 Tax Act

⁷⁹ Section 272-87(2) of schedule 2F of the 1936 Tax Act

Note: There will be further family trust distribution tax payable when the current retained profits and future profits are paid out as dividends.

- The family trust distribution tax is due and payable 21 days after the day on which the distribution to Sussex Family Trust was made.⁸⁰ Interest will also be payable on any late payments.

Note: Family trust distribution tax is a debt which becomes automatically payable. It is not subject to a review period.

Who is liable for any family trust distributions tax?

- Royal Gems Pty Ltd and any directors of Royal Gems Pty Ltd at the time the dividends were paid (Harry and Meghan) are jointly and severally liable to pay the family trust distribution tax.⁸¹

How are the distributions made to Sussex Royal Pty Ltd treated?

- Sussex Family Trust and Sussex Royal Pty Ltd
 - Those amounts received by Sussex Family Trust on which family trust distributions tax is payable will not be included in its assessable income.⁸²
 - However, the dividends received from Royal Gems will form part of the trust income of Sussex Family Trust's as the trust income is defined to include ordinary income.
 - Sussex Family Trust distributed 100% of its trust income to Sussex Royal Pty Ltd for the 2021 to 2023 years.
- This means that:
 - the distributions will form part of the accounting income but not assessable income of Sussex Royal Pty Ltd; and
 - the franking credit attaching to the dividend cannot be added to the franking account of Sussex Royal Pty Ltd and passed on to its shareholders.
- Implications for Harry and Meghan as shareholders of Sussex Royal Pty Ltd
 - The implications for Harry and Meghan as the shareholders of Sussex Royal Pty Ltd is that, when the amounts representing the distributions were or are paid out as dividends, they will be taxed in the hands of Harry and Meghan without the benefit of any franking credits.

⁸⁰ section 271-75(3) of Schedule 2F of the 1936 Tax Act

⁸¹ section 271-30(2) of Schedule 2F of the 1936 Tax Act

⁸² section 271-105 of Schedule 2F of the 1936 Tax Act

- Assuming the existing retained profits of \$3.4 million are paid out to Harry and Meghan (and they are in the 47% tax bracket (including medicare), the approximate additional tax payable by Harry and Meghan would be as follows:

Actual: Tax on unfranked dividend of \$3.4 million	\$1,598,000
Should have been: Top-up Tax based on franked dividend of \$3.4 million	\$ 825,714
Additional tax	\$ 772,286

Would there be any issues under Schedule 2F of the 1936 Tax Act if the business assets were transferred to a new company (which was owned by Sussex Family Trust) for \$10,000?

- If Royal Gems Pty Ltd is required to restructure its assets, there will be tax implications (and depending on the State in which the business is carried on, possibly duty implications) on the transfer of business assets to a new entity.
- The capital gain on the goodwill will be the amount by which the market value of the goodwill exceeds the cost base.
Royal Gems Pty Ltd will be liable for company tax on any net capital gain.
- There will also be family trust distribution tax when the net capital gain is paid out to Sussex Family Trust as a dividend.
- Any transfer of business assets must occur at market value to avoid family trust distribution tax on the transfer, because a transfer of assets at less than market value will be considered to be a 'distribution'.⁸³

Can the IEE be revoked?

- Revoking the IEE
 - There were some changes to Schedule 2F in 2008 which would have allowed Royal Gems to revoke the IEE if, at the time that the IEE was made it was part of Tiggy's family group (which it was because Royal Gems Pty Ltd was 100% owned by a trust of which Tiggy is the test individual).
 - However, the revocation needed to have been made no later than the end of the fourth income year after the year specified in the IEE.⁸⁴

This means that as the year specified in the IEE was the 2014 year, the revocation must have been made no later than the 2018 income tax return.

- Therefore the IEE cannot be revoked as the period to revoke has expired.

Note: There is no discretion for the Commissioner to extend the period.

⁸³ Section 272-60 of Schedule 2F of the 1936 Tax Act

⁸⁴ Section 272-85(5C) of Schedule 2F of the 1936 Tax Act

Summary

- As the IEE has not been revoked:
 - Royal Gems Pty Ltd will be liable for family trust distribution tax on all dividends paid to Sussex Family Trust to date and in the future.

Note: Royal Gems Pty Ltd will have paid company tax on the profits and then will be liable for family trust distribution tax on the after tax profits.

- Sussex Royal Pty Ltd (and Harry and Meghan) will lose the benefit of franking credits on the dividends and distributions they have received.
- Sussex Family Trust should not distribute any further income attributed to the dividends received to a corporate beneficiary.
- Practically, all assets will need to be transferred out of Royal Gems Pty Ltd to a new entity.

- The total tax payable and family trust distribution tax is calculated as follows:

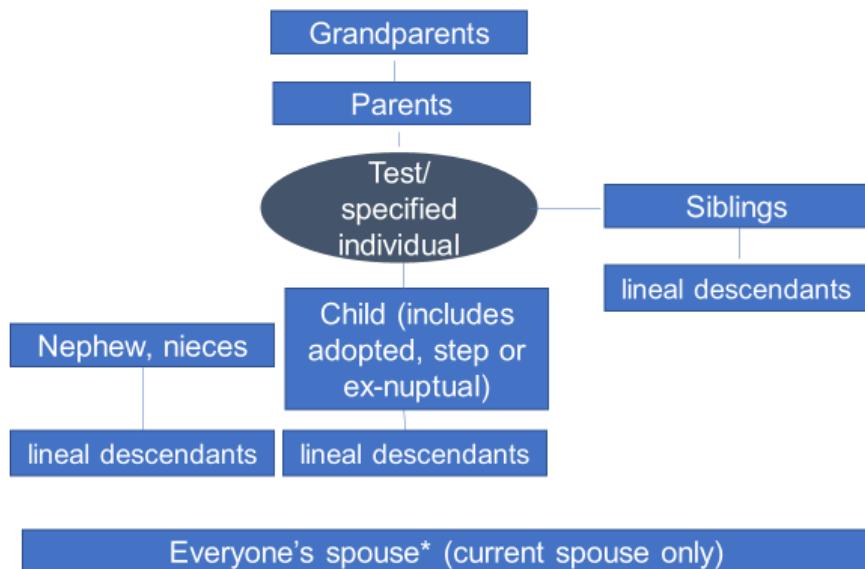
	Subject to FTDT	Not subject to FTDT
Royal Gems (Profit before tax)	\$4,857,142	\$4,857,142
Tax at 30%	(\$1,457,142)	(\$1,457,142)
After tax profit	\$3,400,000	\$3,400,000
Family trust distribution tax (47%)	(\$1,598,000)	Nil
Tax on Susse Royal dividend paid to Harry & Meghan (no franking credits)	(\$1,598,000)	(\$ 825,714)
Net Amount	\$ 204,000	\$2,574,286
Total tax and FTDT	\$4,653,142	\$2,282,856
Percentage of tax on \$4,857,142 profit	95.80%	47%

15.3.2 Royal Farming Trust

Have any distributions made in the 2002 to 2023 years been to individuals or entities outside of Elizabeth's family group?

- Who is part of Elizabeth's family group?⁸⁵
 - Members of Elizabeth's family which will be each of the following individuals on the basis that Elizabeth is the test individual.

Who are members of the 'family'? (Section 272-95)



- The following former family members.
 - A person who was a spouse of either the test individual or of a member of the test individual's family before a breakdown in the marriage or relationship.
 - A person:
 - who was the spouse of either the test individual or of a member of the test individual's family before the death of the test individual or of a member of the test individual's family; and
 - who is now the spouse of a person who is not a member of the primary individual's family; and
 - a person who was a child of the spouse of either the test individual or of a member of the test individual's family before a breakdown in the marriage or relationship of the primary individual or the member of the primary individual's family.
 - A trust in respect of which the FTE was made is a member of the test individual's family group in relation to the conferral or distribution.

⁸⁵ Section 272-90 of Schedule 2F of the 1936 Tax Act

- A trust with the same test individual specified in its FTE is a member of the test individual's family group in relation to the conferral or distribution.
 - A company, partnership or trust is a member of the test individual's family group in relation to the conferral or distribution if:
 - the company, partnership or trust has made an IEE to that effect; and
 - the election is in force when the conferral takes place or the distribution is made.
 - A company, partnership or trust is a member of the test individual's family group in relation to the conferral or distribution if:
 - the test individual; and/or
 - one or members of the test individual's family; and/or
 - the trustees of one or more family trusts, provided the primary individual is specified in the FTE of each of those family trusts;

have fixed entitlements directly or indirectly, and for their own benefit, to all of the income and capital of the company, partnership or trust.
 - A fund, authority or institution in Australia covered by Subdivision 30-B of the 1997 Act (about recipients for gift recipients).
 - An institution, hospital, trustee, society, association, club or fund, all of whose income is exempt under:
 - section 50-5 (charity, education and science);
 - section 50-10 (community service);
 - Items 6.1 or 6.2 of section 50-30 (public hospital or hospital carried on by a society or association);
 - Items 9.1 or 9.2 of section 50-45 (sports, culture and recreation).
- Who received the distributions?

2002 to 2018 years

- Her children – Charles, Anne, Andrew and Edward.

Elizabeth's children are part of Elizabeth's family and therefore are part of her family group (section 272-95(1)(a)).
- Her grandchildren – Peter, Zara, William, Harry, Beatrice, Eugenie, Louise and James.

Elizabeth's grandchildren are part of Elizabeth's family as they are the lineal descendants of her children and therefore are part of her family group (section 272-95(1)(c)).
- Her cousins – Alexandra and Michael.

Cousins are not part of an individual's family or family group. Therefore, they are not part of Elizabeth's family group which means there will be family trust distribution tax payable on the distributions to Alexandra and Michael.

- Blue Ribbon Holdings Pty Ltd

The shares in Blue Ribbon Holdings Pty Ltd are owned by Royal Investment Trust (which made a FTE commencing on 1 July 2001 with Philip as the test individual).

- Blue Ribbon Holdings will be part of Elizabeth's family group if all of the shares which have fixed entitlement to income and capital are owned by:
 - trusts which have made FTE's specifying her as the test individual – which is not the case; or
 - members of her family – which is not the case; or
 - if Blue Ribbon Holdings can make an IEE to be in Elizabeth's family group.
- However, for Blue Ribbon Holdings to be able to make the IEE more than 50% of the shares which have fixed entitlements to income or capital must be owned by:
 - trusts which have made FTE's specifying her as the test individual – which is not the case; or
 - members of her family – which is not the case.

Therefore, Blue Ribbon Holdings Pty Ltd cannot be part of Elizabeth's family group.

- Elizabeth and Phillip
 - Elizabeth is part of Elizabeth's family (section 272-95(1)).
 - Phillip is Elizabeth's spouse and therefore part of Elizabeth's family (272-95(1)(d)).

2019 to 2023 years

Note: FTEs remain in place following the death of the test individual.

- Charles Pty Ltd as trustee of Charles Family Trust
 - Charles Family Trust has made a FTE in relation to Charles and an IEE in relation to a Camilla Family Trust of which Camilla is the test individual.
 - This means that Charles Family Trust is not in Elizabeth's family group as it has not made a FTE in relation to Elizabeth or IEE in relation to Royal Farming Trust.
- Anne Pty Ltd as trustee of Anne Family Trust
 - Anne Family Trust has made a FTE in relation to Anne and an IEE in relation to Royal Farming Trust commencing on 1 July 2019.
 - This means that for the:
 - 2019 year Anne Family Trust will not be part of Elizabeth's family group; and
 - 2020 year and onwards, Anne Family Trust will be part of Elizabeth's family group.
- Andrew Pty Ltd as trustee of Andrew Family Trust
 - Andrew Family Trust has made a FTE in relation to Andrew.
 - This means that Andrew Family Trust is not in Elizabeth's family group as it has not made a FTE in relation to Elizabeth or IEE in relation to Royal Farming Trust.

- Edward Pty Ltd as trustee of Edward Family Trust

Edward Family Trust is not in Elizabeth's family group as it has not made a FTE in relation to Elizabeth or IEE in relation to Royal Farming Trust.

Are there any implications under Schedule 2F of the 1936 Tax Act in relation to the trustee forgiving the loan owed by Alexandra?

- Will the release of the loan be taken to be a 'distribution'?
 - Royal Farming Co Pty Ltd as trustee for the Royal Farming Trust distributes income or capital of the trust to a person if it:⁸⁶
 - pays or credits the income or capital in the form of money to the person; or
 - transfers the income or capital in the form of property to the person; or
 - reinvests or otherwise deals with the income or capital on behalf of the person in accordance with the directions of the person; or
 - applies the income or capital for the benefit of the person; in the person's capacity as a beneficiary of the trust.
 - Royal Farming Co Pty Ltd as trustee for the Royal Farming Trust also distributes income or capital to a person if it:⁸⁷
 - pays (including by way of a loan) or credits money of the entity to the person, or reinvestments such money for the person; or
 - transfers property of the entity to, or allows use of the property of the entity by, the person; or
 - deals with money or property of the entity for or on behalf of the person or as the person directs; or
 - applies money or property of the entity for the benefit of the person; or
 - extinguishes, forgives, releases or waives a debt or other liability owed by the person to the entity.
- Therefore, the release of the loan owed by Alexandra will be a distribution.
- As Alexandra (being Elizabeth's cousin) is not part of Elizabeth's family group, there will be family trust distribution tax payable 60 days of the release.

⁸⁶ Section 272-45 of Schedule 2F of the 1936 Tax Act

⁸⁷ Section 272-45 of Schedule 2F of the 1936 Tax Act

Who is liable for any family trust distributions tax?

- Royal Farming Co Pty Ltd (the trustee of Royal Farming Trust) together with Elizabeth and Philip (as the directors when the distributions were made) will be jointly and severally liable for the family trust distribution tax.⁸⁸
- Based on the above distributions (subject to the trusts making valid FTEs or IEEs to be included in Elizabeth's family group the family trust distribution tax (excluding interest) would be as follows:

Year	Individual or entity	Distribution	Family trust distribution tax (excluding interest)
2002 to 2018	Alexandra	\$20,000 each year	Highest marginal tax rate plus medicare for the relevant year
2002 to 2018	Michael	\$20,000 each year	Highest marginal tax rate plus medicare for the relevant year
2002 to 2018	Blue Ribbon Holdings	\$1 million each year	Highest marginal tax rate plus medicare for the relevant year
2019 to 2023	Charles Family Trust	25% of trust income	Highest marginal tax rate plus medicare for the relevant year
2019	Anne Family Trust	25% of trust income	Highest marginal tax rate plus medicare for the relevant year
2019 to 2023	Andrew Family Trust	25% of trust income	Highest marginal tax rate plus medicare for the relevant year
2019 to 2023	Edward Family Trust	25% of trust income	Highest marginal tax rate plus medicare for the relevant year
2003	Alexandra	\$900,000	Highest marginal tax rate plus medicare for the relevant year

⁸⁸ Section 271-15(2) of Schedule 2F of the 1936 Tax Act

Can any of the trusts make FTEs or IEEs to be included in Elizabeth's family group.

- Charles Family Trust
 - The issue is whether Charles Family Trust can make an IEE in relation to Royal Farming Trust (of which Elizabeth is the test individual).
 - To make an IEE, Charles Family Trust would need to be controlled (as defined under section 272-87) by members of Elizabeth's family.
 - This requirement is satisfied as Charles (Elizabeth's son) is the sole shareholder and director of Charles Pty Ltd (the trustee company)
 - However, Charles Family Trust cannot make an IEE in relation to two different trusts unless the test individual in both are the same.
 - Therefore because Charles Family Trust has already made an IEE in relation to Camilla Family Trust (of which Camilla is the test individual), it cannot make an IEE in relation to Royal Farming Trust.

This means that Charles Family Trust will not be part of Elizabeth's family group.

- Andrew Pty Ltd as trustee of Andrew Family Trust
 - The issue is whether Andrew Family Trust can make an IEE in relation to Royal Farming Trust (of which Elizabeth is the test individual).
 - To make an IEE Andrew Family Trust would need to be controlled (as defined under section 272-87(2)) by members of Elizabeth's family.

This requirement is satisfied as Andrew (Elizabeth's son) is the sole shareholder and director of Andrew Pty Ltd (the trustee company)

 - Andrew Family Trust will be able to make an IEE in relation to Royal Farming Trust commencing 1 July 2018 provided that since 1 July 2018 Andrew Family Trust has not made distributions to individuals or entities outside of Elizabeth's family group.
- Edward Pty Ltd as trustee of Edward Family Trust
 - Edward Family Trust cannot make an FTE specifying Elizabeth as the test individual. This is because the test individual must be alive at the time the FTE is made.
 - The issue is whether Edward Family Trust can make an IEE in relation to Royal Farming Trust (of which Elizabeth is the test individual).
 - To make an IEE, Edward Family Trust would need to be controlled (as defined under section 272-87(2)) by members of Elizabeth's family.

This requirement is satisfied as Edward (Elizabeth's son) is the sole shareholder and director of Edward Pty Ltd (the trustee company)

 - Edward Family Trust will be able to make an IEE in relation to Royal Farming Trust commencing 1 July 2018 provided that since 1 July 2018 Edward Family Trust has not made distributions to individuals or entities outside of Elizabeth's family group.

15.3.3 Royal Land Holdings Trust

Who will the shareholders of the corporate beneficiary need to be for them to be in Elizabeth's family group?

- Share ownership for corporate beneficiary to be in Elizabeth's family group (without having to make an IEE)
 - For each corporate beneficiary to be a member of Elizabeth's family group in relation to the conferral or distribution the following individuals and/or entities must have fixed entitlements directly or indirectly, and for their own benefit, to all of the income and capital of the company:
 - Elizabeth; and/or
 - one or more members of Elizabeth's family; and/or
 - the trustees of one or more family trusts, provided Elizabeth is specified in the FTE of each of those family trusts.⁸⁹
 - Share ownership
 - Provided the shares are owned by individuals who are part of her family (for example, her children, their spouses, their children) the company will be in Elizabeth's family group.
 - If the shares are to be owned by a trust, the trust would have needed to have made a FTE of which Elizabeth is the test individual.

Note however, ATO Interpretative Decision ATO ID 2014/3 – the test individual must be alive when the FTE is made.

- Share ownership for corporate beneficiary to be in Elizabeth's family group (if required to make IEE)
 - Each company will be a member of Elizabeth's family group in relation to the conferral or distribution from Royal Land Holdings Trust if:
 - the company has made an IEE to that effect; and
 - the election is in force when the conferral takes place or the distribution is made.⁹⁰
 - The company must pass the family control test at the end of the specified income year to make an IEE.

A company in respect of which an IEE is proposed to be made passes the family control test if a group consisting of:⁹¹

- the individual who is specified in the FTE in relation to the IEE (Elizabeth); and/or
- one or more members of the test individual's family (that is, Elizabeth's family); and/or
- the trustees of one or more family trusts, provided that Elizabeth is specified in the FTE of each of those family trusts

have between them, directly or indirectly, and for their own benefit, fixed entitlements to a greater than 50% share of the income or a greater than 50% share of the capital of the company or partnership.

⁸⁹ Section 272-90(5) of Schedule 2F of the 1936 Tax Act

⁹⁰ Section 272-90(4) of Schedule 2F of the 1936 Tax Act

⁹¹ Section 272-87(3) of Schedule 2F of the 1936 Tax Act

- Share ownership
 - It may be possible to have two different classes of shares as follows:
 - A class shares have fixed entitlements to capital and voting rights.
 - B class shares have fixed entitlements to dividends and voting rights.
- In relation to Charles' company:
 - The company could issue:
 - **50 A class shares to Charles.**
 - **50 B class shares to a trust controlled by Charles (Charles New Trust).**
 - Charles' company could then make an IEE in relation to Royal Land Holdings Trust because more than 50% of the capital rights are owned by members of Elizabeth's family members.
 - Charles New Trust would make a FTE of which Charles is the test individual (so that it can pass on franked dividends) and an IEE in relation to Royal Land Holdings Trust (to be in Elizabeth's family group).
 - Note: Charles New Trust would need to ensure that any distributions made are to individuals and entities in both Charles and Elizabeth's family group.
- This would be replicated for each of Elizabeth's children.

Were there any measures which could have been put in place whilst Elizabeth was alive to provide flexibility for Elizabeth's children?

- Due to the complexity of having different class of shares and having to make IEEs, it would have been easier to establish four trusts whilst Elizabeth whilst alive, which would have been controlled by each of Elizabeth's respective children and for them to make FTEs in relation to Elizabeth (whilst she was alive).

Note: The Commissioner's view is that the FTE cannot be made prior to the end of the year as the control test must be satisfied at the end of the year. That is, that must be satisfied prior to the FTE being made.

- These new trusts would have been ear marked to be the shareholders of the corporate beneficiaries of Royal Land Holdings Trust in the future.

There was no requirement to establish the corporate beneficiaries whilst Elizabeth was alive.

- The benefit of this is that the corporate beneficiaries would have automatically been in Elizabeth's family group.
- Care would have been needed as the new trusts must have ensured that they only made 'distributions' to Elizabeth's family group.

Are there any terms which can be inserted into trust deeds to safeguard from distributions being made outside the family group?

- To avoid the adverse tax implications of distributing outside the 'family group', the trust deed could include a clause prohibiting distributions (where there is a FTE or IEE in force) to any person who:
 - is not a member of the 'family group' of the test individual in the FTE and/or IEE; and
 - could not have elected to become a member of that 'family group'.
 - Although the beneficiary does not include the amount of the distribution in their assessable income the issue will be that the family trust distribution tax is a debt which is not subject to a review period.

16. Loss Trust Flow Chart

