

VIC Tax Forum

20–21 March 2025

Grand Hyatt Melbourne



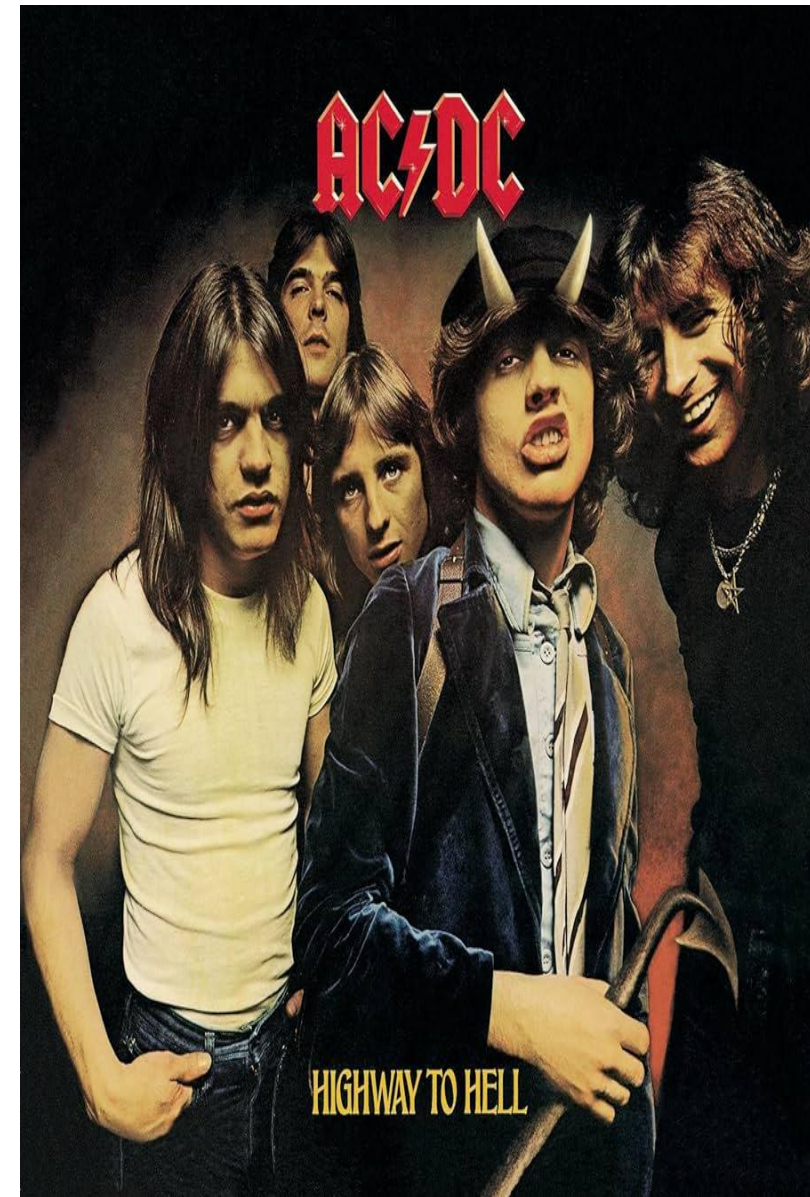
Family trust elections – stairway to heaven or highway to hell?

Presenter:

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OR



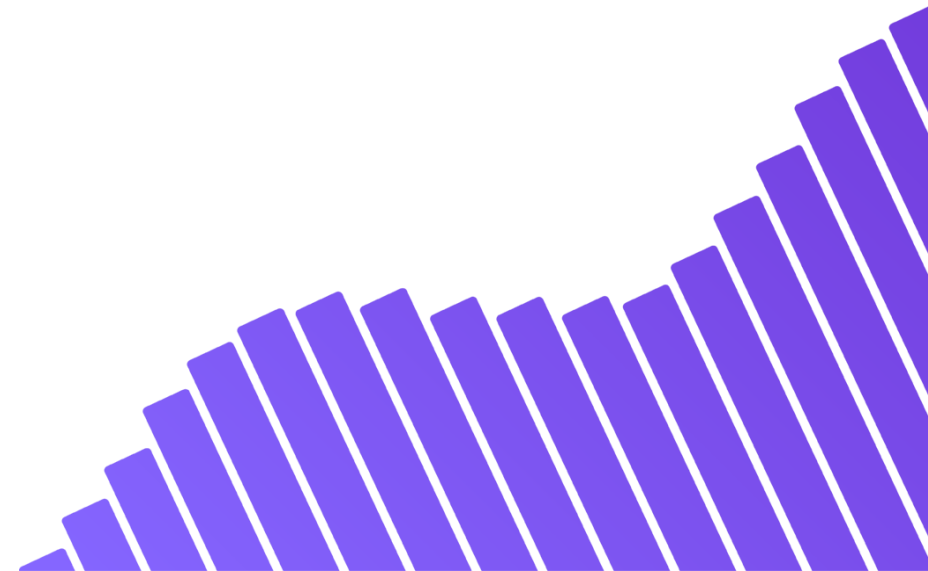
What we will cover

Family trust elections offer considerable benefits to family groups. However, the consequences for getting it wrong – family trust distribution tax at 47% plus the general interest charge – are dire. Adding to the mix is that family trust elections are an area of ATO focus.

This session will work through some of the key issues around FTEs (and IEEs) including:

- When and how to make FTEs and IEEs
- Groups with more than one test individual
- Deaths and relationship breakdowns
- Sales of businesses (or entities) in whole or part; and
- Strategies when a liability for family trust distribution tax arises.

Who and what?



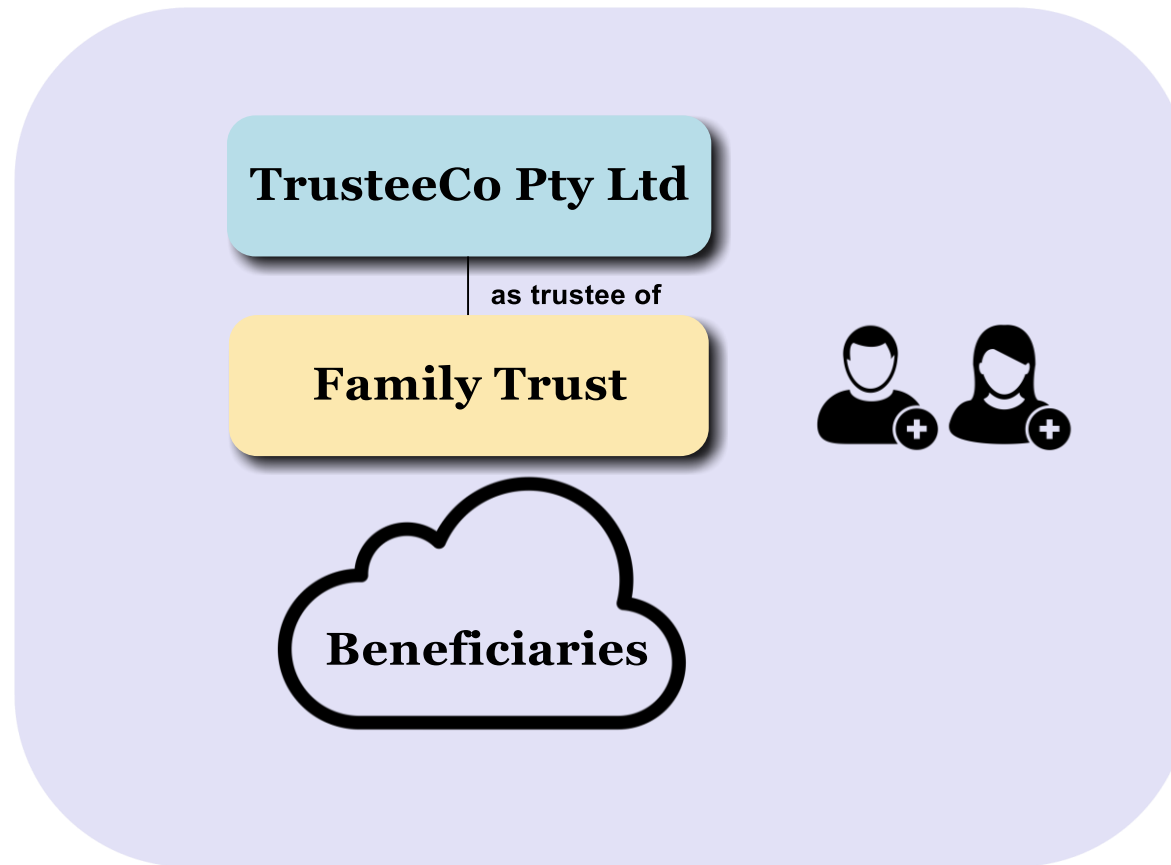
Family trust elections

- The trustee of the trust may make an election (the FTE) that the trust is a family trust for the purposes of the ITAA 36 and ITAA 97 at all times after the beginning of a specified year.
- The FTE must nominate an individual (the test individual) as the individual whose family group is to be taken into account in relation to the FTE.
- An FTE is generally irrevocable (subject to certain exceptions) and, therefore, its implications will continue to apply whilst the trust exists.

Interposed entity elections

- If the trustee of a trust makes a FTE, a company, the partners in any partnership or the trustee of any trust, may make an election (the IEE) that the company, partnership or trust is to be included at all times after a specified day in a specified income year in the family group of the test individual specified in the FTE.
- Subject to certain exceptions, the IEE is generally irrevocable.

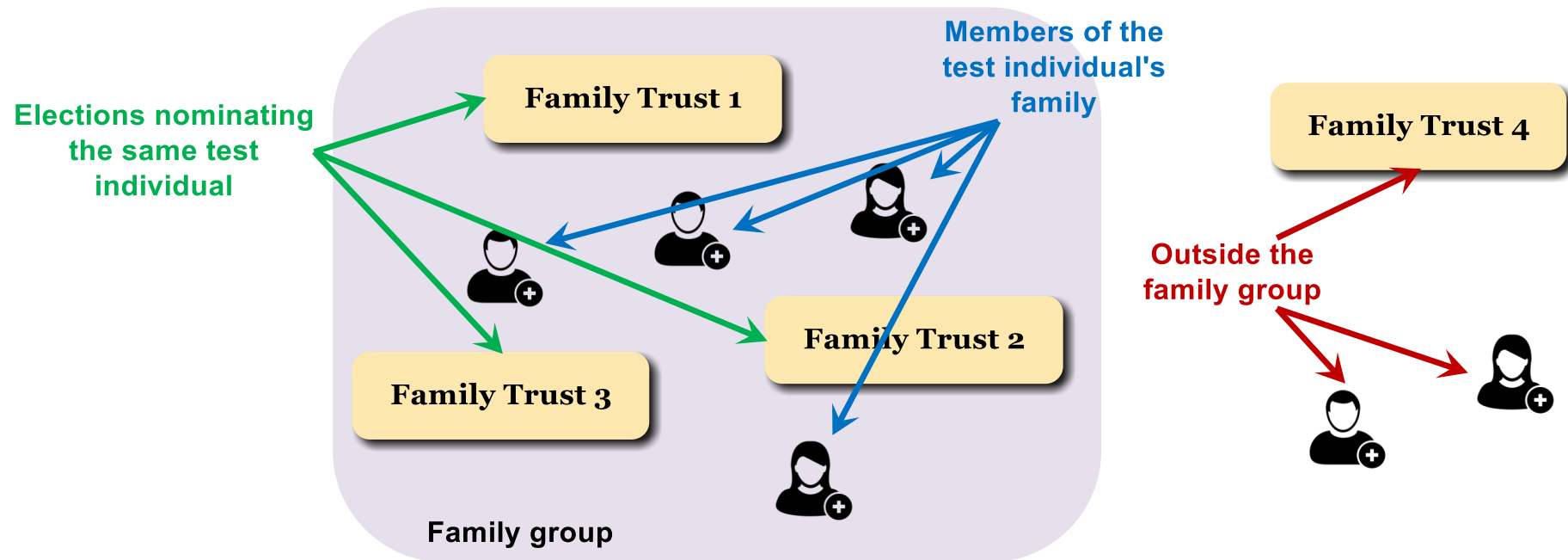
Making a family trust election



Family from 1 July 2007

	Grandparent	Grandparent	
	Parent	Parent	
Brother/Sister	Test Individual	Spouse	Brother/Sister
Child	Child	Child	Child
All lineal descendants	All lineal descendants	All lineal descendants	All lineal descendants
And spouses, former spouses, widows, widowers and step-children of all above parties			

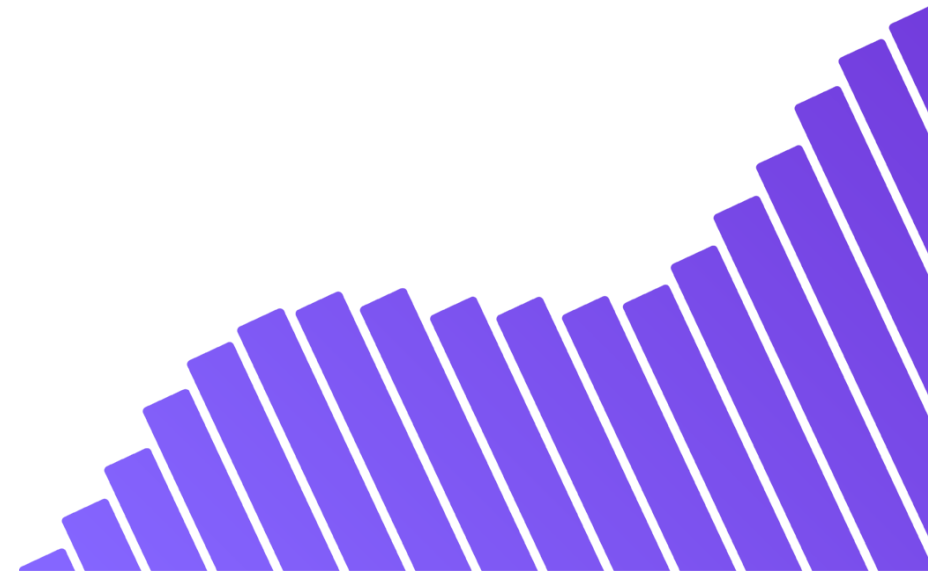
Inside/outside the family group



Primary individual considerations

- Has the family trust election or interposed entity election been relied upon?
- Is the test individual the most appropriate person to define the family group?
 - With the wider coverage of lineal descendants and ex-spouses etc should the test individual be moved to a sibling or up or down a generation?
- Does the current test individual potentially limit the future flexibility of the family group?

How?



Tax Laws Amendment (2004 Measures No. 7) Act 2005

- Elections must always be made in writing in an “approved form”.
- Taxpayers may now lodge an FTE or an IEE to be lodged with retrospective application.
- The specified income year may be a year before the one in which the election is made if:
 - the family control test is passed for that period, and
 - any conferral of present entitlement or distributions of income or capital of the trust by the trustee during that period has been made to the test individual or a member of the test individual’s family group.
- Note the earliest specified income year can only be the income year ended 30 June 2005 (Item 5 of Schedule 8 of the Act).

Passing the family control test

Section 272-87 of Schedule 2F of ITAA 36

Trusts

- (1) A trust in respect of which a family trust election or an interposed entity election is proposed to be made passes the family control test if:
- (a) the requirement in any of the paragraphs of subsection (2) is satisfied in relation to a group consisting of:
 - (i) **the individual (the primary individual) who is to be specified in the family trust election** or, in the case of an interposed entity election, who is specified in the family trust election to which the interposed entity election will relate; or
 - (ii) **one or more members of the primary individual's family** (see section 272-95); or
 - (iii) **the primary individual and one or more members of the primary individual's family**; or
 - (b) the requirement in any of paragraphs (a) to (e) of subsection (2) is satisfied in relation to a group consisting of a person or persons covered by subparagraph (a)(i), (ii) or (iii) of this subsection and **one or more legal or financial advisers to the primary individual or to a member of the primary individual's family**; or
 - (c) the requirement in paragraph (f) of subsection (2) is satisfied in relation to a group consisting of

Family control test (cont'd)

Requirement for purposes of subsection (1)

(2) The requirement for the purposes of subsection (1) is that:

- (a) 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; or
- (b) the group is able (directly or indirectly) to control the application of the capital or income of the trust; or
- (c) the group is capable, under a scheme, of gaining the beneficial enjoyment in paragraph (a) or the control in paragraph (b); or
- (d) the trustee of the trust is accustomed, under an obligation or might reasonably be expected, to act in accordance with the directions, instructions or wishes of the group; or
- (e) the group is able to remove or appoint the trustee of the trust; or
- (f) the group has more than a 50% stake in the income or capital of the trust; or
- (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.

Passing the family control test

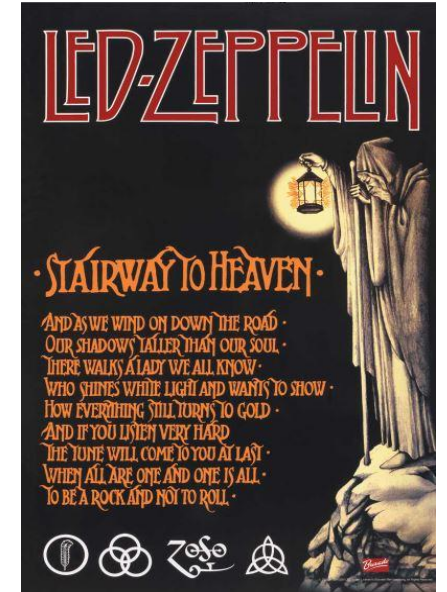
Section 272-87 of Schedule 2F of ITAA 36

Companies and partnerships

- (3) A company or partnership in respect of which an interposed entity election is proposed to be made passes the family control test if a group consisting of:
- (a) **the individual who is specified in the family trust election** mentioned in subsection 272-85(1) in relation to the interposed entity election; or
 - (b) **one or more members of the individual's family** (see section 272-95); or
 - (c) the trustees of one or more family trusts, **provided the individual is specified in the family trust election of each of those family trusts**; or
 - (d) any persons covered by any combination of the above paragraphs;
- 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.**

Why?

The stairway to heaven



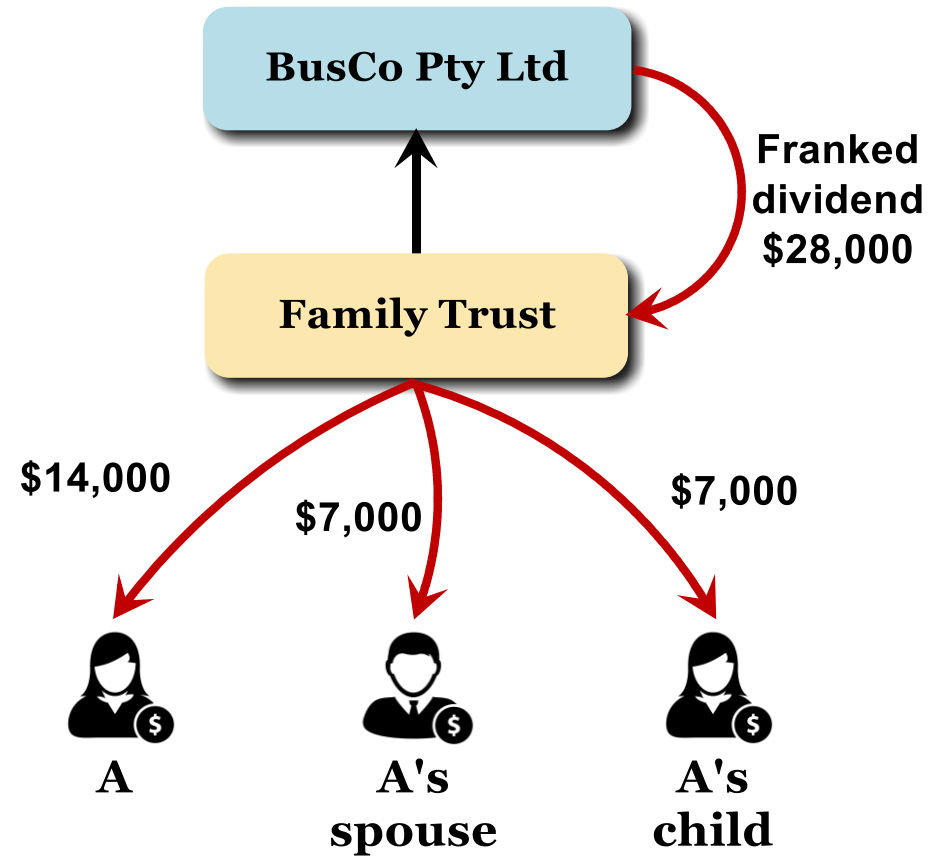
Why make a family trust election?

- Franking credit trading rules.
- Small Business Restructure Roll-over.
- Bad debt deductions or debt-equity swap deductions.
- Trustee beneficiary reporting rules.
- Trust loss rules
 - Income Injection Test

Shares acquired after 31/12/1997

- The beneficiary will be denied the benefit of the imputation credits unless either:
 - the total of imputation credits attaching to all dividends to which the beneficiary is entitled in respect of shares held directly or indirectly by the beneficiary or by the non-fixed trust do not exceed \$5,000; or
 - the non-fixed trust has made an FTE.

Franking credit trading rules



Example

	Imputation credits		
	Discretionary Trust	Direct Shareholding	Total
A	\$6,000	\$0	\$6,000
A's spouse	\$3,000	\$9,000	\$12,000
A's child	\$3,000	\$0	\$3,000

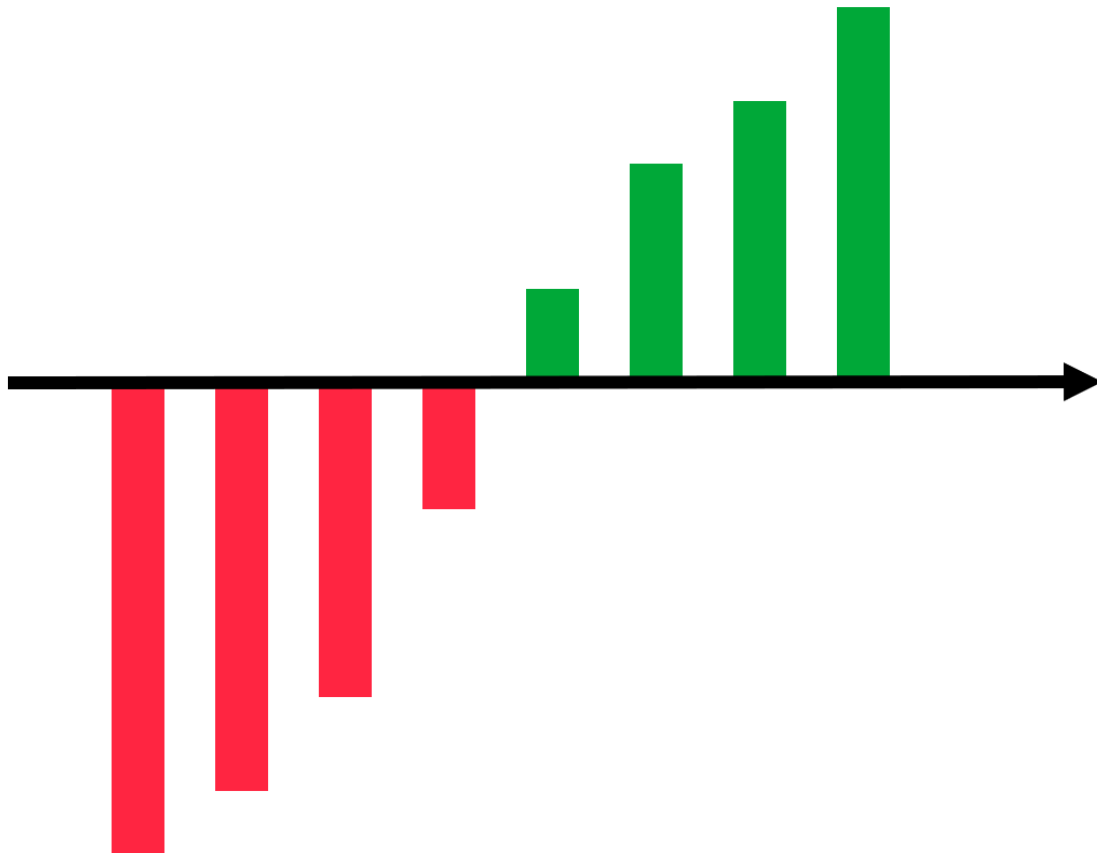
- Unless an FTE made by DT only A's child entitled to benefit of imputation credits for dividends distributed from DT under small shareholder threshold of \$5,000.
- A's spouse is entitled to imputation credits attaching to \$9,000 of dividends from direct shareholding.

Small Business Restructure Rollover

Section 328-440 Ultimate economic ownership - discretionary trusts

- (1) For the purposes of paragraph 328-430(1)(c), a transaction does not have the effect of changing the ultimate economic ownership of an asset, or any individual's share of that ultimate economic ownership, if:
- (a) either or both of the following applies:
 - (i) just before the transaction took effect, the asset was included in the property of a * non-fixed trust that was a * **family trust**;
 - (ii) just after the transaction takes effect, the asset is included in the property of a non-fixed trust that is a **family trust**; and
 - (b) 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 to the *Income Tax Assessment Act 1936*) relating to the trust or trusts referred to in paragraph (a); and
 - (c) every individual who, just after the transfer takes effect, has the ultimate economic ownership of the asset is a member of that **family group**.

Carrying forward losses



- On a single entity basis
- Can only offset against current or future year income.
- Note – loss carry back provisions

Trust loss tests – Schedule 2F ITAA 36

- Applicable test depends on the type of trust.
- The relevant trust loss tests must be satisfied during the test period.
- Generally, the “test period” is the period from the beginning of the loss year until the end of the income year in which the tax losses are to be applied.

Trust loss tests

- A **fixed trust** (other than a widely held unit trust):
 - must satisfy the 50% stake test for the test period (section 266-40) (the **fixed trust 50% stake test**); or
 - must satisfy the non-fixed trust stake test (section 266-45), if the trust fails to meet the 50% stake test (the **alternative fixed trust 50% stake test**).

Trust loss tests

- A **non-fixed trust**:
 - must satisfy the **pattern of distributions test** if applicable (section 267-30); and
 - must not have been prevented from deducting the tax loss in an earlier income year because of a failure to meet the **pattern of distributions test** (section 267-35); and
 - in which there are individuals having more than a 50% stake in the income or capital of the trust, must maintain the same ownership (section 267-40) (**the non-fixed trust 50% stake test**); and
 - a group must not during the test period begin to control the trust directly or indirectly (section 267-45) (**the control test**).
- If no income distributed in loss year and no change in control/unit holders, then NFT tests likely passed in any event.



Income Injection Test (IIT)

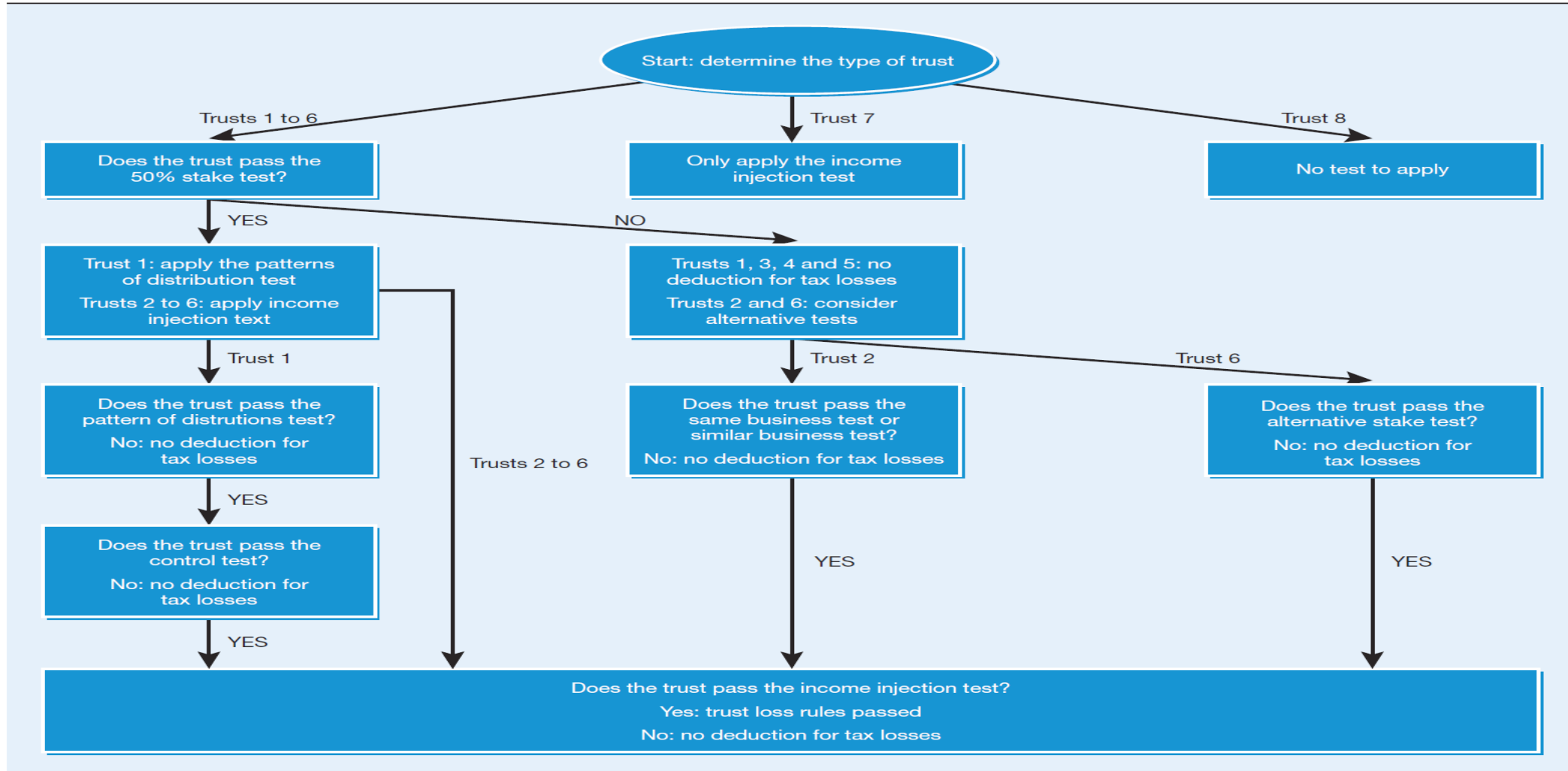
- Pursuant to ITAA 36 section 270-10, the IIT applies when:
 - There is an **allowable deduction** to a trust for an income year; and
 - There is a **scheme** under which:
 - the trust derives assessable income in the income year; and
 - an **outsider** to the trust provides a benefit to the trustee, a beneficiary of the trust or an associate of the trustee or beneficiary; and
 - the trustee, beneficiary or associate provides a benefit to the **outsider** or an associate of the **outsider**; and
 - It is **reasonable to conclude** the assessable income was derived or the benefit was provided under sub-points 2 and 3 wholly or partly but not incidentally because of the deduction.

Summary of trust loss tests

Type of trust	50% stake test	Abnormal trading	Same business test	Similar business test	Pattern of distributions test	Control test	Income injection test
Non-fixed trust	✓				✓	✓	✓
Listed widely held fixed trust	✓	✓	✓	✓			✓
Wholesale widely held trust	✓	✓					✓
Unlisted very widely held fixed trust	✓	✓					✓
Unlisted widely held fixed trust	✓	✓					✓
Fixed trust but not widely held	✓						✓
Family trust							✓
Excepted trust	n/a	n/a	n/a	n/a	n/a	n/a	n/a

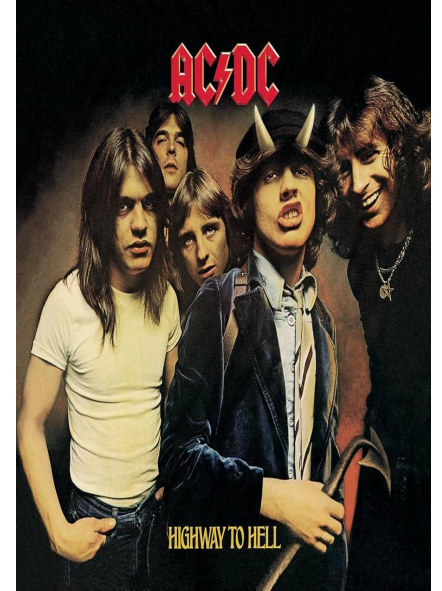
Excepted trust excludes family trusts

The maze of the trust loss provisions

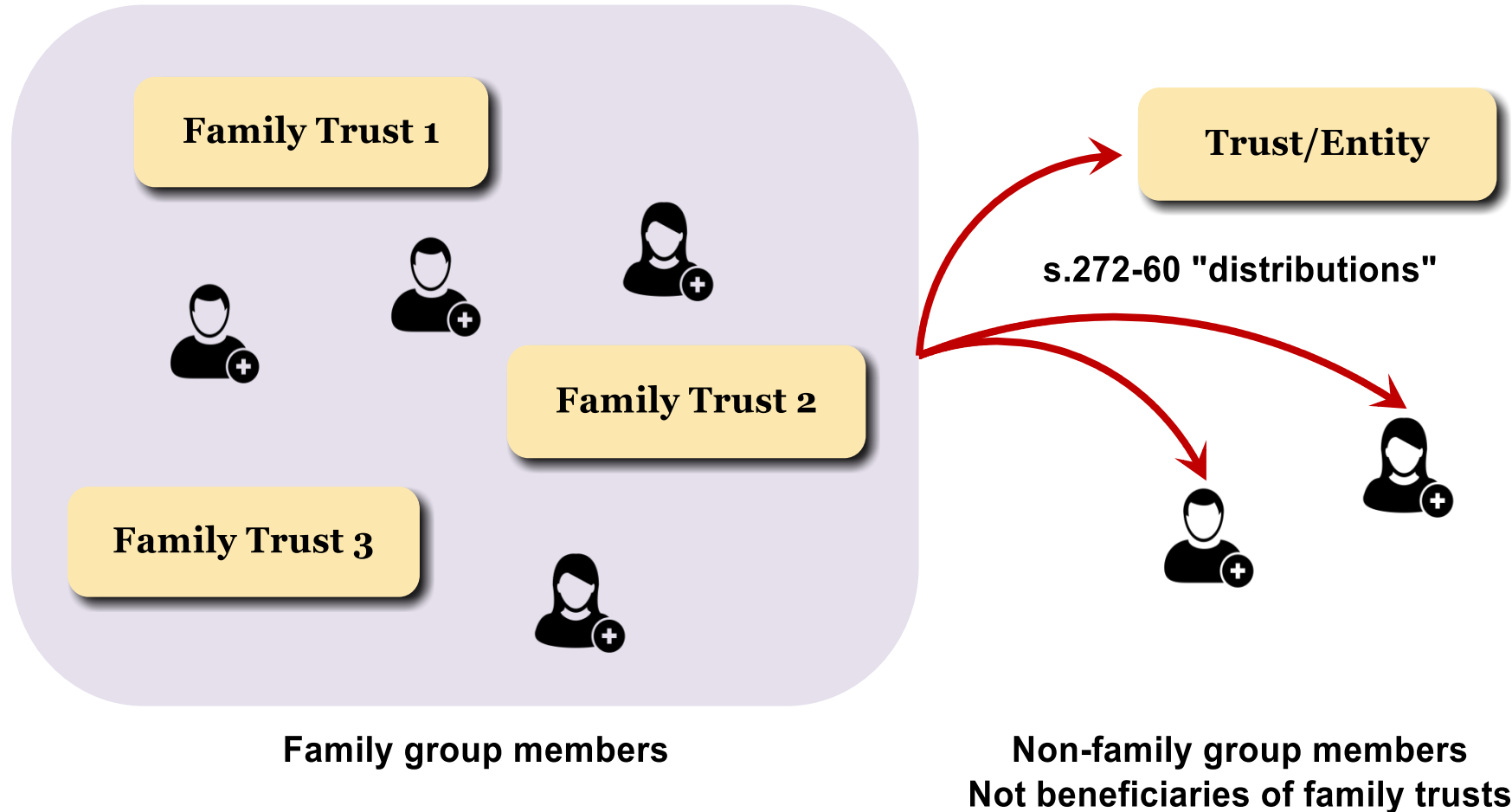


Family trust distributions tax

The highway to hell



Family trust distributions tax



Family trust distribution tax (Division 271)

- If:
 - the trustee of a trust makes an FTE; or
 - a company, the partners in a partnership or the trustee of a trust makes an IEE to be included in a family group in relation to a family trust;
 - and the company, partnership or trust concerned confers a present entitlement to, or distributes, income or capital **other than upon or to a specified individual or members of his or her family group, FTDT is payable on the conferral or distribution.**

Family trust distribution tax (FTDT)

- If the trustee is an individual - the trustee is liable to pay FTDT ... (s.271-15(2)(a)).
- If 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 pay tax ... (s.271-15(2)(b)).
 - (in both cases) on the amount or value of the income or capital to which the entitlement relates, or that is distributed.
- The FTDT rate is 47%
- An analogous approach applies where there is an IEE (including joint and several liable for directors of companies)

Family trust distribution tax (FTDT)

- FTDT is (generally) due and payable 21 days after the conferment or distribution
- The general interest charge (GIC) is imposed 60 days after the FTDT is due and payable if the FTDT is unpaid
- There is no period of review for FTDT – it is not “assessed”
- Amounts subject to FTDT are treated as non-assessable non-exempt with an unlimited period of review
- The Commissioner “may” issue a notice, and the notice can be objected to under Part IVC
- The general administrative power and remedial power are not incorporated in the FTDT Acts

FTDT – Meaning of “distributes”

- Family trust election or interposed entity election results in the payment of FTDT where a distribution is made to a person outside the individual's family group.
- Section 272-60 – the meaning of “distribution” is extended to a range of transactions such as a forgiveness of debt or allowing the use of trust property.
- **ATO ID 2012/12** [withdrawn 8 June 2017] – the meaning of “distribution” only applies to beneficiaries of the trust, not to entities that are not beneficiaries.
- **Taxation Determination TD 2017/20** - A person who is not a beneficiary of the trust is capable of receiving a distribution for the purposes of section 272-60.

Section 272-60: expanded definition of distributes

Section 272-60 of Schedule 2F of ITAA 36

- (1) A company, partnership or trust (an entity) also distributes income or capital to a person in circumstances not covered by section 272- 45, 272-50 or 272-55 if it:
- (a) pays (including by way of a loan) or credits money of the entity to the person, or reinvests such money for the person; or
 - (b) transfers property of the entity to, or allows use of property of the entity by, the person; or
 - (c) deals with money or property of the entity for or on behalf of the person or as the person directs; or
 - (d) applies money or property of the entity for the benefit of the person; or
 - (e) extinguishes, forgives, releases or waives a debt or other liability owed by the person to the entity.

TD 2017/20 – Meaning of “distributes”

- Taxation Determination TD 2017/20:
 - *“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'.”*

TD 2017/20 – Meaning of “distributes”

- “Genuine commercial dealings” – if there is consideration equivalent to the benefit, then there is no FTDT

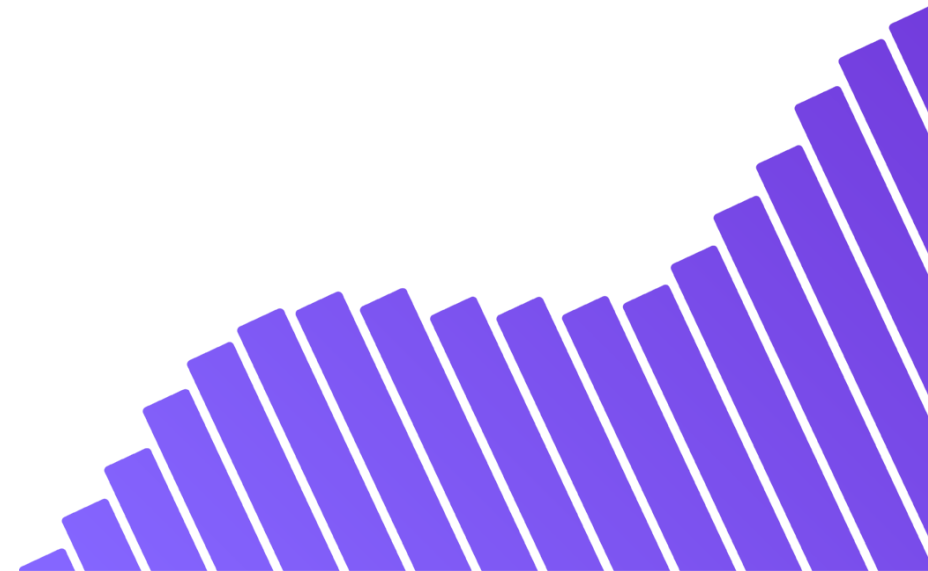
“[20] ...in practice the Commissioner will infer that the amount or value of a benefit provided to a person does not exceed the amount or value of the consideration given in return where the relevant transaction:

- *occurs on arm's length terms, and*
- *is an ordinary incident of a business being carried on by the trust.”*

TD 2017/20 – Meaning of “distributes”

- TD 2017/20 includes a series of examples of situations where the Commissioner would consider that the benefit provided to a person does not exceed the amount or value of the consideration given in return.
 - interest-free loans by a business;
 - entertainment expense for arm's length clients of a business;
 - discounted fees for services provided by a business; and
 - written-off bad trade debts.

Revocation of FTEs and varying the test individual



Revocation of FTEs

- Limited year, available to:
 - Revoke elections.
 - Appoint substitute test individual.
- Time period:
 - Must be in respect of an income year finishing at the end of the fourth income year after the income year specified in the election; or
 - Once only transitional period effectively ending 30 June 2009.
- Mechanism:
 - Tax return; or
 - If not required to give a return for the income year, then on or before 2 months after the end of the income year (31 August).

Vary test individual

- Voluntary changing test individual nomination
 - nominate new test individual who is within the family group of the old test individual existing at election commencement date **AND**
 - actual distributions or UPE under the old family group when compared to the new family Group would not result in family trust distribution tax **AND**
 - revocation occurs before end of 4th income year after FTE effective.
- Marriage breakdown changing test individual nomination
 - nominate new test individual within new controllers of trust.
 - new controllers of the trust must arise due to marriage breakdown order, agreement or award satisfying the CGT rollover concepts.

Family trust elections - summary

- Election for tax purposes.
- Useful in relation to accessing trust losses, for passing franking credits to beneficiaries amongst other things.
- Generally, it is an irrevocable election.
- Very limited ability to:
 - revoke elections; or
 - appoint substitute test individual.
- Election specifies a test individual and defines a family group by reference to that individual.
- Family group includes entities making FTEs with same test individual.
- “Distributions” outside of the “family group” incur FTDT (47%).

Death and deceased estates

Death and deceased estates

- The death of the test individual does not terminate the FTE.
- Death is not a trigger for allowing the change of a test individual.
- A person does not cease to a 'family' member **merely** because of the death of any other family member.
- The family group, but not the family, includes a person who was the spouse of the test individual or of a member of the test individual's 'family' immediately before the death of the test individual or member of the test individual's 'family', and is now the spouse of a person who is not a member of the test individual's 'family'.

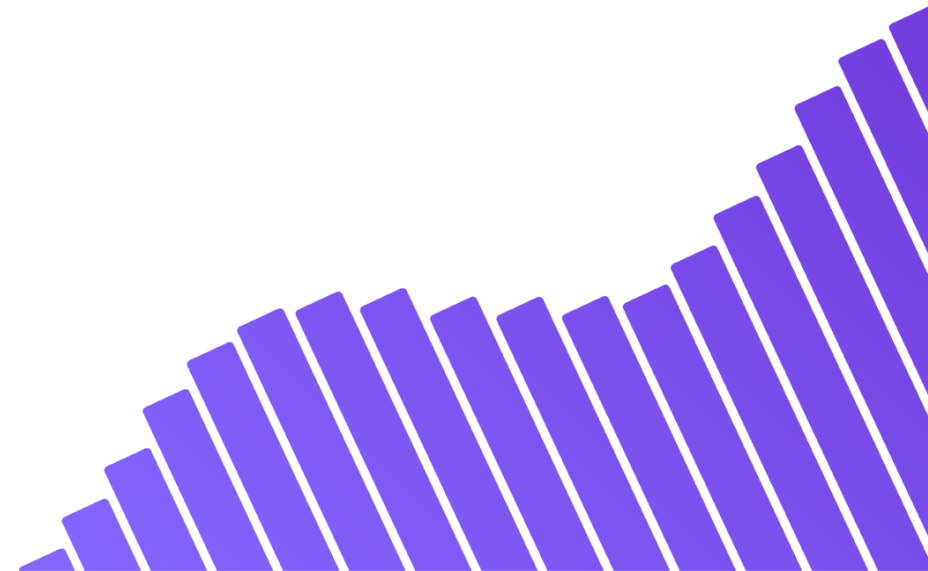
Death and deceased estates (cont)

- If the test individual and **all** the members of their 'family' are deceased, the deceased estates of the test individual and the test individual's 'family' are part of the family group.
- It is not possible to choose a deceased person as the test individual for an FTE.
- The death of test individual does not prevent any other trust, company, or partnership from making an IEE to be included in the test individual's family group.

Can, or should, a deceased estate make an FTE or IEE?

Should you establish dormant trusts with FTEs prior to death?

Relationship breakdowns



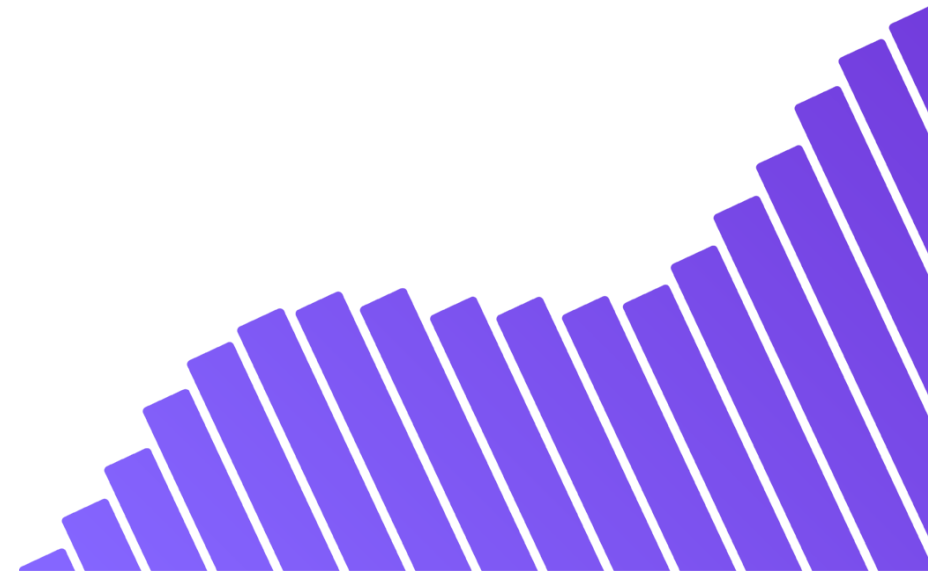
Relationship breakdowns

- The family group, but not the family, includes 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*";
- The family group, but not the family, includes 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 test individual or the member of the test individual's 'family';
- There are some circumstances in which the test individual may be varied relating to marriage breakdown. These provisions are not limited in time (as the general variation power referred to above) and do not contain qualifying restrictions regarding there being no distributions outside of the family group. The provisions only require that because of an order, agreement or award of the kind mentioned in the CGT marriage breakdown provisions the new individuals and members of the new individual's family have control of the trust.

Relationship breakdowns (cont)

- Although an individual does not cease to be a member of the family group because of a relationship breakdown, there may still be issues in distributing to certain members of the spouse's 'new' family.
- The former spouse, and a child of the former spouse, of the test individual would be included in the family group of the test individual. However, if the former spouse remarries, any children, siblings, etc of the new spouse would not form part of the family or family group of the test individual.
- If trust makes an FTE with (say) a husband as the test individual and the couple divorce, and the wife remarries but controls that trust post-divorce, a variation of the FTE can be critical.

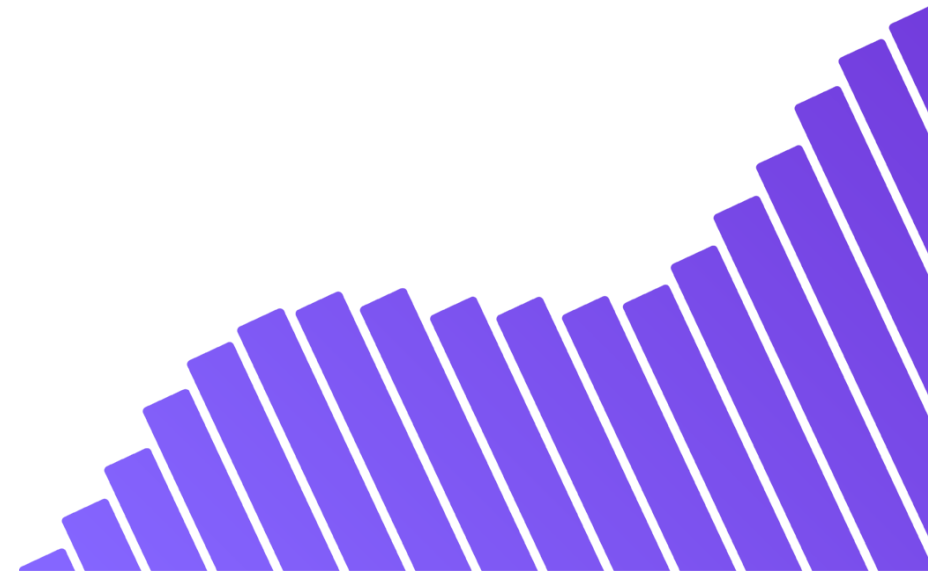
Business sales



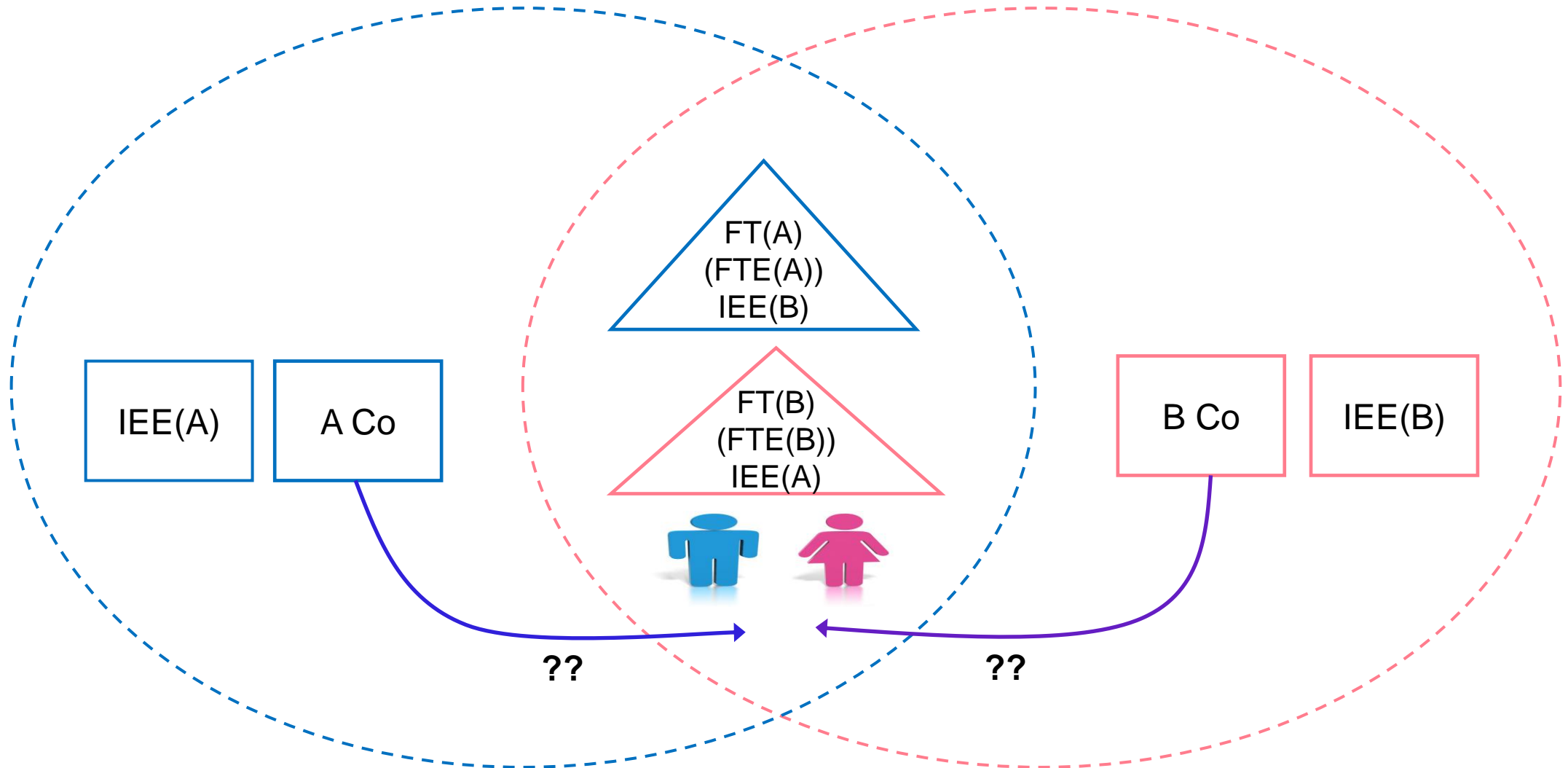
Business sales

- *If there is an FTE or IEE, the sale of the shares or units is for less than market value could be a distribution that would be liable for FTDT.*
- *Even if the sale were for market value, for an outside purchaser, future distributions by the company or trust would be liable for FTDT for being a distribution outside the family group of the vendor.*
- For vendors, the second point means that purchasers will typically not buy the shares or units in a company or trust that has made an IEE. This would necessitate a business sale, rather than an entity sale, and the loss of the CGT discount if the entity is a company.
- The same applies for a partial sale of shares or units to an outsider.
- Could you use rollovers to move the business to a new company, without an IEE, and sell the shares in that company?

Groups with more than one test individual



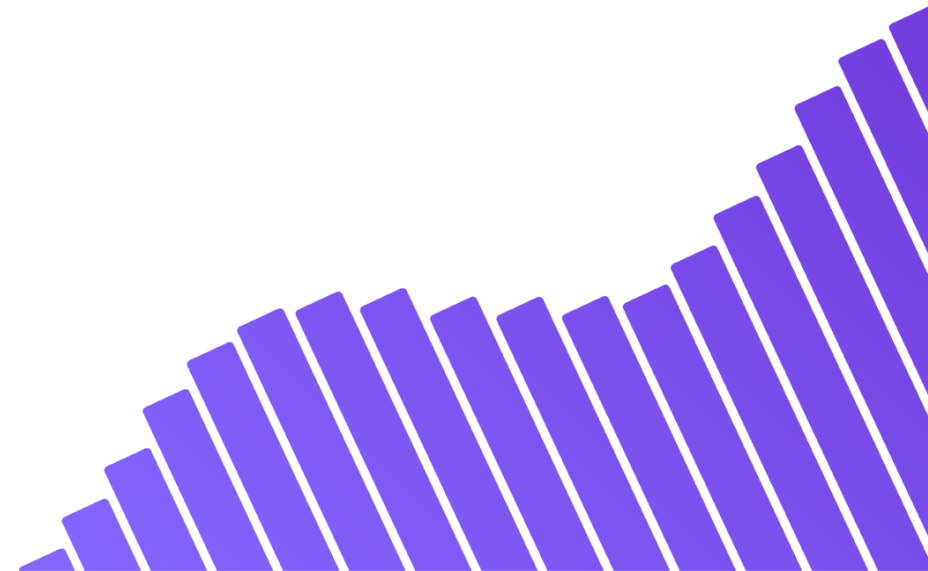
Groups with more than one test individual



Groups with more than one test individual

- Can the A Co and B Co make IEEs to move into the intersection?
 - Maybe, need to satisfy family control test – who owns the shares?
- Can the companies IEE(A) and IEE(B) make IEEs to move into the intersection?
 - Assuming cannot revoke IEE, no, may only make IEEs with one test individual
 - If can revoke, then could make new IEEs if the family control test met
- Will distributions by FT(A) and FT(B) be subject to FTDT?
 - No, if to each other
 - Yes, to IEE(A) and IEE(B)
 - Depends whether A Co and B Co if they can make IEEs to move to the intersection
- What about dividends by the companies?
 - If companies move into the intersection, no FTDT or IIT issues
 - If companies are not in the intersection, then need to consider IIT for dividends paid to FT(A) and FT(B)

When things go wrong



When things go wrong

No one size fits all strategy

Be careful of creating new problems by attempting to fix an FTDT issue

- Can you make retrospective IEEs or FTEs?
- Can you revoke or vary existing FTEs or IEEs
- Were FTEs or IEEs validly made?
- Was it a distribution to someone who was not a beneficiary?
- Can you request a notice and object to the notice under Part IVC?
- Can you apply for a remission of the GIC?
- Can you request that the Commissioner compromise the debt represented by FTDT?

Thank you

Please complete your evaluation form

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