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Trusts tax risks and compliance

Detailed information about compliance for trusts.

Tax issues for trusts - tips and traps

You should read this if you are a trustee or beneficiary of a trust.

Changing a trust position with tax consequences

What to know as a trustee changing the administration of the trust to alter tax consequences.

Tax Avoidance Taskforce - Trusts

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

QC 82253

Tax issues for trusts – tips and traps

You should read this if you are a trustee or beneficiary of a trust.

Last updated 27 January 2021

Trustee resolutions

To ensure discretionary beneficiaries are:

- presently entitled to trust income, trustees of discretionary trusts must make a resolution by 30 June of that income year
- specifically entitled to franked distributions, trustees of discretionary trusts must make a resolution in writing, specifically dealing with the franked distributions (as opposed to trust income) by 30 June
- specifically entitled to a capital gain
  - trustees of discretionary trusts must make a resolution in respect of that capital gain by 31 August following the income year in which the capital gain is made
  - where some or all of a capital gain forms part of the income of the trust estate, the trustee will often need to specifically deal with it by 30 June, when all of the income of the trust estate is otherwise being dealt with – this is because any capital gain forming part of the income of the trust estate cannot be specifically dealt with after a beneficiary has already been made presently entitled to it.

The resolution establishes which beneficiaries are assessed on the trust's net income.

See also:

- Requirements for trust resolutions
- TD 2012/22 (includes examples of the tax consequences of effective and ineffective resolutions)
- Streaming trust capital gains and franked distributions

Lodging trust income tax returns

Generally, all trusts that derive income during the year must lodge an income tax return. Ensure you lodge by the due date. There are exceptions for certain deceased estates.

See also:

- LODGE 2020/1 Table O outlines exceptions for deceased estates

Amounts at income of the trust estate labels

The income of the trust estate labels of the trust tax return require details of the income of the trust estate, which is the amount to which beneficiaries can be made presently entitled or can be accumulated by the trust, and each beneficiary's share of that income.

The amount to include at the label headed **income of the trust estate** is the total income of the trust that is available for distribution to trust beneficiaries for the income year (distributable income). Generally, that amount is calculated in accordance with the trust deed. In some cases, it will be different to the taxable income.

The label headed **share of income of the trust estate** records the amount of the trust's distributable income that each beneficiary was presently entitled to by 30 June of that year.

Generally, a beneficiary is assessed on the same portion of the trust's net income as the portion of distributable income to which it is entitled to.

Distributable income

TR 2012/D1 *Income tax: meaning of 'income of the trust estate' in Division 6 of Part III of the Income Tax Assessment Act 1936 and related provisions* gives guidance on the meaning of distributable income. Under self-assessment, you can follow the meaning as set out in the ruling or, if you disagree with aspects of that ruling, you can apply what you understand the term to mean for the purpose of present entitlement and completing the income of the trust estate labels.

At the **income of the trust estate** label you must show the trustee's honest determination of the trust's distributable income. The trustee may think that the trust's distributable income is calculated based on one of the alternative views in TR 2012/D1 – for example, according to a so-called income equalisation clause. If so, you can include this amount at this label.

Even if we later consider the trust's distributable income is a different amount, the trustee won't have made an error in completing the

income of the trust estate label.

Zeroes at income of the trust estate label

If the income of the trust estate is a loss amount, then a zero should be entered at the **income of the trust estate** label. The label headed **share of income of the trust estate** should be left blank, as trusts cannot distribute losses to their beneficiaries. Where the trust has income to distribute, the amount at the **income of the trust estate** label needs to include the total of all the amounts at the **share of income of the trust estate** label for income distributed to beneficiaries. It must also include any amounts to which no beneficiary is entitled.

Do not leave the labels blank

The information in these labels helps us administer the trust assessing provisions.

We use these two labels to identify what may be contrived differences between the income of the trust estate and the net income of the trust – for example, to obtain tax benefits. If these labels are incomplete, it increases the likelihood we will review you and may lead to a penalty for making a false or misleading statement.

Exempt entities as beneficiaries

Anti-avoidance rules may apply if a trustee makes a tax-exempt beneficiary presently entitled to trust income.

See also:

- Distributions to tax exempt entities: anti-avoidance rules

Property development trusts incorrectly claiming CGT discount

We've noticed that some trusts in the property development industry are characterising their business income as capital rather than revenue to take advantage of the 50% CGT discount.

In many circumstances, the trust should not be characterising the profits from the sale of a developed property as a capital gain because

the trust is either carrying on a business or is involved in a profit-making undertaking involving the development.

See also:

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

Distributions to self-managed super funds

Distributions by trusts to complying super funds (particularly self-managed super funds) are considered 'non-arm's length income' and taxed in the fund at the top rate of tax if the distribution either:

- does not arise as a result of a fixed entitlement to trust income
- arose due to a fixed entitlement but it is part of a non-arm's length arrangement

See TR 2006/7 for guidance on what constitutes a fixed entitlement.

When you complete label **11M** of the self-managed super fund annual return (Gross trust distributions), you should consider whether all or part of the amount is non-arm's length income and, if so, report it at label **U2** of that return (Net non-arm's length trust distributions).

See also:

- Trust tax return instructions
- Trust tax return

QC 44411

Changing a trust position with tax consequences

What to know as a trustee changing the administration of the trust to alter tax consequences.

Last updated 3 May 2016

This information is for trustees who are considering changing a previously advised position in the administration of the trust so that tax consequences are altered.

The ATO should be notified of such a change in position and the matter collaboratively resolved.

What are attempts to change trust positions?

There have been instances where a trustee has taken a position (for example, of the effect of a decision regarding beneficiaries' entitlements reflected in trust resolutions), and then subsequently changed that position (for example, by arguing those entitlements or resolutions are invalid, defective or made at different time).

Where such a change in position has tax consequences, we should be notified as an affected party and the matter collaboratively resolved.

Examples of high-risk behaviour

Changing trust resolutions

In a particular case, tax returns were lodged on the basis that resolutions appointing trust income were made on 30 June. During an audit of the trust, resolutions signed and dated 30 June were provided to the auditors. As a result of the audit, amended assessments issued to the beneficiaries named in the resolution.

At objection, the taxpayer (a beneficiary) argued that the resolutions were not in fact made until after 30 June and that they should therefore not be assessed on any of the trust net income (including the amount they originally returned). It was further argued by the default beneficiaries (those entitled under the deed to the trust income if the trustee fails to make a valid resolution) that no adjustment could be made to their assessments because their period of review had expired.

In this case, it was noted that although we were told that the default beneficiaries were presently entitled under the deed, no attempt was made to contact the default beneficiaries or make

payments consistent with the new version of events that had been conveyed to us.

Attempts to rectify errors without informing us

Errors in trust deeds or resolutions might be able to be corrected by application to the court. In such cases, where the ATO is an affected party, we need to be informed and may want to be involved in any rectification proceedings.

Early vesting of a trust where there are tax consequences

If a decision is made to vest a trust early, there may be tax consequences such as a tax debt owing that might prove difficult to recover once the trust has vested. We should be notified if it is intended to vest a trust and there are tax consequences.

Failure to advise the ATO of mistakes in the trust deed or errors in the administration of the trust

As soon as you become aware of errors in a trust deed or in the administration of a trust you should advise us. Some trustees and their advisers are aware of serious problems with trust deeds or the administration of the trust yet fail to inform us until we discover the error, or it becomes convenient to disclose to us.

Failing to involve us may result in us taking action, including amending tax assessments for fraud or evasion (which are not subject to the usual four-year time limit) and imposing possibly significant penalties.

QC 45418

Our commitment to you

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

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

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

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

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