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Let's chat

Navigating the Annual Trust Tax Traps: Clearing the Key Hurdles – September 2025

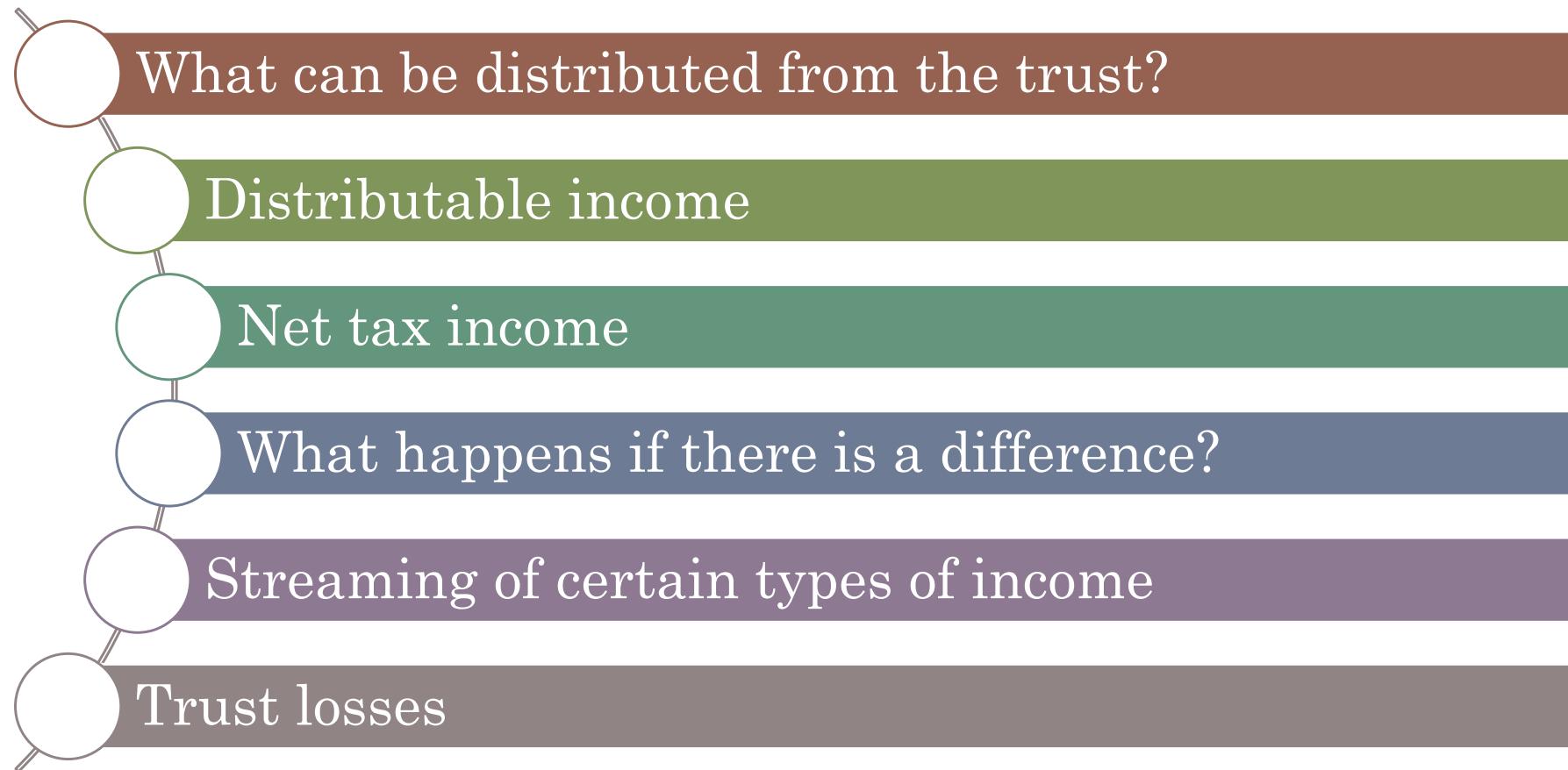
With:

Darius Hii – Tax and estate planning lawyer; Chartered Tax Advisor; and Director at Chat Legal

Information provided is general in nature; precise application depends on specific circumstances



What is income?





Key legislation provision

“(1)...where a beneficiary of a trust estate who is not under a legal disability is presently entitled to a share of the income of the trust...the assessable income of the beneficiary shall include:

the assessable income of the beneficiary shall include:

so much of that share of the net income of the trust estate as is attributable to a period when the beneficiary was a resident”

- Section 97 ITAA 1936



In plain English

Such share of the ‘income of the trust’ to which a beneficiary is entitled to receive – **Distributable Income** (income that can be distributed from the trust)

The beneficiary is taxed on such share of the ‘net income of the trust estate’ that is attributable to such a beneficiary – **Net Tax Income** (the assessable or taxable income)



Issues arising

Discrepancy between Distributable Income and Net Tax Income

- Deductions that are not taxable
- Capital gains made

Example

- Income available to distribute (after expenses) - \$66,000
- Assessable income of \$100,000 and \$34,000 of non-deductible expenses
- Income split 50/50 between persons A and B
- Person A and Person B each receives \$33,000
- Does Person A and Person B pay tax on the \$33,000 received?
- Does Person A and Person B pay tax on \$50,000 allocated to them?



Bamford

Correct approach to adopt is the **proportionate approach**

Ended a long running debate

Other queries?

- A capital gain was made in a later year
- Sought to distribute capital gain as income beneficiaries
- Commissioner argued that capital gain could not be distributed as capital gains were not ordinarily considered as 'income' (and thus were taxed at the top marginal rate per section 99A ITAA 1936)
- Taxpayer argued that the capital gain could be distributed as income as there was a power in the trust deed to allow the trustee to include a capital gain as income for distribution (i.e. Distributable Income)
- Held that Distributable Income was determined in accordance with the terms of the trust deed, general trust law and appropriate accounting principles



Issues arising

Key take-aways

- Tax flows in proportion to how **Distributable Income** split
- Distributable Income is whatever the trust deed allows it to be
- Importance to review terms of the trust deed

They do not always align

Line of thinking developed to match Distributable Income with Net Tax Income

No right or wrong as different beliefs allow for issues to consider



Streaming

Bamford

- Streaming was not possible – as tax flowed in proportion to distribution
- Classifying separate classes would have such distributions flowed in proportion between beneficiaries

Interim streaming provisions introduced:

- Capital gains
- Franked distributions
- Allowed trustee to separate 'stream' (distribute) such capital gain or franked distributions to other beneficiaries (or in different proportions):
- Useful if certain persons held capital losses
- Useful if distributing to other corporate entities



Specifically entitled

Beneficiaries to be made 'specifically entitled' to such capital gains or franked distributions being streamed

- I.e. beneficiaries must receive or reasonably be expected to receive an amount equal to the 'net financial benefit' linked to the capital gain or franked distribution

Other steps also taken:

- Separately record character of such amount in records of the trust
- Complementing resolutions, accounts, ledgers and financial statements



Faces of Distributable Income

-  Distributable Income means income according to ordinary concepts
-  Distributable Income means section 95 (or Net Tax Income) less notional amounts
-  Distributable Income means such amount which the trustee determines
-  Each meaning impacts whether certain 'income/gains' are included
-  Some will include capital gains, some will exclude discounted capital gains, some will exclude capital gains attributed to the active asset reduction



Traps for capital gains streaming

Assume

- \$100,000 rental income
- \$1,000,000 capital gain

Proposed distribution

- Rental income to Husband and Wife
- Capital to Dad (who has made massive capital losses during his lifetime)

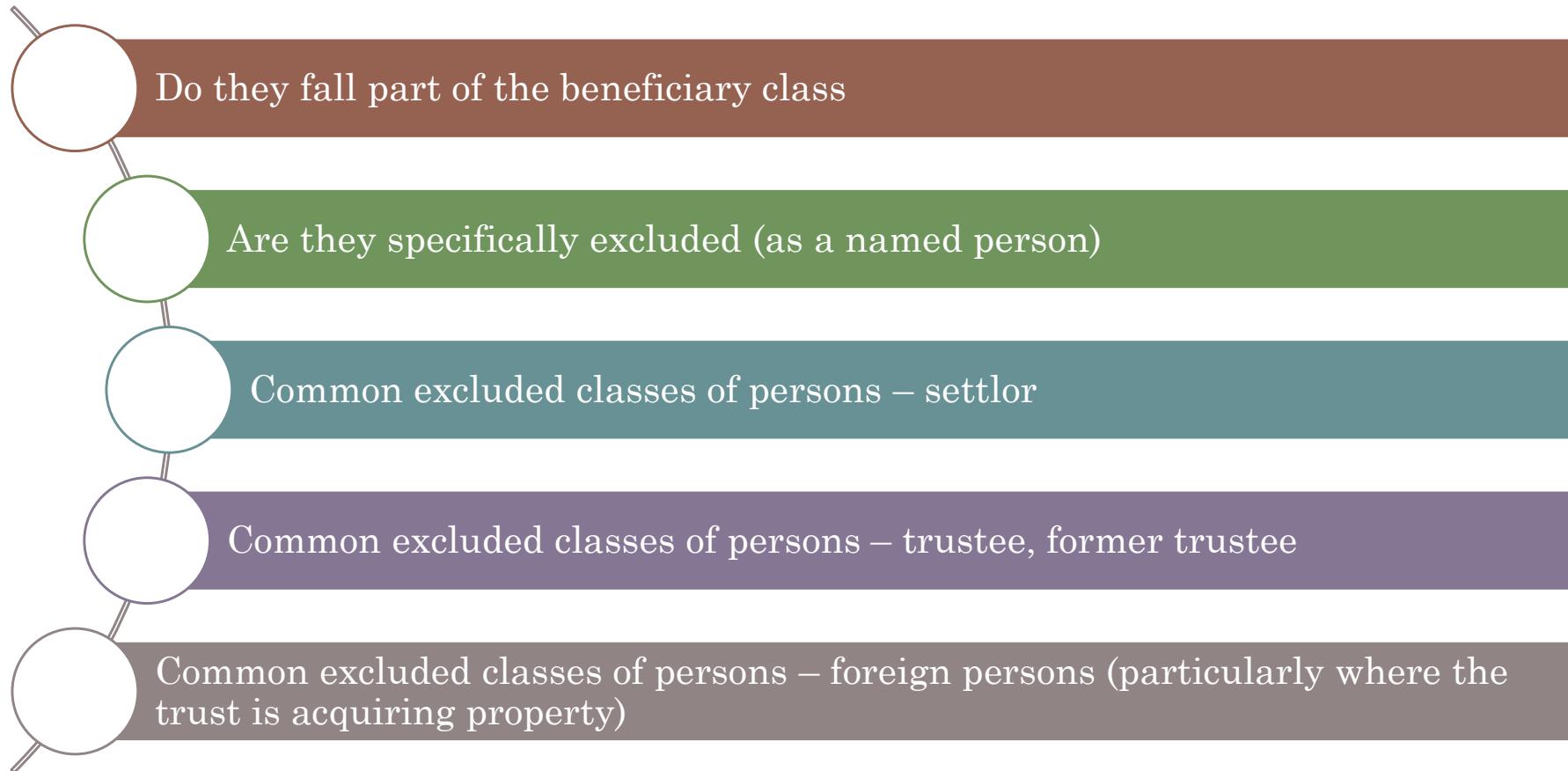
Depending on the definition of Distributable Income

- Equals ordinary income – a capital distribution would be needed to be made to ensure Dad is specifically entitled to the capital gain
- Equals section 95 income – an income distribution relating to 50% of the capital gain needs to be made in conjunction with 50% of the capital gain via an interim capital distribution
- Equals such amount as the trustee determines – trustee has flexibility

Read the deed – not all trust deeds are made equal

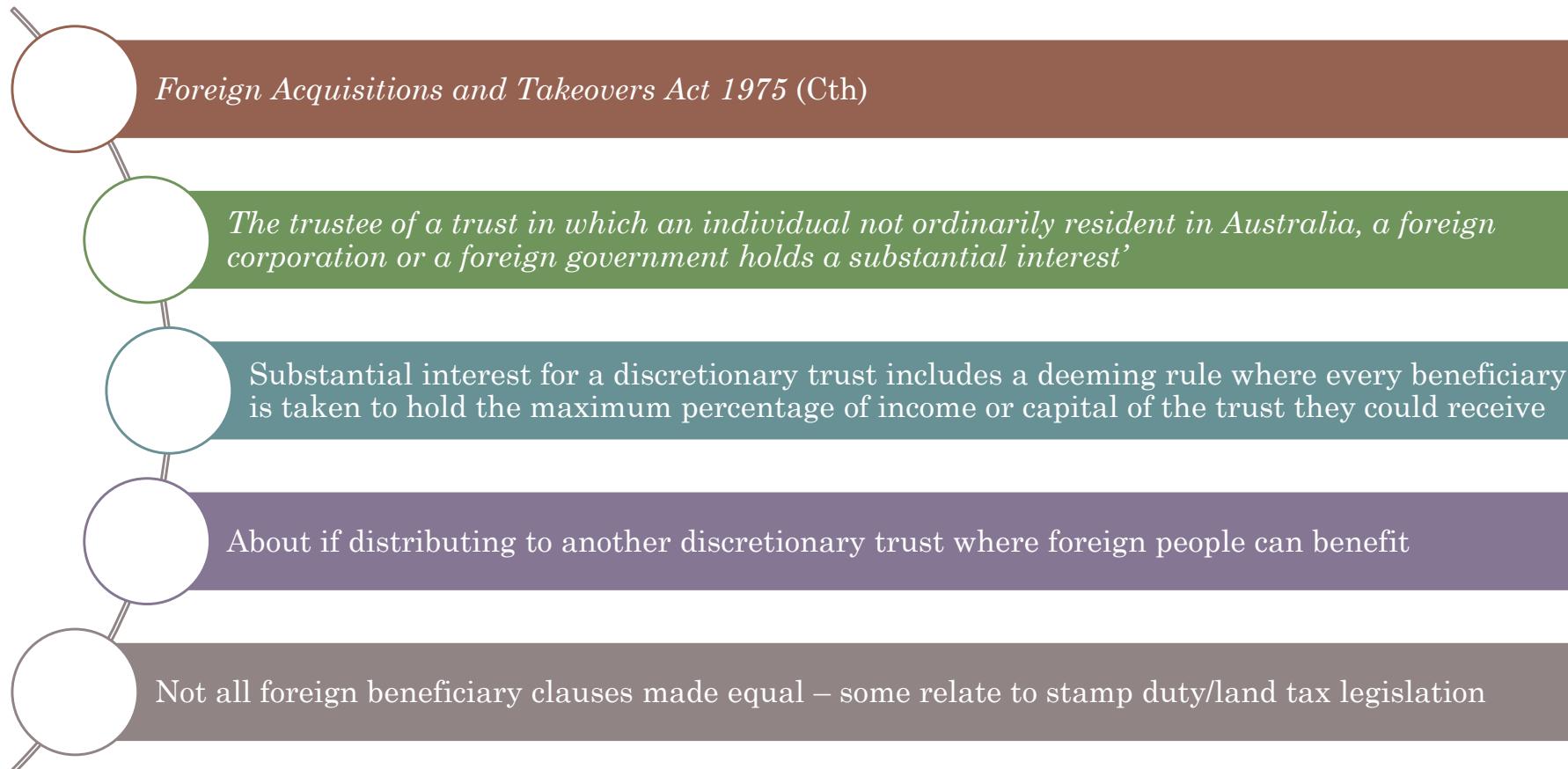


Who is a beneficiary?





Why foreign beneficiary clause





Lost trust deeds

- Importance to review terms of the trust deed (so actions valid)
- Need to meet the *three certainties* (intention, object and subject matter)
- Failure to know original terms may cause trust to fail
- Check everywhere possible: lawyer, accountant, financier, titles office
- Last resort – go to Court



Lost trust deeds

Vanta Pty Ltd v Mantovani [2023] VSCA 53

- Initial decision that trust failed for uncertainty and **a resulting trust arose in favour of the settlor**
- Only schedule of the deed locatable
- On appeal, Court noted existence of schedule that identified date of deed, settlor, name, trustee, settlement sum, appointor and beneficiaries sufficient to identify the essential terms of the trust to meet the three certainties test
- Lack of evidence in relation to management powers does not necessarily cause the certainties test to fail
- Case arose due to a family dispute between siblings and the lack of a trust deed to be crucial power
- Financial accounts and records were retained notwithstanding lack of a full trust deed



Lost trust deeds

Re Cleeve Group Pty Ltd [2022] VSC 342

- Two unexecuted copies of the trust deed
- 1999 draft deed v draft deed mirroring earlier family trusts prepared
- 1999 draft deed provided to other parties and accounts prepared on 1999 draft deed
- Alternate deed involved inconsistent recollections and meta data issues
- Held 1999 draft deed likely the deed executed

Re Thomson [2015] VSC 370

- Superannuation fund established by way of trust deed
- Variation document in 2000 executed but lost
- Unsigned copy of 2000 variation document relied upon
- Presumption of regularity
- Presumption of approval of the SMSF's financial statements and reports taken to mean the 2000 variation document must have been executed
- No contesting, no fraud, no irregularity and given it has been 15 years since the variation would have been executed, presumption considered appropriate



Lost trust deeds

Sutton v NRS(J) Pty Ltd [2020] NSWSC 825

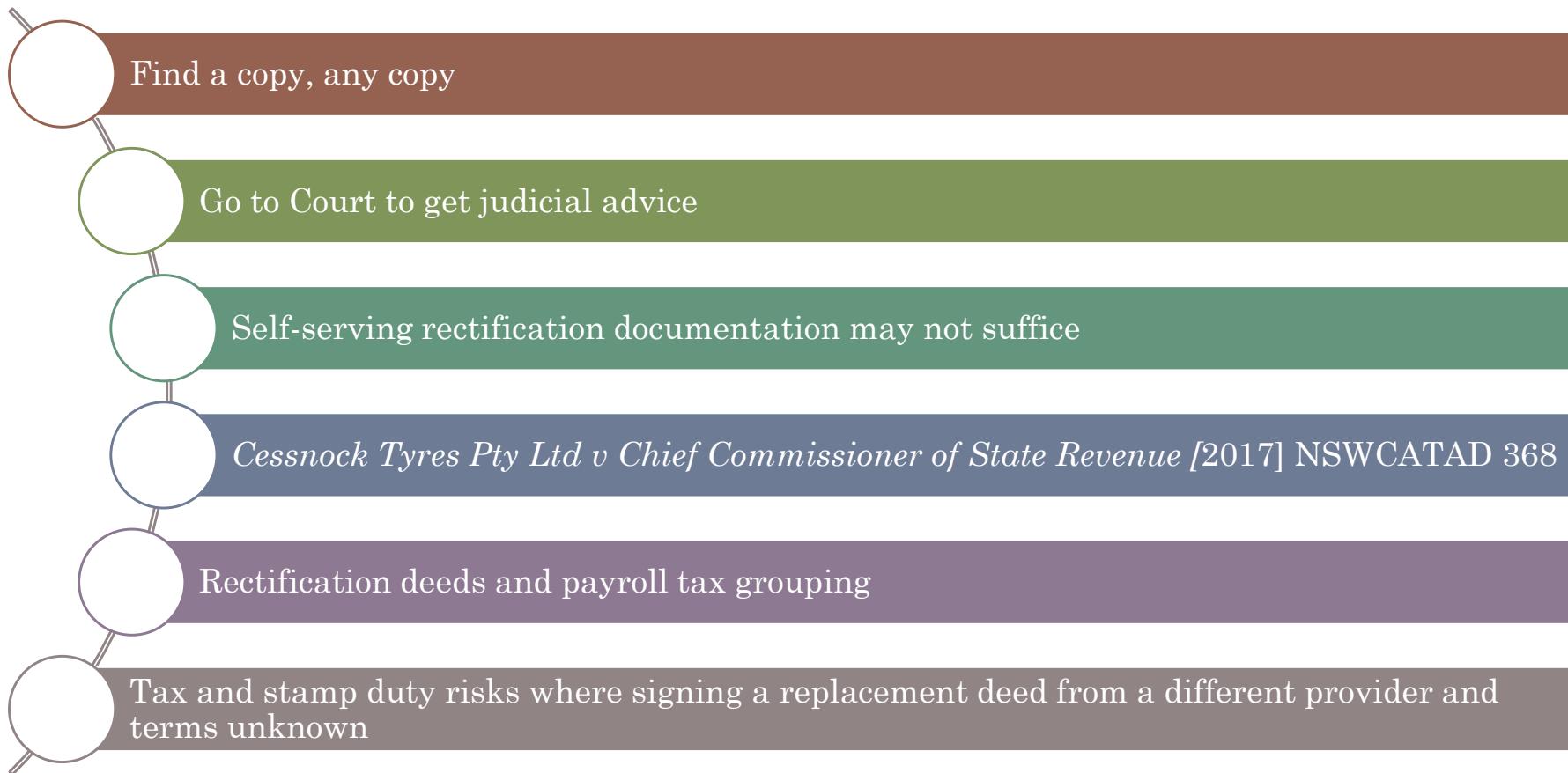
- Original trust deed cannot be located
- Photocopy of fully executed deed locatable
- Established in 1972 and dormant until 2007
- Transactions made
- Bank undertaking 'KYC' and required citing of original deed
- Bank account frozen until Court justified trustee reasonable to administer the trust based on a photocopy of the full executed trust deed

Application of DEK Technologies Pty Ltd as trustee for DEK Technologies Unit Trust & Ors [2023]
NSWSC 544

- Original deeds lost
- Accountant provided evidence as to advice regarding structure and preferred trust provider and process
- Employee of trust provider provided evidence of order form and template of trust provider at the time
- Court accepted such terms could be inferred



Lost trust deeds





Real and genuine consideration

The trustee has a duty to administer the trust bona fide having regard to the purpose for which it was established. This is a duty which the court will enforce at the behest of the beneficiary. In this way, the remedy defines the nature of the interest of an individual beneficiary.

- Per Owen J in R and I Bank of Western Australia Ltd v Anchorage Investments Pty Ltd [1992] 10 WAR 59 at 79

“... in my opinion, in the ordinary case the beneficiary of a discretionary trust, other than perhaps the sole beneficiary of an exhaustive trust, does not have an equitable interest in the trust income or property which would fall within even the most generous definition of “property”...

Per French J in Richstar Enterprises Pty Ltd and Others; Australian Securities and Investments Commission v Carey (No 6) (2006) 153 FCR 509 at 29



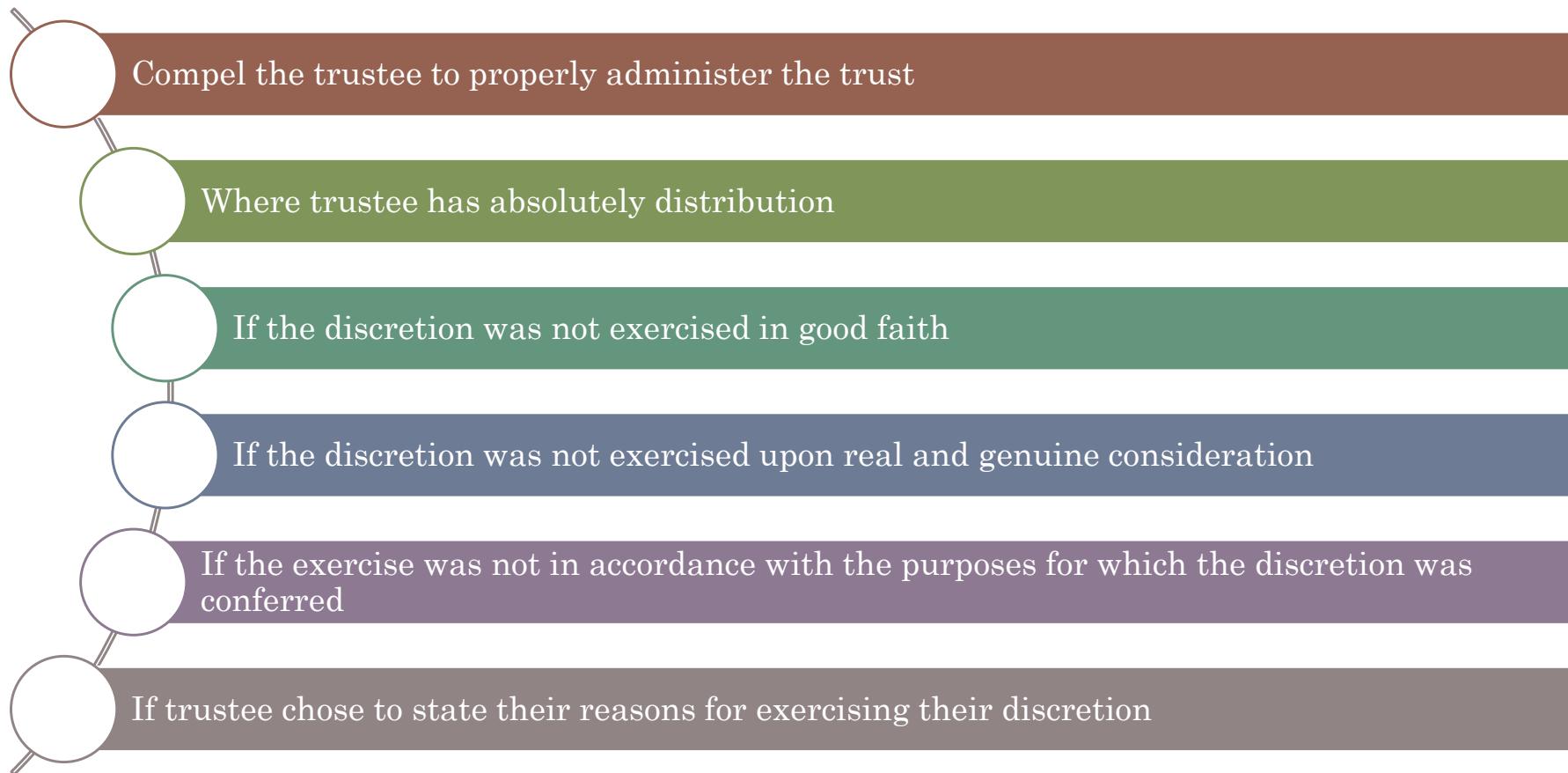
Real and genuine consideration

[A] discretionary beneficiary has no proprietary interest, vested or contingent, in the assets of a trust but only an expectation...a discretionary beneficiary, is not entitled as of right to disclosure of that which could be properly described as 'trust document'

- *Kestenberg v Kestenberg* [2020] VSC 84 at 7



Real and genuine consideration





Real and genuine consideration

Hoh v Ying Mui Pty Ltd [2019] VSCA 203

- Case where actions clearly in bad faith
- Two family groups
- *By letter dated 31 July 2010, she rejected the proposed meeting and stated that the dispute was 'past the point of discussion' because: 'MY DAD HAS MADE HIS DECISION — in his words, he wants "out" of all business associations with the extended Hoh family'....whether you want to accept my proposal as set out in my letter, or take your chances with what my dad will do if you reject my proposal'.[25] She set a deadline of 6 August 2010 for acceptance of her proposal and, on Frank's instructions, threatened that he would 'do it his way' if the proposal was not accepted by that time.*

Callus v KB Investments [2020] VCC 135

- Property transferred to beneficiary
- No written reasons left
- Disgruntled beneficiary member challenged
- Court determined trustee exercised having consideration to fiduciary duties and considered wishes of deceased; and on the balance of probabilities obtained appropriate legal advice



Real and genuine consideration

Owies v JJE Nominees Pty Ltd [2022] VSCA 142

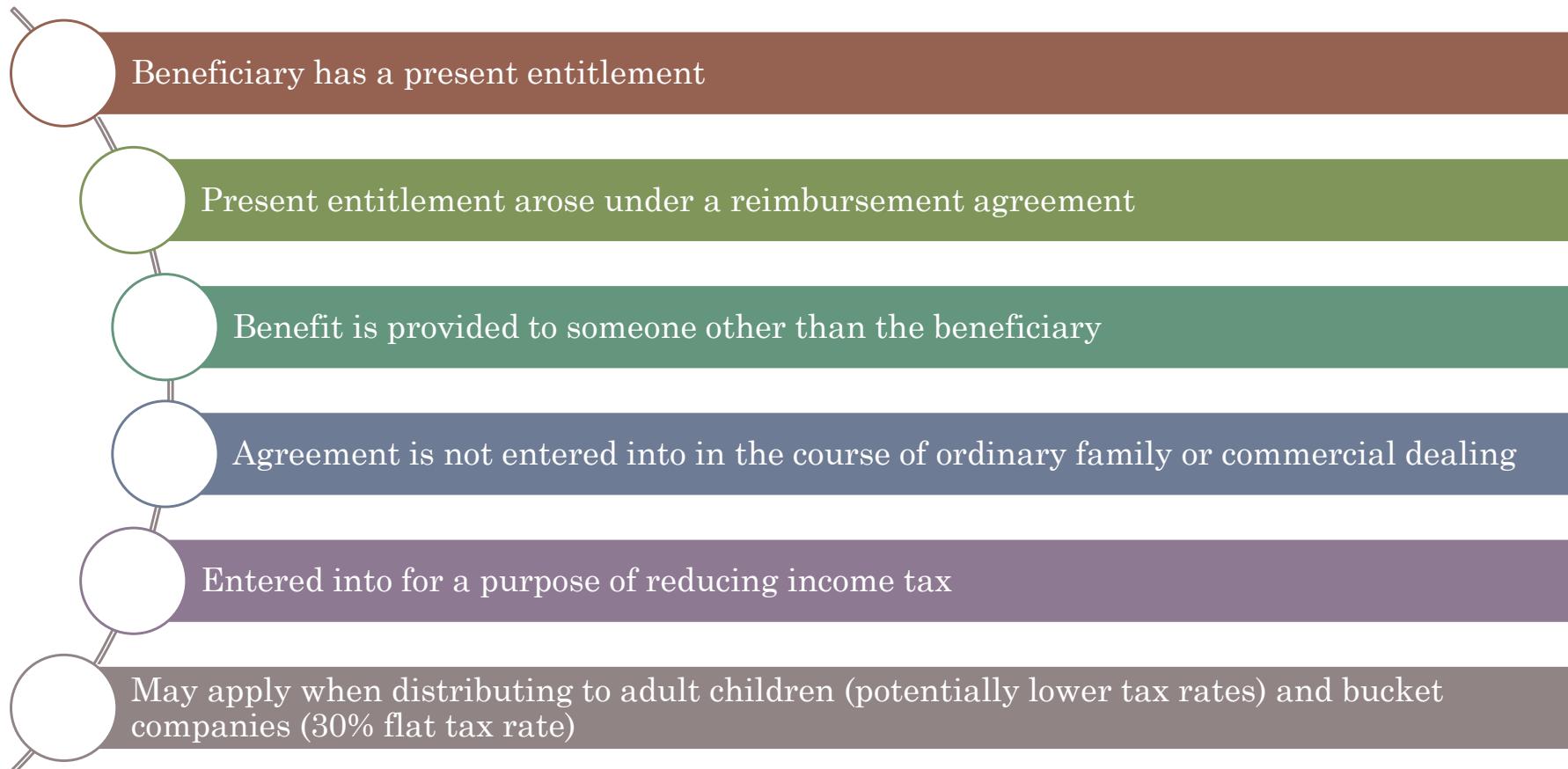
- Child 1 and Advisor controlled trustee company
- Child 2 and 3 disputed distributions
- Came out that little thought had in relation to trustee decisions as trustee would sign the prior year's distribution resolution
- Child 1, 2 and 3 were all named default beneficiaries under the terms of the trust deed
- Came out little consideration had as to the circumstances of Child 2 and 3

Williams v Robba [2025] QSC 203

- Self-managed superannuation fund case
- Trustee absolutely discretion to determine death benefits
- Paid to deceased's second wife and a child of the deceased's first marriage (effectively 50/50)
- Trustees sought information from all relevant parties including 3 other children of the deceased
- Although dispute about second wife receiving a portion of the superannuation, it was not up to the Court to consider whether the trustee undertook sufficient questions in relation to inquiring about the beneficiaries

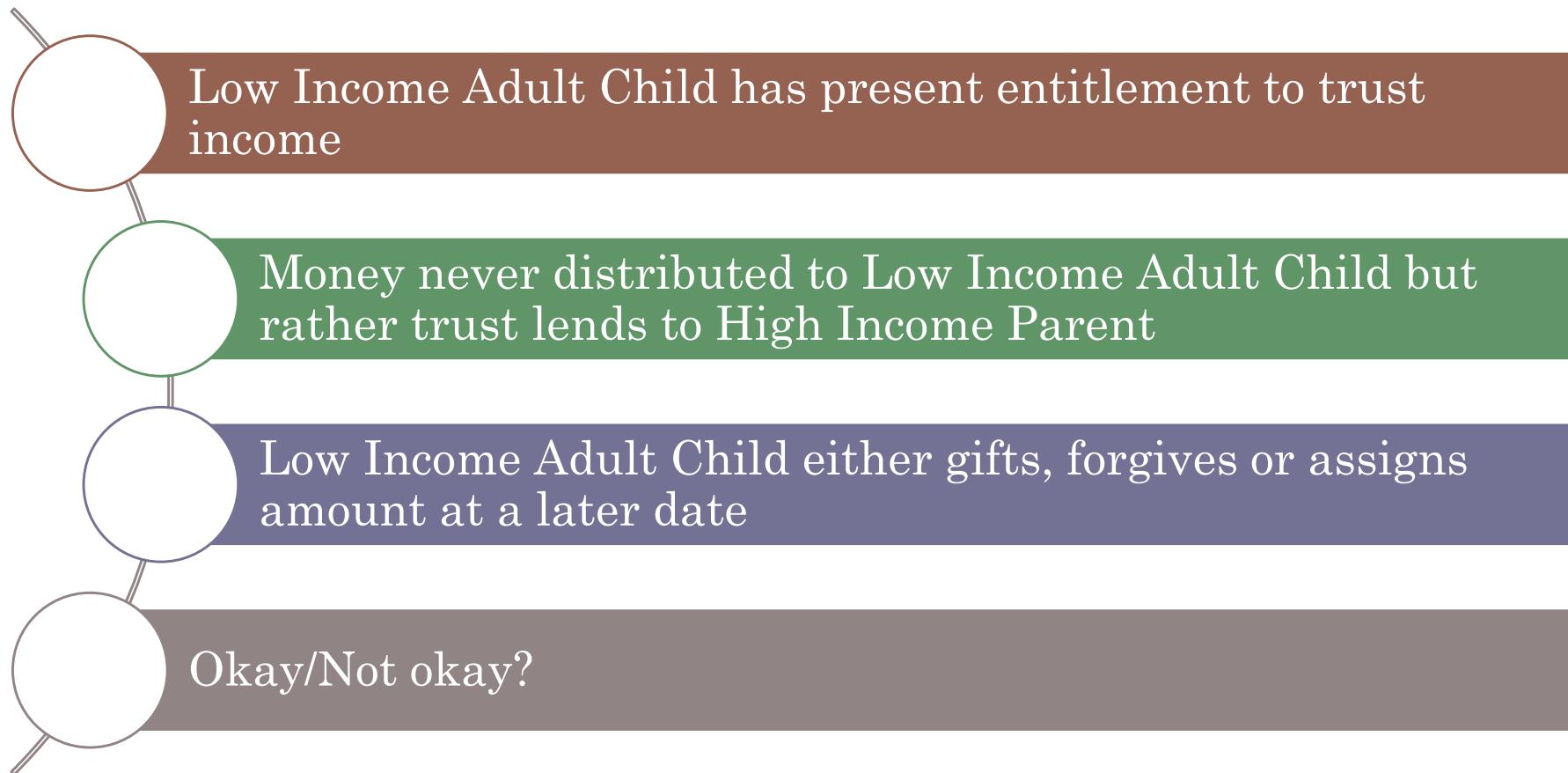


Section 100A



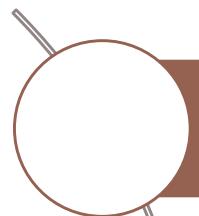


Section 100A – the basic example





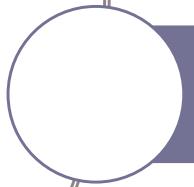
Section 100A – the ATO guidance



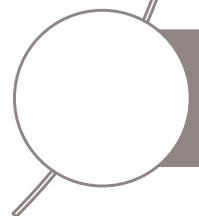
TR 2022/4 – Income tax: section 100A reimbursement agreements



PCG 2022/2 – Section 100A reimbursement agreements:
ATO compliance approach



TA 2022/1 – Parents benefitting from trust entitlement of
their children over 18 years of age



The above outlines the ATO position on what is 'ordinary
family or commercial dealing'



TR 2022/4 comments

Paragraph 98

- Acknowledges test involves an inquiry into the objectives of the dealing and whether steps comprising of the dealing would achieve the objective. Can the dealing or steps be explained by different objectives to those said to be behind the ordinary family or commercial dealing
- Ruling provides example of *Guardian* and *Bblood*

Paragraphs 110 to 113:

- Acknowledges that cultural factors may inform question on what is an 'ordinary family dealing' depending on cultural practices of a family group.
- '*grandparents [to gift]...money or goods to younger members of the family'*
- '*for religious reasons will not accept the entitlement'*
- '*children will meet the needs for shelter and living of their parents and other older relatives when they are no longer participating in the workforce'*



TR 2022/4 comments

If the arrangements were to involve parents gifting money received from a trust to their children repeatedly and one or more of the following factors are present

- a) the parents have a lower marginal tax rate*
- b) the parents have lesser financial means than the adult child, or*
- c) the adult child is also capable of benefitting under that trust in their own right; for example, the parents may be subject to lower tax rates because they are retired and in pension phase or have significant losses to reduce tax payable on trust distributions.*

Arrangements where the situation is reversed, so that Alex (who has limited financial resources apart from a distribution made to her and has a lower marginal tax rate) gifts money to her parents Lisa and Jessie who are subject to higher rates of tax, and there is no financial or cultural circumstance that would explain the gift.

Arrangements where Alex, who has a lower marginal tax rate, agrees to apply her trust entitlements to reimburse her parents for costs incurred by them on her maintenance, education and financial support while Alex was a minor.”

Example 8 outlines various factors that may impact trust distributions from a parent's trust to an adult child to assist with the purchase of a home



PCG 2022/2 comments

Cumbersome to apply an analysis for every trust

PCG Guidelines

Red Zone distributions to adult children

- Involves an adult beneficiary in receipt of a trust distribution making gifts or loans to another party where such:
- *distribution is paid to the parent or caregiver of the beneficiary in connection with expenses incurred before the beneficiary turned 18 years of age;*
- *distribution is applied by the trustee of the trust against a debit balance account for the beneficiary representing expenses incurred by the trustee in respect of the beneficiary before they turned 18 years of age; or*
- *adult beneficiary is a non-resident relative of the resident controller of the trust and the distribution is made available to a resident taxpayer by way of loan or gift.*



PCG 2022/2 comments

Green zone distribution for company

- there is a retention of funds;
- the company is a member of the same family;
- the retained funds are used for the working capital of a business that the trust actively carries on; or are used to acquire, maintain or improve investment assets of the trust
- a complying Division 7A loan agreement is entered into
- no exclusions apply



PCG 2022/2 comments

The Taxpayer Alert outlines the scenarios in which the ATO will consider parents as benefiting from trust distributions made to adult children.

Includes example of adult children receiving \$160,000 from trust distributions without being paid the entitlement (the amount instead being used to offset the parent's mortgage account).

Distinguishes between the following examples:

- Risky example – where adult child presently entitled to \$160,000 but such amount is paid to the father for repayment of expenses incurred whilst adult child was a minor.
- ‘Ordinary dealing’ example – where adult child presently entitled to \$40,000 and a proportion of such amount is paid to relatives who have either incurred expenses on behalf of the adult child (whilst an adult) or is owed to the relative (for board)

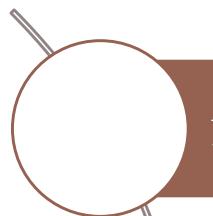


Evidence – company beneficiary

- Complying Division 7A loan agreement
- Evidence proving use of retained funds in working capital for the trust (resolutions, notes or records of discussions or meetings)
- Appropriate accounting records
- Evidencing future dividends declared are sourced separate from the trust distribution



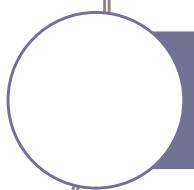
Evidence – adult beneficiary



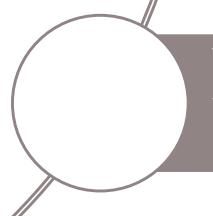
Appropriate steps to ensure trust resolutions are prepared pursuant and in compliance with the terms of the trust deed.



Ensuring each beneficiary recipient is advised of their entitlements in writing.



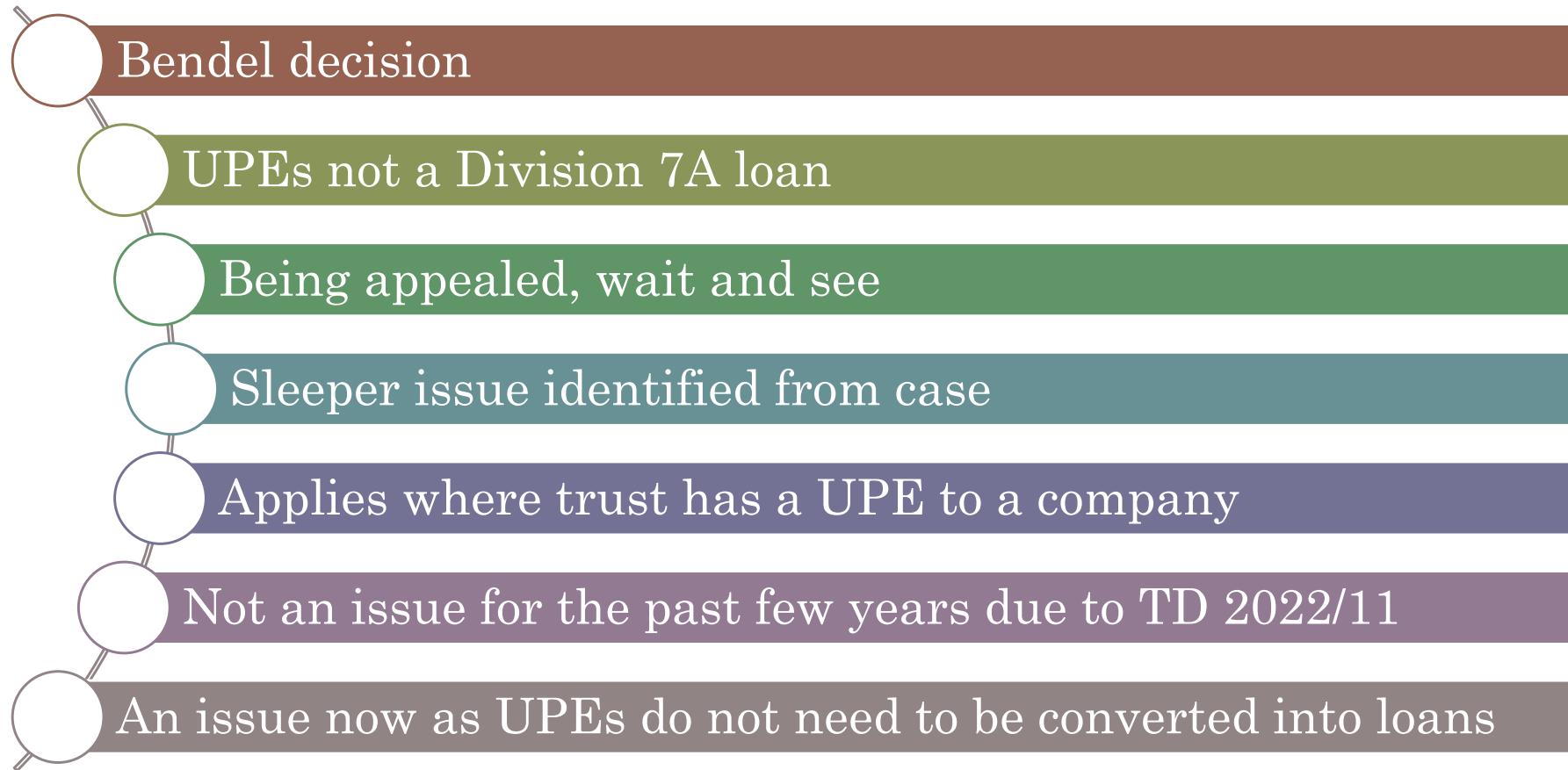
Ensuring the accounts of the trust properly reflect the treatment of such entitlement.



Where a beneficiary wishes to apply their entitlement in a certain manner (whether by way of gift or loan), steps should be taken that appropriate written documentation are drawn and executed to confirm how such entitlement is to be dealt with.

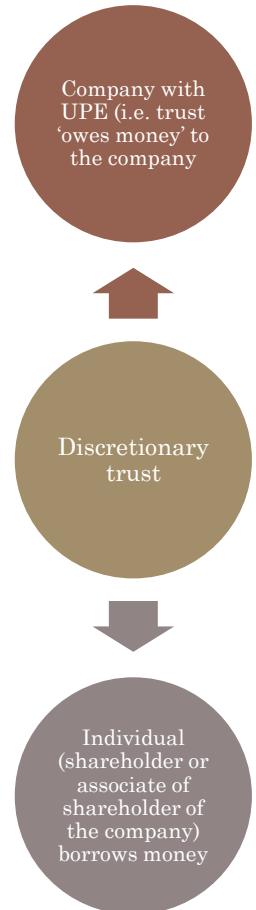


Subdivision EA





Subdivision EA





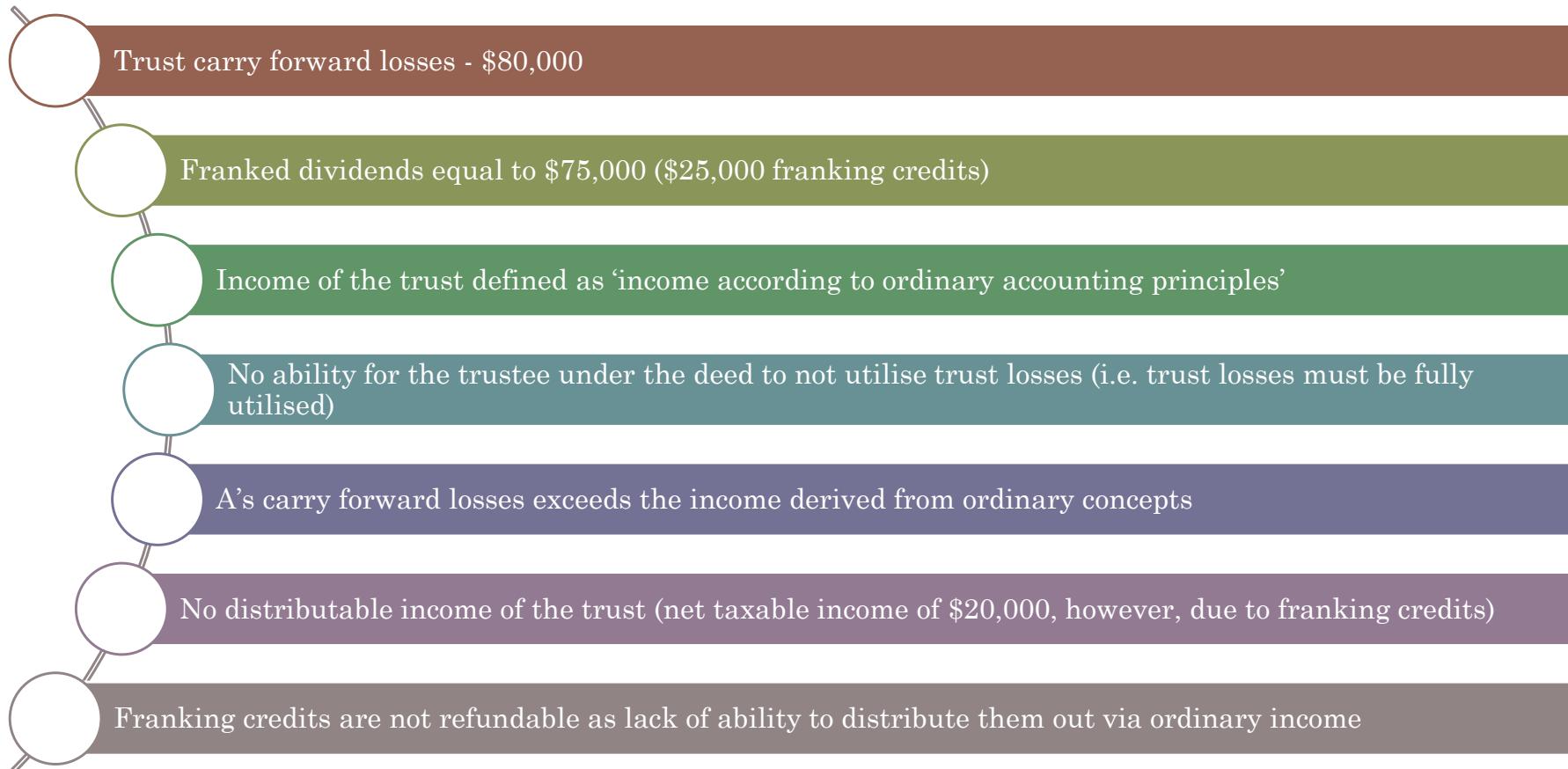
Subdivision EA

“as if it were a dividend paid by the company at the end of the year of income of the company in which the actual transaction took place, in the assessable income of the shareholder or associate referred”

Section 109XB ITAA 1936

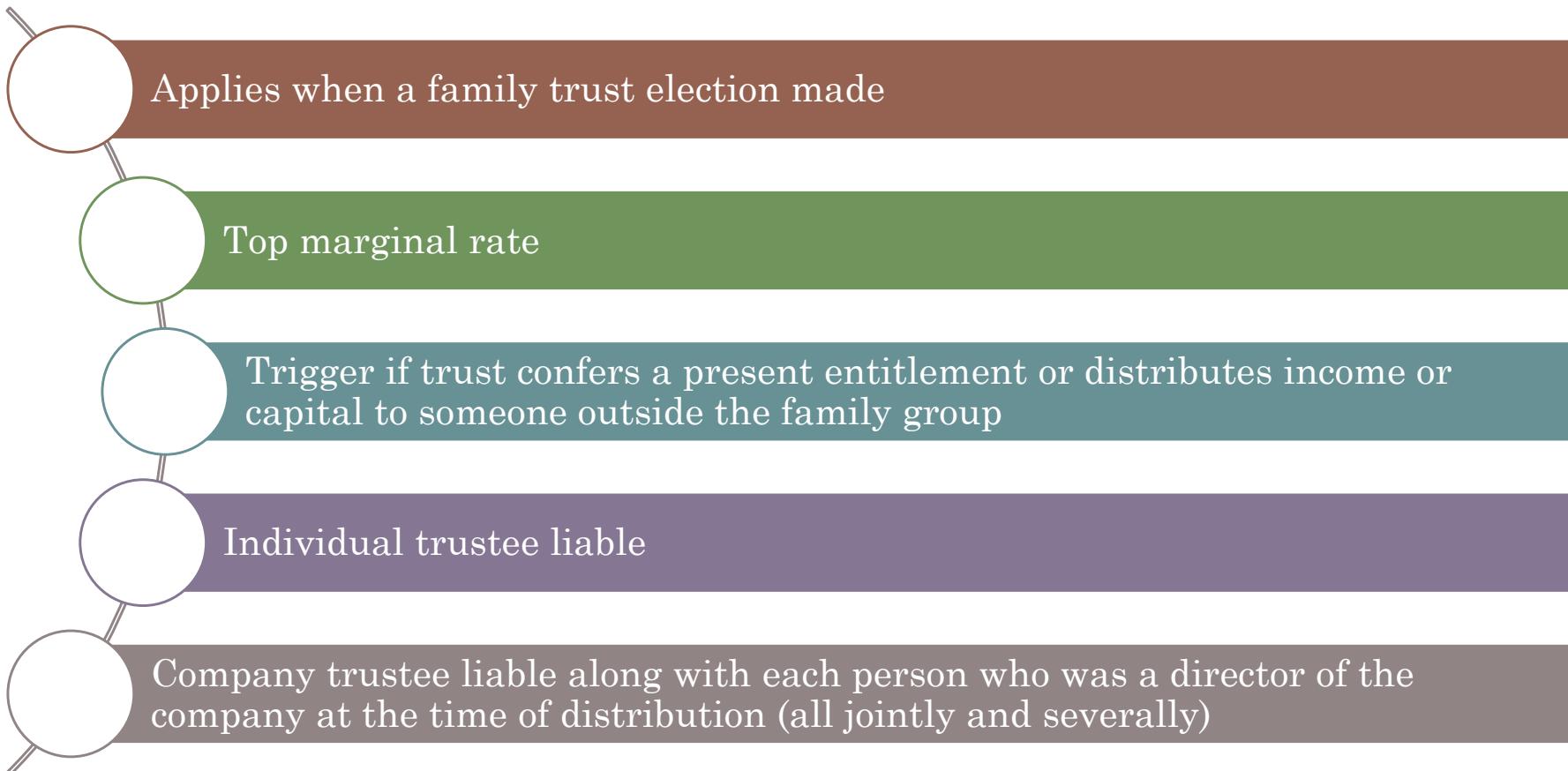


Trust losses



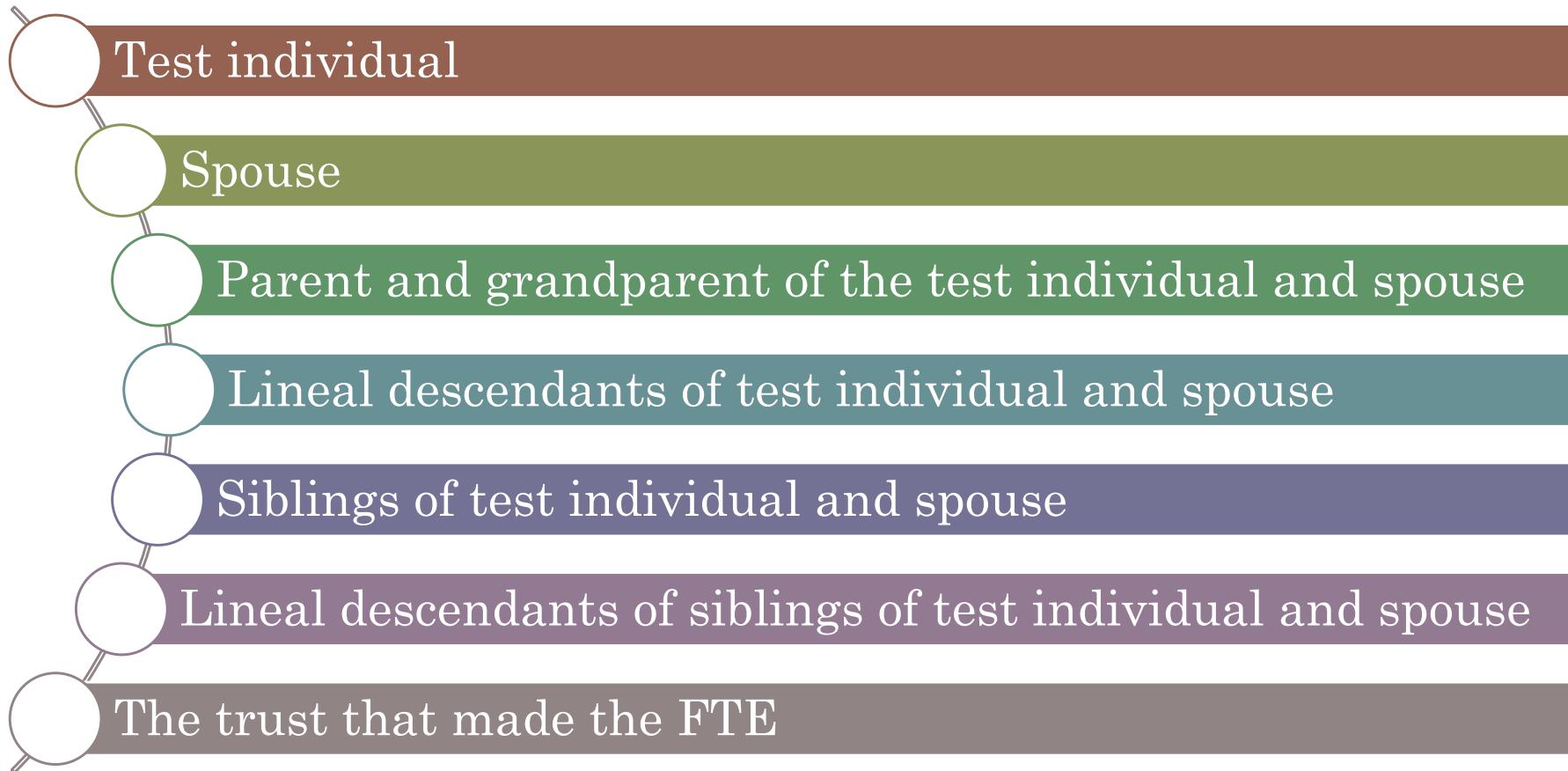


Family trust election traps



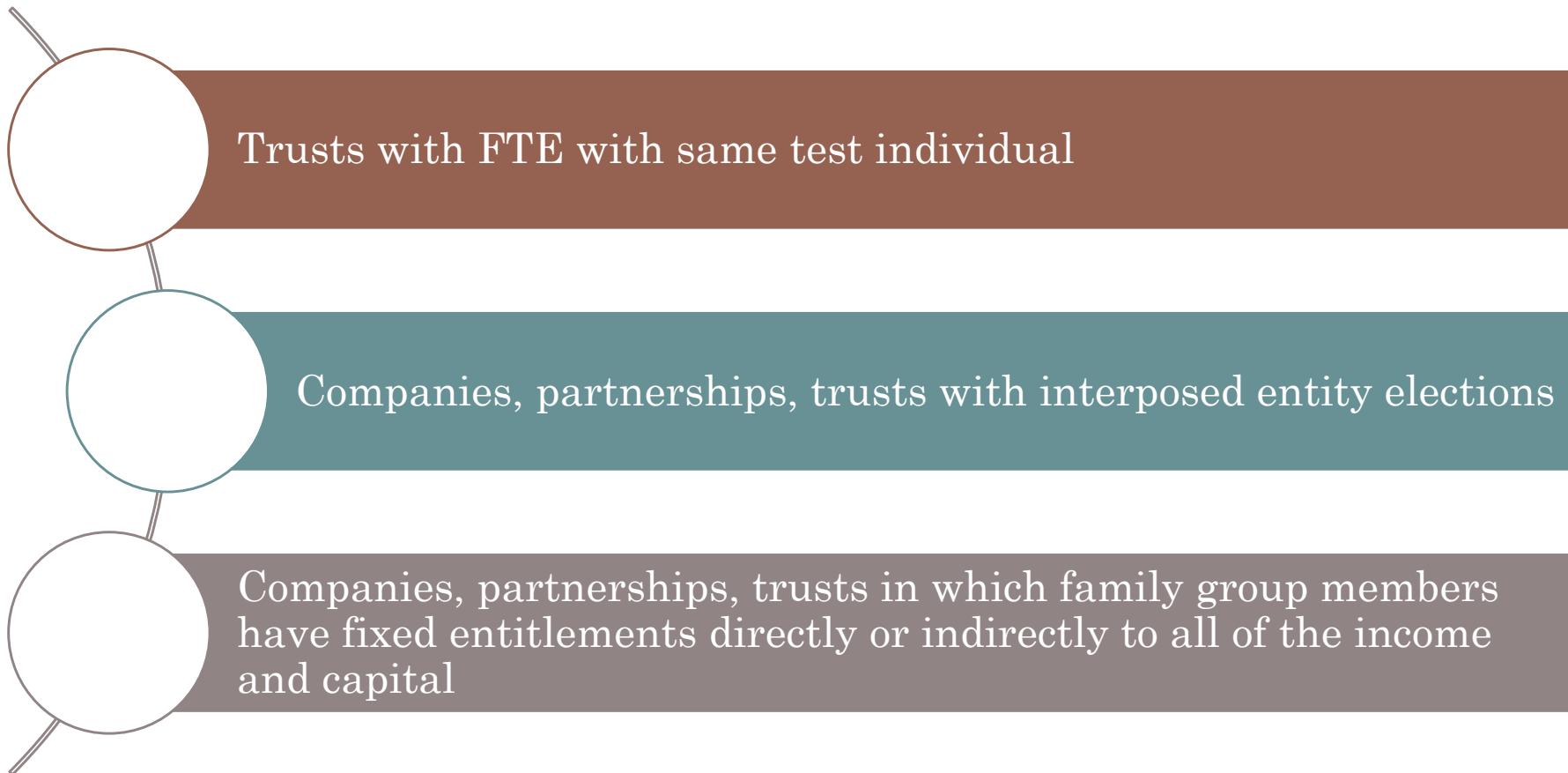


Family group



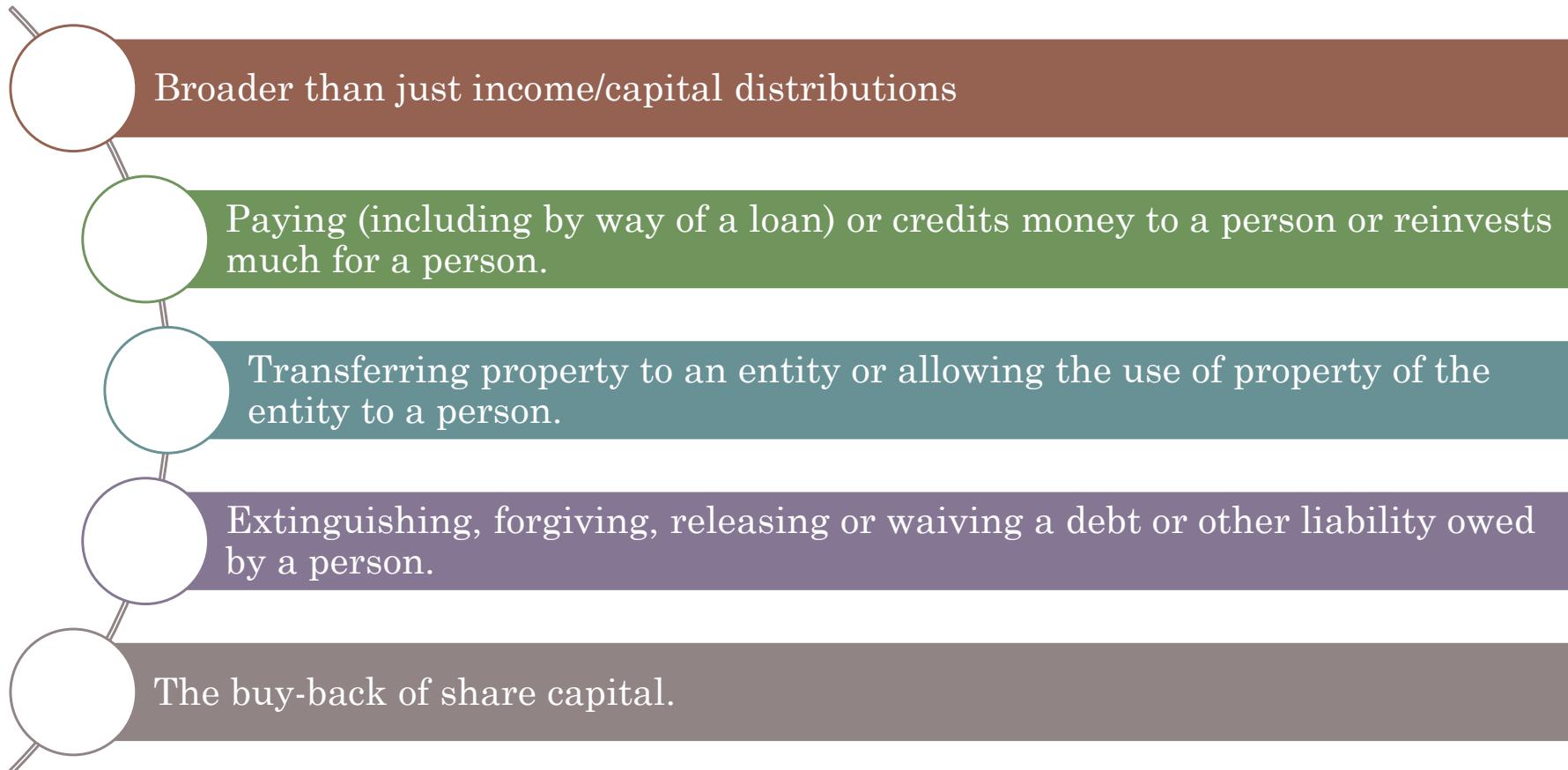


Family group



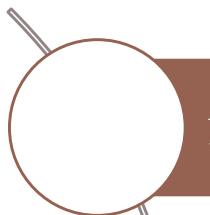


Distributes





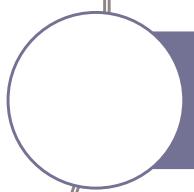
Buyer beware



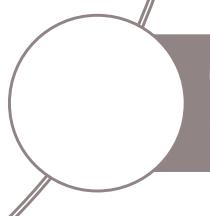
ATO ID 2004/162 – Family Trust Distribution Tax can apply to a redemption of units where the amount paid exceeded the value of any consideration given in return.



Transfer of shares by family trust for less than market value to an entity outside the family group.



Dividends declared by a company (which has made an interposed entity election) to a newly introduced shareholder (outside the family group).



Transfer of business assets out of a company (which has made an interposed entity election) to an unrelated entity (outside the family group).



Part IV-A and distributions

Commissioner of Taxation v Guardian AIT Pty Ltd ATF Australian Investment Trust [2023] FCAFC 3

In the 2012 income year - Guardian appointed income that was not in the form of franked dividends to AITCS. The distribution was not paid to AITCS, creating an unpaid present entitlement (2012 UPE).

In the 2013 income year

- (i) AITCS drew on the 2012 UPE (which represented its only retained earnings) to discharge its liability to tax for the 2012 income year
- (ii) AITCS declared a fully franked dividend to the AIT which was an amount equal to the remaining 2012 UPE. The dividend was paid by way of set-off, reducing the balance of the 2012 UPE to nil
- (iii) Guardian appointed so much of the income of the AIT in the 2013 income year as was attributable to franked dividends (including the fully franked dividend paid by AITCS) to Mr Springer. No additional Australian tax was payable on this amount.



Part IVA and distributions

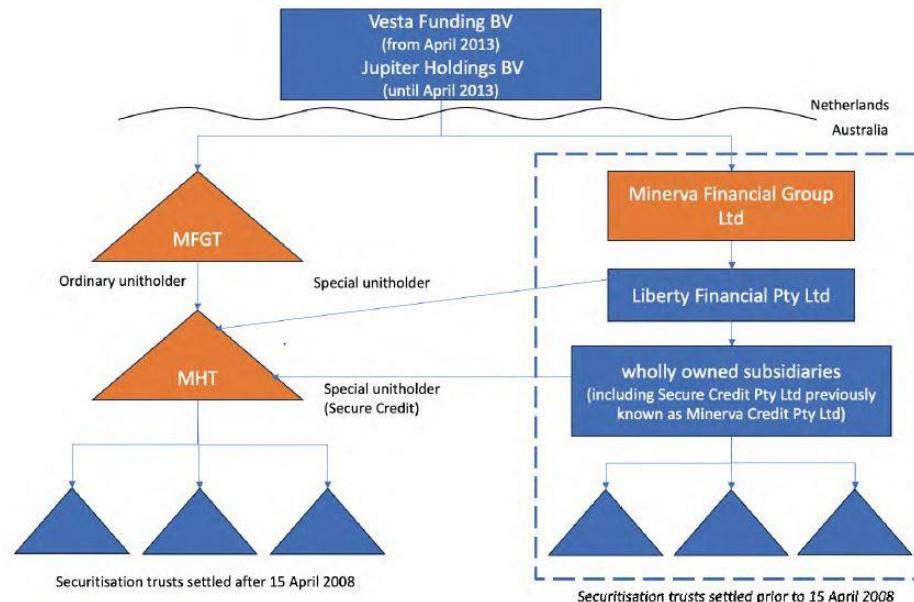
Commissioner of Taxation v Guardian AIT Pty Ltd ATF Australian Investment Trust [2023] FCAFC 3

- Section 100A and Part IVA issues
- Section 100A held not to apply as could not link the transactions
- “*The Court observed that, in order for a relevant arrangement or understanding to exist, it must be adopted in the sense that it must be assented to, whether expressly or impliedly. This could not be established on the evidence (which included the testimony of witnesses), given the absence of a finding that Mr Springer's advisers had communicated a plan or recommendation to him for the payment of a dividend or that they were otherwise acting on his behalf at the relevant time*”
- Part IVA considered and held to apply
- “*The Court concluded that a party entered into or carried out the 2013 scheme for the dominant purpose of enabling Mr Springer to obtain a tax benefit. In contrast to its finding that there was no such purpose in respect of the 2012 scheme, the Court considered that 'the form of the 2013 ... scheme was not the product of an evolving set of circumstances'; rather, it was a further implementation of a strategy that had already been developed.*”



Part IVA and distributions

Minerva Financial Group Pty Ltd v Commissioner of Taxation [2024]
FCAFC 28





Part IVA and distributions

Minerva Financial Group Pty Ltd v Commissioner of Taxation [2024] FCAFC
28

- Schemes involved:
- (a) the trustee of MHT choosing not to exercise its discretion to make any substantive distribution to the special unitholders (Liberty Financial and the wholly owned subsidiaries); and
- (b) the trustee of MHT lending monies to Liberty Financial (with interest applying).
- The resulting effect is that distributions from the Trust Silo (which included the interest received from the loan to Liberty Financial) would be subject to 10% withholding tax, whilst distributions from the Corporate Silo attracted a 30% tax rate.
- Primary judge held Part IVA could apply
- On appeal, Full Federal Court allowed the appeal



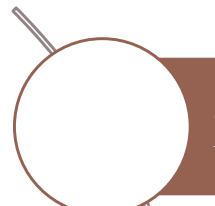
Part IVA and distributions

Minerva Financial Group Pty Ltd v Commissioner of Taxation [2024] FCAFC
28

- (a) Part IVA requires an objective assessment of the purpose behind entering into or executing the scheme, based on the statutory factors listed in section 177D of the Income Tax Assessment Act 1936.
- (b) It does not allow for an investigation into the subjective motives of the taxpayer or other participants.
- (c) The test for determining dominant purpose is not a “but for” test and does not involve causation.
- (d) Simply choosing between two transaction forms based on tax considerations does not, in itself, indicate that the scheme was entered into with the dominant purpose of obtaining a tax benefit, considering the section 177D factors.
- (e) Part IVA does not mandate that a taxpayer must choose a transaction form that results in the highest or higher tax payable



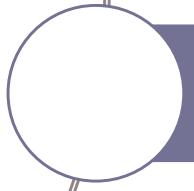
Part IVA and distributions



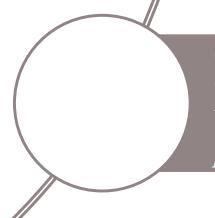
(b) *First, and most importantly, it discounts entirely the financial consequences to Vesta and Jupiter of the distributions made to them by MFGT which distributions would not have happened if MHT's income had been distributed to LF...*



(c) *Second, it fails to have regard to the totality of the circumstances including the fact that the Liberty group's business was growing. Additional debt and equity capital were raised by the group from 2016 to support that growing business...*

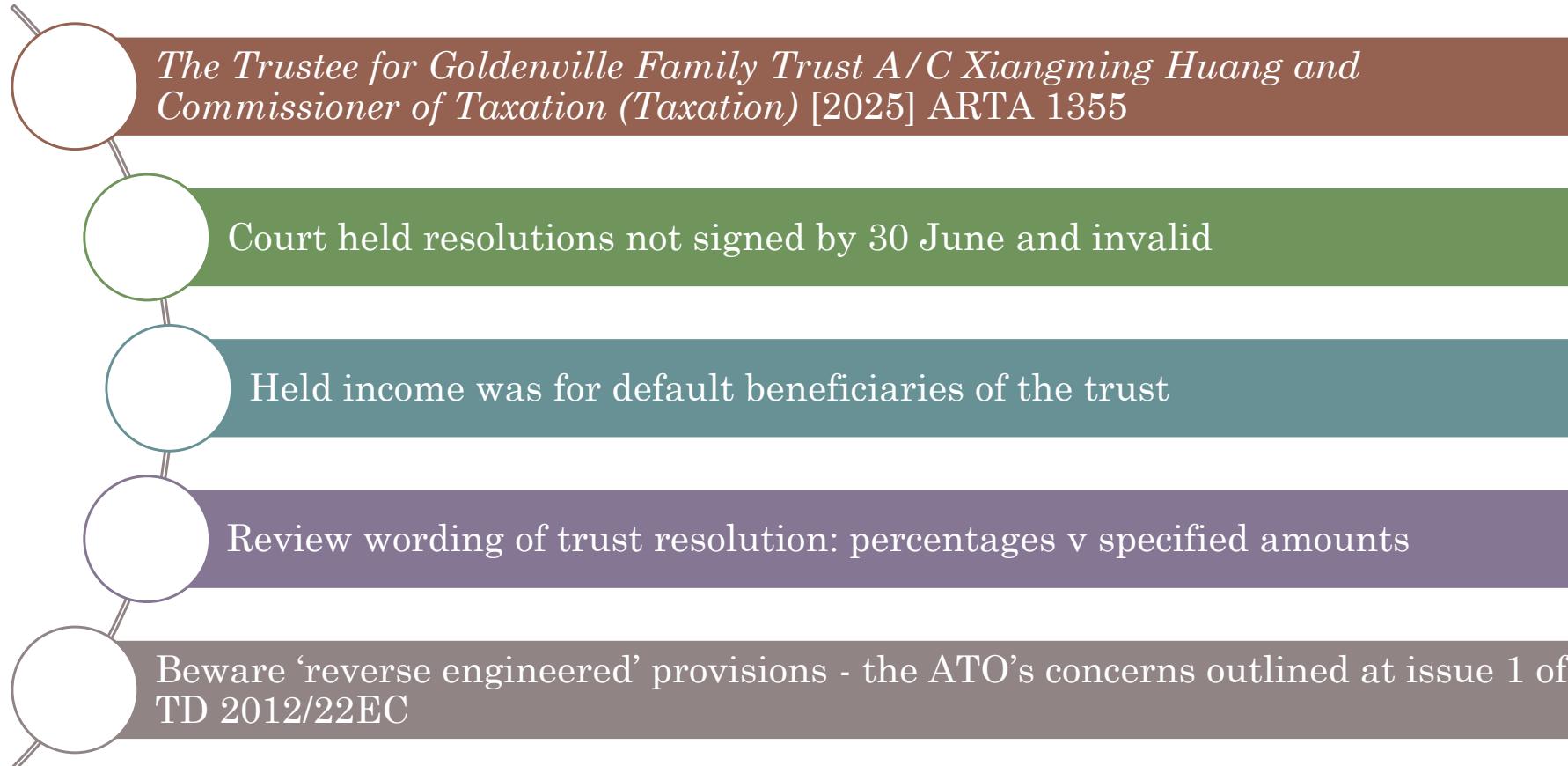


(d) *Third, the Commissioner's contention that the non-exercise of the discretion to distribute income to LF adversely affected LF's capital adequacy ratio and thereby put LF's credit rating at risk is not supported by the evidence. The evidence was that LF's credit rating improved from 2000 to 2014...*



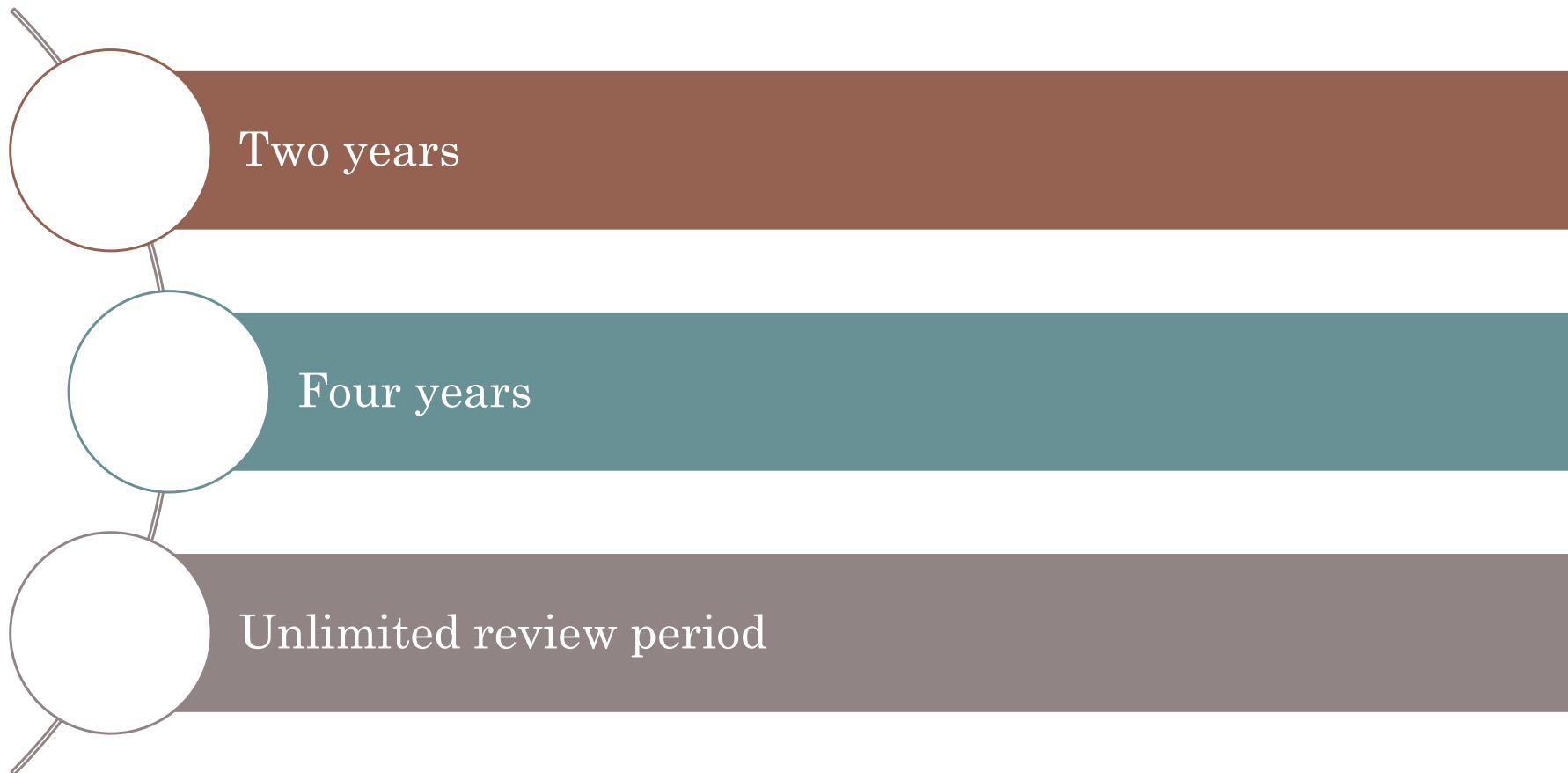
(f) *The evidence was that the non-payment of distributions to LF in the relevant years did not affect the solvency, profitability or credit rating of LF. LF had derived sufficient revenues to support its business needs in the relevant years. The changes in the financial position of LF as a result of the appellant's exercise of its discretion as trustee of MHT to distribute no more than a small amount to LF as special unitholder in the relevant years do not support a conclusion that a party entered into or carried out any of the schemes for the dominant purpose of obtaining a tax benefit.*

Invalid distributions and section 99A





Amendment time limits



Contact details

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