Current issues with trusts and the tax system:

Examining the operation and performance of the tax system in relation to trusts, with a particular focus on discretionary trusts linked to high net worth individuals

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Executive Summary

By 2022, it is expected that over 1 million trusts will exist in Australia. Trusts are used as a vehicle for business, investment and estate planning by various segments of Australian society. There are many types of trusts, the most common type being discretionary trusts. In total, trust income in 2013/14 exceeded $340 billion making this vehicle a defining feature of the Australian economy with trusts in the financial services sector alone accounting for over $24 billion ¹.

Another central feature of Australia’s economic landscape is its tax system and in particular the way in which it regulates the behaviour and activities of trust users. The purpose of this investigation was to examine the efficacy of the current system of taxation of trusts. Key highlights of our study include:

- The interactions between the trust and tax laws are being manipulated which could contribute to the sheltering of significant amounts of tax. At conservative levels this amount is estimated to be between $672m and $1.2b per annum.
- Chains of trusts and interlinking trusts are common which may reflect a deliberate intent to create a degree of opacity with relation to trust income.
- Trust tax lodgment patterns differ according to trust type, however these are difficult to ascertain given the current level of information available.
- The current system of trusts presents significant challenges in implementing international transparency obligations and recommendations.
- Australian trust taxation law is remarkably different from other common law jurisdictions.

These highlights are based on an in-depth investigation which:

1. Analysed Australian Tax Office (ATO) de-identified data, relating to various discreet groups of taxpayers² (Wealthy Australians, Potential High Net Wealth Individuals, High Net Wealth Individuals and other private groups), in order to assess:
   - current effectiveness of the tax system in relation to the tax use of trusts, including taxpayers’ responses to administrative or legislative changes;
   - trends or indicators as to future tax use of trusts and their impact on the performance of the tax system, including suggestions of how to improve taxpayers’ voluntary compliance; and
   - administration issues arising from the current interaction of tax and trust law.

¹ Amounts sourced are total business income values from Table 5 of ATO taxation trust statistics data
² At time of data analysis, the following acronyms were in use - HWI: High Net Wealth Individuals; PHWI: Potential High Wealth Individuals. However, the ATO has recently changed its classification system and now combines these two categories into one. For the purposes of this report the former method of classification is retained
2. Examined how other common law jurisdictions (a) tax trusts (with a particular focus on jurisdictions with similar legal systems to Australia), (b) deal with similar tax use of trusts (c) address similar issues that arise from the interaction of tax and trusts law and (d) regulate trusts. Instructive comparisons are made with the Australian trusts' taxation system.

3. Assessed other known commercial or legal matters that are relevant to the use of trusts and may have an impact on the ATO’s tax administration.

In particular, the investigation focused on the following areas:

1. The income tax shuffle: How inconsistencies between trust and tax income definitions can be used to shelter income from higher rates of tax. This opportunity is brought about by creating and subsequently utilising the mismatch between income for tax law purposes (net income) and income under trust law purposes (distributable income)

2. Complex distributions: How distributions between trusts can be effectively used to disrupt ATO oversight of income streams.

3. Non-lodgment and trust lodgment patterns of trust tax returns: How effective the current system is in identifying the number of trusts and monitoring their activity.

4. Transparency: How the current system for the taxation of trusts in Australia is positioned to meet the requirements and expectations of Australia’s international treaty partners.

In addition, this report also includes a review of the taxation of trusts in Canada, New Zealand, the United Kingdom and the United States and how they compare with the Australian context. A critical review of the roles of accountants and legal professionals in providing advice in relation to the use of trusts is also presented. Finally, industry practitioner perspectives were gathered via in-depth interviews to provide insight on motivations and behaviours in relation to the use of trusts.

The following is a summary of key findings presented in the order in which they appear in this report.

**Income Tax Shuffle**

Income tax shuffles exploit the differences in the definitions of income under trusts law and tax law. Beneficiaries are made liable for tax on the amounts which they do not receive resulting in a separation of economic and tax outcomes.

This separation, following the decision in *FCT v Bamford* (2010) 240 CLR 481, takes the form of trustees and/or the terms of trusts reducing distributable trusts law income to below the level of tax law income. The amount calculated for trusts law purposes (distributable income) is then distributed to presently entitled beneficiaries. However, the tax liability of these beneficiaries is calculated from their share of the trusts tax law (net income) income. Presently entitled beneficiaries to whom reduced distributions are made may be concessionally taxed or insolvent. Amounts withheld by the trust (being the difference between the net income and distributable
income) are distributed tax-free to other beneficiaries in subsequent years. Findings from this investigation suggest:

- The major indicator that an income tax shuffle has occurred is that a trust has a smaller amount of distributable income than net (taxable) income, however it should be noted that there may be other explanations for this indicator. Nevertheless, an income mismatch is present in every case of an income tax shuffle – a review of five cases (some spanning more than one year) featured 18 arrangements involving income sheltering estimated to be in excess of $700 million with potential tax leakages of $195 million.

- Most subordinate indicators in relation to income tax shuffle are beneficiary-specific – such as the use of ‘bucket’ companies, loss-making entities/companies. The use of companies and trusts in combination provide several avenues through which an income tax shuffle could be fully exploited.

- Anti-avoidance provisions may not be sufficient to deal with common cases of income tax shuffles, and such arrangements can be easily enacted by taxpayers.

Recent case investigations by the ATO reveal the ease with which wealthy taxpayers can utilise trusts in private groups and reduce their tax liabilities. The analysis of five investigations included in this report demonstrates the range of taxpayer behaviours in relation to the full exploitation of income tax shuffles. In just these five cases alone, the tax leakage is estimated to be approximately $195m. The data analysis carried out as part of this report clearly shows that the potential for widespread use of income tax shuffles exists given the current regime of the taxation of trusts.

Specifically, analysis of de-identified trusts’ tax return information provided by the ATO revealed:

- Strong evidence of income mismatches.
- Distributions to company beneficiaries accompanied by franking credits to permanently limit the tax liability and cap the tax rate at 30%.
- On average, ‘loss-making’ company beneficiaries received 22% of trust total distributions while ‘non-loss-making’ company beneficiaries received only 14%.
- A conservative estimate indicates that $672 million to $1.2 billion of tax revenue could be sheltered annually.
- Less conservative estimates suggest the amount of tax sheltered could be several billion dollars which will be further inflated as the corporate tax rate decreases.

These findings demonstrate that orchestrating income tax shuffles can be particularly advantageous for high wealth individuals. Further, some of these schemes appear to be (deliberately) complex.
Complex Distributions

Complex distributions were the second area of focus for this investigation. It was observed that taxpayers can derive income from trusts in convoluted ways in order to defer, reduce or extinguish tax liabilities.

Based on analysis of ATO supplied case studies, four key traits emerged:

1. **Multiple trust structures**: Chains of trusts make it difficult for the ATO to identify the ultimate beneficiaries to assess. “Circular entitlements” are an extreme example whereby at least two trusts make each other presently entitled.

2. **Questionable present entitlements**: Low-taxed and tax-preferred entities – charities, tax exempts, loss companies and ‘bucket companies’ - agree with existing trust beneficiaries that they will become trust beneficiaries and transfer the (low-taxed) distributions they receive in that capacity, less a service fee.

3. **Association with income tax shuffles**: Income tax shuffles seem to be a common feature of complex distributions, in particular added complexity aids individuals in having arrangements whereby a trust’s trusts law income happens to be less than its tax law income, or a distribution that is made to an unlikely tax exempt or corporate beneficiary.

4. **Income Re-characterisation**: Provisions of the Tax Act may be manipulated through the use of trusts in complicated transactions. For example, substitution of income character to achieve a lower rate of withholding tax for non-resident beneficiaries.

Analysis of ATO data revealed:

- Approximately 80% of inter-trust complex distributions are only one level deep (i.e., trust A distributes to trust B), while 13% engage in a further third tier distribution (i.e., trust A distributes to trust B and trust B distributes to trust C).
- Five tier deep trust chains were not uncommon.
- Distributions from trust A to trust B more than doubled over a three year period: $21 billion (2012) to $50 billion (2015).
- Circular distributions were observed.
- Distribution amounts decrease (in aggregate) at each successive level.
- A “spread thin then thick” approach was apparent, where the intention, and the outcome, is to create a degree of opacity around trust income and the ultimate beneficiaries to which the funds flow.

These observations suggest there is a significant administrative challenge for the ATO, particularly in levying the correct tax burden on the appropriate ultimate beneficiary or entity. In addition, administrative costs are likely to be inflated due to the deliberate attempt to confound oversight. This also increases the amount of tax sheltered and hinders equitable and transparent tax outcomes.
Non-Lodgment and Lodgment Trust Patterns

A complicating administrative challenge is non-lodgment of trust tax returns. The Commissioner has limited sources of information on trusts and these are insufficient given the increasing complexity surrounding the use (and misuse) of trusts. Current information sources include:

- Taxpayers’ voluntary disclosure in their tax returns.
- Internal data-matching and information corroboration from government and public sources.
- Audit specific information and tax-related record-keeping obligations imposed on taxpayers. It is notable that ITAA36 s262A does not require taxpayers to produce or maintain a trusts’ constitutive documents or other trust-related information.

Lack of information is a major problem given the importance of trusts to the nation’s economic activities. Some trusts law jurisdictions have trusts registries which assist in the management of this sector.

Transparency

Analysis of ATO data suggests that different types of trusts have different lodgment patterns. However, there was no way to corroborate this given the lack of information available. The limited information is not just a domestic concern but has broader implications as Australia is party to a number of global initiatives including:

- The OECD’s Standard for Automatic Exchange of Financial Account Information in Tax Matters (CRS Standard) which Australia committed to from the 1 July 2017.
- The Financial Action Task Force (FATF) which is an inter-governmental body established in 1989 by the finance ministers of 35 member jurisdictions (including Australia). Standard-setting is FATF’s primary task to further legal, regulatory and operational responses to money-laundering, terrorist financing and other threats to the international finance system.

The implementation of OECD Financial Action Task Force recommendations in Australia will be difficult without some means of identifying the beneficial ownership of trusts. Other jurisdictions, including the United Kingdom, New Zealand, South Africa and India, are better equipped to address these recommendations as they have a central registry of trusts and trust assets.
Other Common Law Jurisdictions

In the United States and Canada, tax on trust income (including capital gains) is attributed to trustees at a high marginal rate subject to the trustees being entitled to a deduction for income distributed or distributable to beneficiaries. New Zealand trustees are taxed on trust income at a 33% rate amounting to a tax credit for beneficiaries to whom the income is distributed. The Australian ITAA36 s97 present entitlement formula is not applicable in these countries.

Canadian capital gains tax charges occur when property is transferred to a trust, when trust property is disposed of and, as an anti-deferral measure, every 21 years all the property of a trust is deemed to be disposed of unless it has “vested indefeasibly”. In Australian terms, this means that the subsisting assets of discretionary trusts (before appointment) will be taxed once every 21 years — limiting some of the remarkable immunities of the Australian discretionary trust.

Unauthorized Legal Practice

Non-lawyer tax agents (and accountants) are known to regularly advise their clients about trusts and supply trust deeds. It is questionable whether they are able to perform this work without appropriate legal expertise. Analysis of the Tax Agents Services Act 2009 and state-law Legal Profession Acts indicates that tax agents may not be authorised by federal law to engage in legal practice as unqualified persons, contrary to state-law prohibitions.

Practitioner Perspectives

Finally, in-depth interviews complemented the investigation. Interviews were conducted with ten industry practitioners (tax/accounting and legal experts) and explored the behaviours and attitudes surrounding the use of trusts with a particular focus on any taxpayer/industry practices which may facilitate tax avoidance strategies. The data provided the following insights with regard to the use of trusts, the complexity of the current system and potential reform:

- Trusts provide flexibility in terms of structuring businesses and tax affairs when compared to establishing companies or partnerships.
- Trusts are viewed as useful vehicles for asset protection and estate planning since legal ownership and beneficial ownership are separated.
- Most if not all high net worth and wealthy groups utilise multiple trusts and companies within their structures. In many cases it was suggested that one of the aims is to reduce the effective tax rate to the corporate rate of 30%.
- The participants identified several legal complexities (but they did not advocate for substantial reform), with the major one pertaining to the separation of distributable income (income according to trusts law principles) and net income of the trust (income according to taxation laws).
Most participants claimed that extreme cases of tax avoidance were rare. Participants generally held the view that the ATO currently has sufficient powers under Part IVA of the ITAA 1936 to prosecute ‘egregious cases’ of tax avoidance through the use of trusts. Participants suggested that any reform could include a withholding tax regime similar to that in place for salary and wage earners or taxing the trust/trustee as an entity and maintaining the current flow through features of trusts.

In conclusion, the findings presented in this report highlight a number of issues associated with the current system pertaining to the taxation of trusts. However, suggestions as to how these areas could be addressed is beyond the scope of the report.
**Glossary of selected terms**

<table>
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<th>Term</th>
<th>Description</th>
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<td>Beneficiaries of a trust</td>
<td>A trust beneficiary can be a person, a company or the trustee of another trust. The trustee may also be a beneficiary, but not the sole beneficiary unless there is more than one trustee. Beneficiaries may have an entitlement to trust income or capital that is set out in the trust deed or they may acquire an entitlement because the trustee exercises a discretion to pay them income or capital. Generally, the beneficiaries are taxed on the net income of a trust based on their share of the trust's income – regardless of when or whether the income is actually paid to them.</td>
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<td>Beneficial ownership</td>
<td>Addressed in detail in section 5.1.2 of the report</td>
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<td>Bucket company</td>
<td>A company set up for the sole purpose of receiving entitlements to trust distributions.</td>
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<tr>
<td>Capital gains or losses</td>
<td>Gains or losses arising from Capital Gains Tax (CGT) events (as per Division 104 of ITAA 1997) involving CGT assets (as per Division 108 of ITAA 1997)</td>
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<td>Complex distributions</td>
<td>For the purposes of this report, this term is used to refer to distributions between trusts or other entity types within private groups. These are referred to as complex due to deliberate actions of taxpayers which make tracing these distributions difficult.</td>
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<tr>
<td>Corpus</td>
<td>The term used to denote capital of the trust.</td>
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<td>Discretionary trusts</td>
<td>Under a discretionary trust, some or all of the entitlements of the beneficiaries in any particular income year are determined by the exercise of the trustee’s discretionary powers. The trust instrument may place limits on the extent of the trustee’s discretion. The discretion may include the right to add or remove beneficiaries.</td>
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<tr>
<td>Distributable income</td>
<td>This is the income of the trust estate as that expression is found in Division 6 of the ITAA 1936 and related provisions. This is the total distributable income of the trust that the trustee determine is legally available for distribution to trust beneficiaries in the income year. This calculation may depend on the terms of the trust and general trust law principles: you may need to carefully consider the trust deed, the trust accounts and relevant resolutions to determine what the trust's distributable income is. Because this amount is determined in accordance with trust law principles and where applicable, the terms of the particular trust, it may be different to the accounting income of the trust or the net (taxable) income of the trust for tax purposes.</td>
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<tr>
<td>FACTA</td>
<td>Foreign Account Tax Compliance Act, see <a href="https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx">https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx</a></td>
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<tr>
<td>FATF</td>
<td>Financial Action Task Force, see <a href="http://www.fatf-gafi.org/">http://www.fatf-gafi.org/</a></td>
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<tr>
<td>Fixed trust</td>
<td>Under a fixed trust, each beneficiary is entitled to a fixed or</td>
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<td><strong>predetermined share of the income and/or capital of the trust. The fixed entitlement may be defined as a set fraction or a set amount of the income and/or capital of the trust, or the balance or part of the balance of the income or capital after taking account of the entitlements of other beneficiaries.</strong></td>
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<tr>
<td><strong>Franking credits</strong></td>
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<td>Franking credits represent the income tax paid by a company. These credits are passed on to shareholders who utilise it as a tax offset against their income tax liability.</td>
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<td><strong>HWI</strong></td>
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<td>High net worth individuals</td>
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<td><strong>Income tax shuffle</strong></td>
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<td>For the purposes of this report, a term used to refer to situations where distributable income of a trust differs from its net income. The difference can be exploited to separate economic and tax outcome. See Chapter 3 for a more detailed description of these arrangements.</td>
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<tr>
<td><strong>Lodgment patterns</strong></td>
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<td>For the purposes of this report, this term is used to refer to what is known about the duration for which trusts of different types lodge tax returns. Lodgment patterns give some indication as to the known tax related activities of trusts which have lodged tax returns.</td>
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<td><strong>Net income of the trust</strong></td>
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<td>The net income of a trust (effectively its taxable income) is its assessable income for the year less allowable deductions worked out on the assumption that the trustee is a resident (even if the trustee is actually a non-resident).</td>
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<td><strong>PHWI</strong></td>
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<tr>
<td>Potential high net worth individuals</td>
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<td><strong>Presently entitled</strong></td>
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<td>A beneficiary is presently entitled to trust income for an income year where they have, by the end of that year, a present or immediate right to demand payment from the trustee. The entitlement will depend on the trust deed and any discretion that the trustee has under the deed to allocate income between beneficiaries.</td>
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<td><strong>Private groups</strong></td>
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<td>The ATO identifies a 'private group' as a group of entities under the control of an individual and their associates. 'Control', in this context means effective control, i.e. where an individual has the primary decision-making role for the group.</td>
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<td><strong>Settlor</strong></td>
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<tr>
<td>The settlor is the person who effectively bring a trust into existence by transferring legal or beneficial ownership in property to a trustee/s.</td>
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<tr>
<td><strong>Tax avoidance</strong></td>
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<td>Tax avoidance refers to deliberate exploitation of the tax system by a taxpayer to gain a tax advantage.</td>
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<td><strong>Trading trust</strong></td>
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<td>A trust through which business activity is carried out.</td>
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<td><strong>Trustees</strong></td>
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<td>The trustee(s) (there may be more than one) of a trust may be a person or a company (the latter is known as a corporate trustee). In either case, the trustee must be legally capable of holding trust property in their own right. The trustee holds the trust property for the benefit of the beneficiaries.</td>
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Where the trust is established by deed (which in the case of a deceased estate is the will), the trustee must deal with the trust property in line with the intentions of the settlor as set out in the trust deed. They must also act in accordance with the relevant state or territory law regulating trusts, and with any other applicable law, including tax law.
Under trusts law, trustees are:

personally liable for the debts of the trusts they administer, and entitled to be indemnified out of the trust property for liabilities incurred in the proper exercise of the trustee's powers (except where a breach of trust has occurred).

Under tax law, the trustee is responsible for managing the trust's tax affairs, including registering the trust in the tax system, lodging trust tax returns and paying some tax liabilities.

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<th>Vesting</th>
<th>In most cases, a trust will 'vest' within 80 years of being settled. On vesting, the beneficial interests in income and capital of the trust become fixed and determinable. This applies to all trusts, including discretionary trusts.</th>
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<td>7.1.1</td>
<td>Attribution method</td>
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</table>
This is an independent report commissioned by the Australian Tax Office. Interpretations and opinions expressed should be ascribed to the authors only.
1 INTRODUCTION

In May 2013 the Federal Government established a Trusts Taskforce to investigate the use of complex arrangements involving trusts to avoid or evade tax. The Taskforce seeks to obtain intelligence on the operation and performance of the tax system in relation to trusts and to improve their understanding of community and industry perceptions of the tax use of trusts. Trusts are an important part of the Australian economy and a widely used vehicle for business, investment and estate planning. However, they are sometimes used in ways that deliver unintended tax advantages. This has implications for community perceptions of trusts, in particular being used for tax avoidance.

This report was commissioned by the Australian Taxation Office (ATO) for its internal purposes to advance the priorities of the Tax Avoidance Taskforce – Trusts after the end of the Trusts Taskforce by providing the following:

1. Analysis of ATO de-identified data relating to various discreet groups of taxpayers in order to assess:
   - current effectiveness of the tax system in relation to the tax use of trusts, including taxpayers’ responses to administrative or legislative changes;
   - trends or indicators as to future tax use of trusts, and their impact on the performance of the tax system including suggestions of how to improve taxpayers’ voluntary compliance; and
   - administration issues arising from the current interaction of tax and trust law.

2. An outline of how other common law jurisdictions (a) tax trusts (with a particular focus on jurisdictions with similar legal systems to Australia), (b) deal with similar tax use of trusts (c) deal with similar issues that arise from the interaction of tax and trust law and (d) regulate trusts. Instructive comparisons will be made with the Australian trusts’ taxation system.

3. An outline of other known commercial or legal matters that are relevant to the use of trusts that may have an impact on the ATO’s tax administration.

To address these requirements, this investigation has undertaken legal analysis of the current Australian system for the taxation of trusts and contrasted trusts taxation in comparable common law systems. Statistical analysis has been made of de-identified trusts data provided by the ATO. Depth interviews have been conducted with relevant practitioners and advisers, exploring their behaviours and attitudes with a particular focus on taxpayer/industry practices.

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3 In particular to identify key areas of focus for compliance activities
which facilitate tax avoidance strategies. Given the large and complex nature of the law in this area, the research focused on five key areas of investigation:

1. Taxation issues arising from Division 6 of ITAA 1936, focusing on mismatches between trusts’ distributable income and net income of trust estates to identify areas to improve compliance or guidance.
2. Complex trust distributions, including distributions between trusts and the implications of complex trust distributions for tax administration.
3. Non-lodgment of trust tax returns and the difficulties that tax administrators have in knowing the “trusts demographic”, or population of trusts in Australia.
4. Australia’s international obligations under CRS, FATF and FATCA and implications for the taxation of trusts regime.
5. A comparison of the taxation regime for trusts in comparable jurisdictions. The countries included in the analysis are USA, United Kingdom, New Zealand, and Canada.

This introduction to the report provides an overview of trusts including key statistics pertaining to size and growth rate. This analysis demonstrates the importance of trusts to the Australian economy as well highlighting some of the key legal issues and challenges that affect taxation of trusts. The final section of the introduction outlines the structure of the report.

1.1 OVERVIEW OF TRUSTS

“A trust is a fiduciary relationship respecting property.”4 Trusts law imposes duties on the titleholder or controller of property (the “trustee”) which require him or her to hold or deal with that property for the benefit of others. In its essential form, the trust is a property-management regime. Persons to whom trustees owe obligations are called “beneficiaries”, of whom the trustee may be one.

In addition to dealing with the property of the trust, the “trustee” is also responsible for managing the device’s tax affairs, including lodging trust tax returns in cases where the trust generates income, and paying tax liabilities where all or part of the income has not been distributed to beneficiaries, or where the beneficiaries are under legal disability. Trusts are not taxed at the entity level. Instead, tax liabilities flow through trusts to either trust beneficiaries or the trustee. Beneficiaries (except minors and some non-residents) include their share of the trust’s net income as income in their own tax returns.

Trusts can be classified in several ways. The first classification looks to beneficial interest and distinguishes fixed and discretionary trusts. A fixed trust is one where each beneficiary has a specified interest in the trust property.5 Unit trusts may be fixed trusts or have both fixed and discretionary characteristics.6 Beneficial interests in unit trusts are divided into units which

4 See American Law Institute Restatement of the Law Third: Trusts (St Paul, Minn, 2001), at §2.
6 See CPD Custodian v FCT (2005) 224 CLR 98.
constitute a proportional interest in the trust fund. By contrast, discretionary trusts do not stipulate the interests of a beneficiary in the trust property. Until a trustee exercises his or her discretion under a discretionary trust, no one has any interest in the property of the trust. Prior to the making of a discretionary distribution (or “appointment”), the trustee holds the trust property subject to discretionary power rather than a trust. The second classification looks to the way in which the trust was created and distinguishes express trusts created by persons from trusts arising from court orders or statute. A third classification looks to the time during which trusts operate and distinguishes inter vivos trusts which function during the lifetimes of their creators from testamentary trusts arising from the wills of deceased persons.

Trusts are frequently used in tax planning arrangements including as part of large private groups which can include other trusts, companies, superannuation funds, partnerships and individuals (see chapter 3). Group members can be residents or non-residents of Australia.

According to the ATO, there were approximately 823,448 trusts in Australia in 2015. The numbers of trusts have increased by almost 700% from 1990 to 2014. Most trusts are discretionary trusts and fixed unit trusts. Figure 1 shows the total number of trusts from 1990 to 2014 compared to companies, while Figure 2 reports the total number of trusts by trust types.

7 There are other classifications of trust types: see Ford & Lee: The Law of Trusts (looseleaf and online) 4th edn, Sydney: Thomson Reuters, 2010-) at [1.230]-1.250]. Trusts are termed “express”, “constructive” or “implied” –depending on how they come into existence – and inter vivos or testamentary, depending on when they are effective.
As shown in Figure 1, trusts have grown in popularity over time. For comparison and context, the graph also shows the growth in company numbers over the same period. It is interesting to note that while there are more companies than trusts, the growth rate of trusts is similar to that of companies. It is also important to note that while the regulation and legislation governing companies has dramatically changed since 1990, trusts remain largely unregulated.

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8 It is important to appreciate that trust use across industries varies considerably. The Rental, Hiring and Real Estate sector represents nearly 17% of the known population. Conversely Agriculture, Forestry and Fishing represent less than 4% of the known trust population.
As shown in Figure 2, 73.2% of trusts in Australia are discretionary trusts that are engaged in either trading or investment activities. The large number of trading trusts (261,752 or 32.6%) highlights the unusual role of the Australian trust as a vehicle for business entities. No other country is comparable. Trusts in other jurisdictions (excluding New Zealand) are primarily used in the administration of wills and deceased estates, provision for incapable persons and the endowment of charities. The combined business and investment context of Australian trusts and the prevalence of the discretionary trust form presents challenges for the fair and efficient administration the tax system, as discussed in the next section.
Figure 3 Number of trusts per industry

<table>
<thead>
<tr>
<th>Industry</th>
<th>Number of Trusts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other</td>
<td>229,710</td>
</tr>
<tr>
<td>Rental, Hiring and Real Estate Services</td>
<td>134,081</td>
</tr>
<tr>
<td>Financial and Insurance Services</td>
<td>108,728</td>
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<tr>
<td>Construction</td>
<td>68,642</td>
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<tr>
<td>Professional, Scientific and Technical Services</td>
<td>56,920</td>
</tr>
<tr>
<td>Retail Trade</td>
<td>32,020</td>
</tr>
<tr>
<td>Agriculture, Forestry and Fishing</td>
<td>11,022</td>
</tr>
<tr>
<td>Accommodation and Food Services</td>
<td>124,388</td>
</tr>
<tr>
<td>Health Care and Social Assistance</td>
<td>22,091</td>
</tr>
<tr>
<td>Other Services</td>
<td>18,459</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>16,480</td>
</tr>
<tr>
<td>Administrative and Support Services</td>
<td>16,396</td>
</tr>
<tr>
<td>Transport, Postal and Warehousing</td>
<td>15,555</td>
</tr>
<tr>
<td>Wholesale Trade</td>
<td>13,911</td>
</tr>
<tr>
<td>Arts and Recreation Services</td>
<td>4,541</td>
</tr>
<tr>
<td>Education and Training</td>
<td>4,017</td>
</tr>
<tr>
<td>Information Media and Telecommunications</td>
<td>2,517</td>
</tr>
<tr>
<td>Electricity, Gas, Water and Waste Services</td>
<td>1,289</td>
</tr>
<tr>
<td>Public Administration and Safety</td>
<td>1,230</td>
</tr>
<tr>
<td>Mining</td>
<td>1,093</td>
</tr>
</tbody>
</table>

Note: The horizontal axis is in logarithm scale.

Of the industries that used trusts in 2014 in Figure 3, the Rental, Hiring and Real Estate Services sector had the largest number of trusts, accounting for almost 17% of total number of trusts. Interestingly, when disaggregating these trusts in terms of their size, it is notable that 99% of Australian trusts (approximately 798,277 trusts) are small and micro size. Only 1% of trusts are sized medium to large size (Figure 4).
Figure 4 Number of trusts by size

Note: The horizontal axis is in logarithmic scale.

Figure 5 presents the total trust income per industry in 2014. It is observable that the Financial and Insurance Services industry reported the most trust income at approximately $100 billion while the Public Administration and Safety sector is the smallest with total income reported at $800 million. The graph demonstrates that trusts are widely used in the Australian economy, across most of the major industry sectors (this includes discretionary and other trust types).
Figure 5: Reported income of the trust estate ($ million) per industry

Income of the trust estate $

Financial and Insurance Services
Rental, Hiring and Real Estate Services
OTHER
Construction
Professional, Scientific and Technical Services
Health Care and Social Assistance
Retail Trade
Agriculture, Forestry and Fishing
Manufacturing
Accommodation and Food Services
Wholesale Trade
Administrative and Support Services
Transport, Postal and Warehousing
Other Services
Electricity, Gas, Water and Waste Services
Education and Training
Mining
Arts and Recreation Services
Information Media and Telecommunications
Public Administration and Safety

88,007
33,621
19,531
7,916
5,789
3,745
3,169
2,528
2,383
1,864
1,529
1,279
1,670
1,357
1,004
420
324
297
167
124

1
10
100
1000
10000
100000

Note: The horizontal axis is in logarithm scale.

These figures demonstrate the importance and prevalence of trusts throughout the economy. Significantly, trusts are used in Australia as a trading vehicle and most trusts are discretionary. This report is primarily concerned with discretionary trusts, especially those used by high net-worth individuals and wealthy Australians in private groups.
1.2 CHALLENGES AND RISKS IN THE CURRENT SYSTEM OF TAXATION OF TRUSTS

The Trusts Taskforce was initiated due to concerns about the misuse of trusts. Recent cases investigated by the ATO suggest that there are three key risk factors. The risk factors provide the context for this report and suggest a need to investigate whether the current system is functioning effectively and efficiently. Risks described in this section have the potential to undermine community confidence in the system, together with revenue implications, particularly in cases where trusts are used in aggressive tax planning. Three key risks are as follows.

1. Uncertainty in calculating distributable income:

The current provisions in Division 6 of Part III of the ITAA 36 allow for the trust deed to be the primary determinant of what constitutes distributable income — or income under ‘trust law’ principles. Trust-creators and/or trustees determine a trust’s distributable income, independently of how income of the trusts is calculated for taxation law purposes. Taxpayers, in this way, control an important element of a trust’s tax liability. The ability of trustees (where permitted by the trust deed) to determine what constitutes a trust’s taxable income is a primary risk of the current regime and if fully exploited by the relevant taxpayers could have substantial revenue implications (see section 3.3 for a detailed discussion).

2. Separation of economic benefits from tax outcomes:

A consequence of the abovementioned discrepancy between definitions of ‘trust income’ and ‘tax income’ is the separation of economic benefits from the tax outcomes. Tax outcomes under normal circumstances should follow economic benefits. For instance, when an employee earns a salary, he/she receives an economic benefit. Tax outcomes flowing from economic benefit are based on the employee’s overall income and deductions, etc. However, as this report will demonstrate, there are several cases where tax outcomes associated with trusts do not follow economic benefits received in relation to trusts — a mismatch permitted by the structure of the current Division 6 of the ITAA 36.

3. Non-lodgment and complex structures of trusts in private groups

As highlighted in Chapter 5 of this report, there are practical difficulties involved in identifying the population of trusts that should lodge tax returns. This is primarily the case due to the features of trusts, particularly discretionary trusts outlined earlier. Trusts, jurisprudentially, are not considered to be entities and are not required to be registered, or file annual returns of income and assets or profit and loss accounts.
Entitlements of beneficiaries of discretionary trusts need not be determined until the end of a tax year. The existence of a trust itself need not be disclosed in years when no net income is derived by the trustee. This level of opacity causes several administrative challenges and has the potential to undermine community confidence in the current system for taxing trusts. Additionally, trusts and companies are often used by private groups in complex structures that involve entities in Australia and overseas. This results in cases where it is very difficult for the ATO to trace where income goes within these structures, let alone follow the economic benefits and tax outcomes. The ability to create complex structures with trusts is a risk to the effective functioning of the current system of taxation of trusts and this report deals with this issue in detail in Chapter 4 of the report.

In summary, the current system of taxation of trusts may be failing to function in an optimal manner as it allows for several unforeseen outcomes to eventuate. This report evaluates the current system and points out where it results in outcomes that are not ideal. While this report was not commissioned to provide recommendations for reforming the current system, the analysis provided in this report should serve to inform the ATO about the effectiveness and efficiency of the current system.

1.3 OUTLINE OF THE REPORT

The structure of the report is as follows:

Chapter 2 provides a general introduction to the current trusts taxation regime, which may be useful for non-experts in the area.

Chapter 3 focuses on the issues that arise specifically from Division 6 of Part III ITAA1936. In particular, this chapter provides an in-depth analysis of how income mismatches result in situations where the tax burden does not follow the economic benefits. This chapter also provides some forecasts in relation to revenue that may be at risk if income mismatch schemes were used more broadly by the public.

Chapter 4 covers issues arising from complex distribution patterns used by taxpayers who utilize trusts, particularly in private groups. The nature of complex distribution arrangements poses several problems for the efficient and effective administration of the law.

Chapter 5 examines the problems arising from non-lodgment of tax returns by trusts and difficulties in accurately identifying the population of trusts in Australia. Both Chapters 4 and 5 highlight the need for greater transparency in relation to trusts and their tax affairs.

Chapter 6 examines Australia’s international obligations under the CRS, FATF and FACTA. These recent commitments have implications for the trusts and disclosure regarding beneficial ownership and reporting requirements.
Chapter 7 provides a comparison of the taxation of trusts across comparable jurisdictions including the United States of America, United Kingdom, New Zealand and Canada. This chapter serves to highlight the unique use and nature of trusts in Australia when compared with other jurisdictions. While there is no perfect solution to the issues surrounding taxation of trusts, lessons may be learnt from the treatment of trusts in these jurisdictions.

Chapter 8 provides an in-depth legal analysis of the issues surrounding accountants and other non-legal advisers providing advice in relation to trusts.

Chapter 9 presents the qualitative work undertaken for this project. Interviews conducted with advisers from both the accounting and legal professions provide insights into taxpayers’ perceptions and use of the current taxation of trusts regime. The findings from this data provide the context within which the broader legal and technical issues analysed in this report can be framed.

Chapter 10 draws together the findings of this report and presents the conclusions. We show how the analysis in the preceding chapters points toward several risks that, if left unchecked, could negatively impact on community confidence and potentially lead to greater problems in the administration of Australia’s taxation system in relation to trusts.

The details of the statistical work undertaken for this report, as well as our assumptions and methodological issues, are presented in the Appendices.
2 OVERVIEW OF TRUSTS AND TAXATION

A trust is a relationship of a fiduciary nature concerning property. Trusts law imposes duties on the property's title-holder or controller which require that person to deal with the property for the benefit of others or a limited class of purposes in a particular way. Persons subject to these obligations are called “trustees”. Acts or neglect on the part of trustees contrary to the terms of the trust are known as “breaches of trust”. Persons to whom the obligations are owed are called “beneficiaries” (or cestui que trust), of whom the trustee may be one.

Trusts can be classified according to the type of interest that the beneficiary enjoys. A fixed trust is one where each beneficiary has an ascertained interest in the trust property. Unit trusts are traditionally a species of fixed trust. Beneficial entitlements under unit trusts are divided into units, which may constitute a proportional interest in the trust fund.

Non-fixed or “discretionary” trusts do not confer on the beneficiaries an entitlement to the trust fund until trustee exercises their dispositive discretions. Ownership interests are created when discretionary trustees “appoint” trust property (including income) to eligible persons. Property appointed may be distributed to beneficiaries. Alternatively, property appointed may be retained by discretionary trustees. "Unpaid present entitlements" are appointed property which trustees do not distribute to beneficiaries entitled. Property retained by trustees is held on new fixed trusts for the persons to whom appointments are made.

Consequently, one cannot own or be “presently entitled” to property which remains subject to a discretionary trust. There must be an appointment of the discretionary trust property to create an ownership interest. When appointments occur, the appointed property leaves the trust.

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12 The “unpaid present entitlement” recorded in the books of the trust: see Re Baron Vestey's Settlement: Lloyds Bank v O'Meara [1951] 1 Ch 209 at 224 per Jenkinson J; and further discussion below.
2.1 Taxation of Trustees and Beneficiaries

Trusts in Australia are not taxed at entity level. Tax liabilities flow through trusts to either the beneficiaries or the trustees. “Taxation of trusts” is a misnomer.

Division 6 of Part III of the ITAA36 together with Subdivisions 115-C and 207B of the ITAA97 are designed to ensure that income derived by or through a trust in any given year is taxable in that year either to the beneficiaries or to the trustee. Subdivisions 115-C and 207B are applicable to capital gains and franked dividends comprised in the net incomes of trusts.

Division 6 is the primary source of income tax liability for trustees.\(^\text{13}\)

Division 6 defines the primary tax liabilities of beneficiaries. First, the taxable “net income” of a “trust estate” is established on the basis that the trustee is an ordinary resident taxpayer. Secondly, beneficiaries who are not under any “legal disability” and are “presently entitled” to a share of the income of the trust estate have the same share of the trust’s taxable “net income” included in their assessable incomes. Additional beneficiary tax liabilities arise from specific provisions of the ITAA36 and the *Income Tax Assessment Act 1997 (ITAA97)*. Trustee tax liabilities under Division 6 occur when:

1. a beneficiary who is presently entitled to a share of the income of a trust estate is “under a legal disability” (i.e., not of full legal capacity) — liability for tax on that beneficiary’s share of net income is imposed on the trustee at an appropriate individual rate — ITAA36 s98;\(^\text{14}\)
2. some or all of the net income of the trust estate is attributable to “income to which no beneficiary is presently entitled” and is not assessed to any one else (excepting foreign source income to which a non-resident beneficiary is entitled) — liability for tax on that net income is imposed on the trustee at the highest marginal rate — ITAA36 s99A;
3. net income of the trust estate is “income to which no beneficiary is presently entitled” and is derived by a trustee administering a will or intestacy (no will), bankruptcy, injury compensation or relief of various sorts — liability is imposed at individual rates without the benefit of a tax-free threshold pursuant to ITAA36 s99 if ss-s99A(2) and (3) are applicable;\(^\text{15}\)

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\(^{13}\) See ITAA36 s96; *Union Fidelity Trustee Co v FCT* (1969) 119 CLR 177 at 181 per Barwick CJ; *Traknew Holdings Pty Ltd v FCT* (1991) 21 ATR 1478 at 1491 per Hill J.

\(^{14}\) If the beneficiary under a legal disability is a beneficiary of more than one trust estate or derives income from any other source, ITAA36 s-s100(1) assesses the beneficiary personally subject to a credit under s-s100(2) for any tax paid or payable by a trustee in respect of that beneficiary’s interest in the net income of the trust estate.

\(^{15}\) See *Income Tax Rates Act 1986* Schedule 10, Part II, clause 2.
4. A beneficiary who is presently entitled to a share of the income of a trust estate is a “non-resident” at the end of a year of income — liability is computed at individual rates (not subject to deductions) for share of net income which is attributable to the beneficiary’s period of residency or is derived from Australian sources — ITAA36 s-s98(4) and (5); and,

5. A person has created a revocable trust of income or a trust of income applicable for the benefit of his or her minor children — liability for the trustee is computed at a rate which assumes that the income was added to that derived by the trust creator — ITAA s102.

### 2.2 Present Entitlement

Trust beneficiaries are assessed on shares of the net income of trusts that equal the proportion of their (equitable) present entitlement to trust income: s-s97(1).

For example, over a given period, a beneficiary might be entitled to one-half of the income of a family discretionary trust. Trusts law would direct the trustee to pay the beneficiary half of the relevant income appearing in the trust’s books of account. The beneficiary is presently entitled to a one-half proportion of the trust income. The s-s97(1) formula uses the same proportion to compute that beneficiary’s liability for the taxable “net income” of the trust estate.

A transposition occurs. Present entitlement defined in trusts law terms measures tax law liabilities. Note that beneficiaries are not taxed on income to which they are presently entitled. They are taxed on (a proportion of) a trust’s net taxable income computed with reference to beneficiaries’ present entitlement to the distributable income of a trust.

As originally conceived, present entitlement was part of an elegant scheme which blended trusts law entitlements with tax liabilities. Whether and to what extent trusts law would treat beneficiaries as entitled to a trust’s income becomes the determinant of tax liability for that income. Equitable learning computes tax law liabilities. For many years, however, the original scheme of Division 6 has been complicated by provisions designed to counter tax avoidance and regulate the foreign residence of trustees and beneficiaries.

Present entitlement is given an extended meaning so as to include the status of a person who receives income distributions from a discretionary trust. Persons who benefit from the exercise of a trustee’s discretion to pay or apply the income of a discretionary trust are deemed by ITAA36 s101 to be presently entitled to amounts paid or applied for their benefit. Beneficiaries remain presently entitled after a discretionary distribution until the end of each tax year. “Pay”, in
“pay or apply”, is a reference to a trustee handing over or transferring money or its equivalent. For the trustee to “apply” income for a beneficiary’s benefit, neither possession nor control of the income need pass from the trustee. For instance, the beneficiary might be a child and trust income is applied by payment of the child’s school fees. Alternatively, a trustee can apply income for a beneficiary’s benefit by crediting the amount to the beneficiary’s account in the books of the trust. The last possibility is significant and will be discussed under the next heading.

2.3 UNPAID PRESENT ENTITLEMENTS

Disparity between the tax rates of beneficiaries provides tax arbitrage opportunities. Much of the popularity of the trust as a business and investment vehicle is associated with income-splitting between beneficiaries and the practice of trusts retaining distributed income (subject to meeting beneficiaries’ tax liabilities). Beneficiaries who might be subject to the top marginal tax rate may pay tax at a rate equal to that applicable to corporations. A common use of unpaid present entitlements exploits the arbitrage between individual and corporate tax rates. A trustee, for example, resolves to make a closely held company presently entitled to an amount of trust income. Instead of paying the company, the trustee credits the income appointed to company’s account in the books of the trust. The trustee then lends an equivalent amount to a trust beneficiary who is a shareholder (or associate of a shareholder) of the company. In these circumstances, ITAA36 Division 7A sub-division EA deems the amount loaned to the beneficiary to be a dividend (unfrankable) to have been paid by the company.16

2.4 LOSS OF PRESENT ENTITLEMENT

Where a beneficiary who is not under a legal disability is presently entitled to a share of the income of a trust estate pursuant to a (broadly defined) “reimbursement agreement”, ITAA36 s100A applies to treat the beneficiary as not being presently entitled for tax purposes.17 Section 100A applies automatically and imposes tax on the trustee at section 99A rates.18

18 See the example in Taxpayer Alert TA 2008/15.
3 INCOME TAX SHUFFLE

In this chapter we introduce the first area of investigation – Division 6 income mismatching — which we also refer to as “income tax shuffles”. The first part of this chapter defines and then examines various manifestations of income tax shuffles, including indicators that income tax shuffle activity may be occurring. This is followed by analysis of case investigations carried out by the ATO which serve to illustrate the ease with which taxpayers can enact income tax shuffles. This is followed by quantitative analysis of de-identified ATO data, which reveals patterns in taxpayer behaviour in relation to income tax shuffles and a scenario analysis which estimates potential tax sheltered from income tax shuffle activity.

3.1 DEFINING THE MISMATCH

Division 6 mismatches affect the way in which Australia taxes the beneficiaries of trusts. The ITAA36 formula for taxing a trust’s net income makes a beneficiary liable for tax on a trust’s taxable income in the same proportion as the beneficiary is entitled to the trust’s income under trusts law. A beneficiary entitled, say, to 100% of a trust’s income of $100 under trust law is liable for 100% of the tax on its tax law income of $100. The trust law income part of the formula can be manipulated. Trustees sometimes reduce a trust’s trust law income to a very small dollar amount. For example, the trust’s trust law income may now be only $2. The beneficiary who is entitled to 100% of the trust’s $2 income under trusts law remains under a liability to pay the tax on 100% of its tax law income of $100. A significant disequilibrium is introduced. Large tax law income liabilities may be attributed to beneficiaries who are entitled only to small or negligible amounts of trust law income. Displacement of normal beneficiary liability for tax on a trust’s net income creates arbitrage and tax avoidance opportunities. The case investigations presented in section 3.3 show some of the avenues through which taxpayers have exploited this arbitrage opportunity.

There are usually three steps in an income tax shuffle.

- First, a difference arises naturally or is created between a trust’s distributable income and its net income.\(^{19}\) The trustee might exercise a discretion provided in the trust deed to

\(^{19}\) By “distributable” income we are referring to the income to which is distributable according to trusts law. Section 97 of the ITAA36 describes this as “Income of the trust estate” to which beneficiaries may be made presently entitled. See *FCT v Bamford* (2010) 240 CLR 481 at [17] and [40]-[41] discussed below.
exclude some income or capital gains amounts from trust income which is distributable to beneficiaries. Alternatively, the deed itself may define distributable income in a way that differs from tax law income referred to in the *Income Tax Assessment Acts*.

- Secondly, trust income is distributed to beneficiaries who pay tax on their share of net income, thereby discharging the beneficiaries’ liability to pay tax on the year’s net taxable income of the trust.  

- Thirdly, amounts excluded or withheld in the first step are distributed tax-free to other beneficiaries or accumulated.

Income tax shuffles exploit tax arbitrage opportunities comparable to those associated with unpaid present entitlements and present entitlements arising from reimbursement agreements. However, unpaid present entitlements are not a necessary feature of the device. The trust income amounts to which beneficiaries become entitled are often paid to them. Amounts are usually small. Distributed income and whatever tax is paid on the distributed income are transaction costs.

Income tax shuffles differ from distribution “washing” under ITAA36 s100A. Reimbursement agreements which trigger s100A are not needed to perform an income tax shuffle. The distributed income need only be nominal. After deduction of this amount, any tax paid by a tax-preferred beneficiary on the trust's net income and a washing fee, income tax shuffle beneficiaries can enjoy the tax-free benefit of a trust’s undistributed assets.

Not all Division 6 mismatches are contrived and amount to income tax shuffles. Naturally occurring mismatches between distributable income and net income are possible. For example, Division 40 (ITAA1997) depreciation deductions reduce net (taxable) income, but are excluded when calculating the quantum of income for trust law purposes. Depreciation is unknown to trust law. Similarly, Part 3.1 Capital Gains (ITAA97) increase tax law income, but are not normally included in the calculation of trust law’s distributable income. Capital gains are not normally due to income beneficiaries in trust law. There are a number of other incongruences. Depending on the nature of a trust’s receipts and its activities, the Division 6 taxation formula will sometimes apply unevenly in the absence of tax avoidance activity.  

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20 By “net taxable income” we refer to what s-s95(1) of the *Income Tax Assessment Act 1936 (ITAA36)* defines as “the total assessable income of the trust estate calculated under this Act as if the trustee were a taxpayer in respect of that income less all allowable deductions . . . .” Net taxable income is the assessable income upon which the trust’s tax liability is computed.

21 Division 6 mismatches cannot occur in cases where trust deeds define distributable trust income to equal the trust’s taxable net income defined in ITAA36 s-s95(1). Depreciation deductions, capital gains and other tax-law amounts will then be included in the calculation of the trust’s distributable amount. Known as “income equalisation clauses”, provisions which equate tax law
3.1.1 **EXCLUSION OF INCOME (AND/OR CAPITAL GAINS AMOUNTS) FROM DISTRIBUTABLE INCOME TO WHICH A BENEFICIARY CAN BECOME PRESENTLY ENTITLED**

Exclusion of some trust income from distributable income is an important part of the income tax shuffle. Manipulation of the ITAA36 s97 present entitlement formula through mismatching of trusts’ trusts law and tax law incomes is an essential step. Either the trust creator drafting the trust deed, or a trustee exercising a power of amendment or income re-determination excludes an amount reflected in the trust’s net taxable income from the trust’s distributable income.22

A smaller, perhaps nominal, amount of income is distributed by the trust pursuant to the original or an amended/re-determined definition of income in the trust deed. All or a proportion of the smaller or nominal income is distributed to a tax-preferred beneficiary. That beneficiary then becomes liable to pay tax on the same proportion of the trust’s net taxable income. Because trusts law income is significantly smaller than tax law income, the trustee retains a substantial amount upon which tax has been paid and can be distributed without further tax consequences.

The Court in *Bamford* at [39] stated that the expression “presently entitled to a share of the income” in ITAA36 s-s97(1) “directs attention to the processes in trust administration by which the share is identified and entitlement established.” Earlier, the Court had noted that trusts law distinguished capital gains from the income of a trust estate by way of “presumptions which would yield to provision made in the trust instrument.”23 Two propositions may follow from this. One, there is no trusts law definition of the “income of the trust estate” which overrides the terms of individual trust deeds.24 Two, trust deed creators (or amenders) have almost unrestricted

and trusts law incomes will avoid difficulties which can arise if a trust has taxable income, but no distributable trust law income.


23 At [17], citing *Jacobs Law of Trusts in Australia* 7th edn (2006) at p 485 [1952].

24 Recognised by Philip Bender in “Taxation of trust income following *Bamford*” (2000) 44 *Taxation in Australia* 87 at 89.
liberty to exclude items from the deed’s definition of distributable income.\textsuperscript{25} New manipulation of the present entitlement formula has been the result.\textsuperscript{26}

It is commonly regarded that taxpayers use considerable ingenuity in finding reasons why distributable (trusts law) income should differ from trusts’ (tax law) net income. The presence of mismatch justifications may be an important sign that Division 6 manipulation has occurred. The defensibility of mismatch justifications is a matter for the tax authority.

3.2 INCOME TAX SHUFFLE INDICIA

In order to examine the occurrence of Division 6 mismatches, the research team has identified a number of indicators pointing to the fact that an income tax shuffle or contrived mismatch has occurred. These indicia were based on the case studies/investigations provided by the ATO with regard to recent cases as well as the research team’s expertise in this area.

It is important to note that the “indicia” identified below are just that – indicators. They do not necessarily prove the existence of an income tax shuffle. Several indicia may be present in a given case. The indicia isolate key features of the income tax shuffle phenomenon and the key indicators were used in the quantitative analysis undertaken for this chapter.

Differences between distributable and taxable income and the role of capital gains:

- Trusts which have a smaller amount of distributable income than net (taxable) income\textsuperscript{27} This indicium is found in all Division 6 mismatches involving income tax shuffle activity.

- Trusts which make large capital gains

\textsuperscript{25} See AH Slater “Taxing trust income after Bamford’s case” (2011) 40 AT Rev 69 at 84, noting the High Court’s acceptance that the “income” of a trust means what the trust deed says it means. Mr Slater adds at 86 that the power to amend a deed’s “income” definition does not extend to the inclusion of some statutory net income amounts (conversely to Bamford shuffle facts) and to the introduction of changes to the rights of beneficiary classes — referring to Forrest v FCT [2010] FCAFC 6 at [27] and Clark v Inglis [2010] NSWCA 144. Similar deed-dependent “income” and “distribution” definitions apply in some jurisdictions where trusts are taxed as entities: see Alex Evans “The ‘economic benefits model’ for trusts — fool’s gold?” (2014) 43 AT Rev 162 at 182.

\textsuperscript{26} For an early warning about Bamford shuffle tax avoidance: see Terry Murphy SC “Bamford v Federal Commissioner of Taxation” (2010) 44 Taxation in Australia 649 at 657.

\textsuperscript{27} ATO What attracts our attention p 18
Income tax shuffles are often motivated by the size of potential income tax liabilities which result from the making of large capital gains.\textsuperscript{28}

Distributions to beneficiaries where further tax liabilities are extinguished:

- Where distributions to company beneficiaries are accompanied with franking credits which extinguish the liability arising from the distributions. A trust could appoint franked dividends to a company with the result that associated franking credits equal the tax liability arising from the net income associated with the distribution. In this way tax liabilities can be capped at the corporate tax rate.

- Where distributions are made to beneficiaries in a loss position\textsuperscript{29} Beneficiaries in a loss position (individuals, partners, companies) may have the ability to offset their losses against their share of net income\textsuperscript{30}

- Distributions to (corporate) beneficiaries with carry-forward tax losses\textsuperscript{31} Carry-forward losses can be offset against liabilities flowing from trust distributions.

Distributions to insolvent or tax-preferred entities:

- Where distributions are made to beneficiaries with minimal assets and/or insufficient assets to meet tax liabilities arising from distributions\textsuperscript{32} i.e., where a beneficiary has accrued losses to offset against the liability to pay tax on the net taxable income of a trust.

- Where a newly incorporated company is made presently entitled to a trust distribution\textsuperscript{33}

\textsuperscript{28} This motive is unrelated to the mischaracterisation of income receipts as capital gains to access the 50 per cent discount: see Taxpayer Alert TA 2014/1, discussed in Michael Blissenden “The income-capital distinction and how it applies to property development” (2014) 49 Taxation in Australia 258.

\textsuperscript{29} ATO What attracts our attention p 18; PS LA 2010/1, Example 1.

\textsuperscript{30} Claire Malone in “A matter of trusts” (2010) 45 Taxation in Australia 49 at 49 stated that the “ability to selectively stream income and capital clearly has significant tax planning advantages. For example, a beneficiary’s own capital losses are applied against the beneficiary’s share of a trust’s capital gain.”

\textsuperscript{31} Comment was made by an ATO official. ATO briefing 22.8.16.

\textsuperscript{32} ATO What attracts our attention p 18
Newly incorporated companies may be acquired for low-cost liquidation and have no assets or other capacity to pay tax on their share of net income.

- Where distributions are made to beneficiaries who or which are tax exempt entities\(^{34}\), e.g., a charity
- Distributions made to companies in liquidation. Companies with tax losses are often liquidated after use of their tax concessional status.
- Where distributions are made to non-resident beneficiaries. Non-residence is an easily acquired tax concessional status. Withholding tax payable by trustees when dividend, interest and royalty income is paid to non-residents beneficiaries is a final tax at 10% and 30% rates (subject to double tax treaties).

As the above list indicates, trust income shuffles take several forms with the common requirement of a mismatch between a trust’s distributable income and net income. The following three key issues were investigated in the chapter’s quantitative analysis and findings about trust income shuffles.

### 3.3 CASE STUDIES – ATO INVESTIGATIONS

In this section, five case studies of investigations conducted by the ATO are discussed. These cases serve to illustrate that:

- Trusts allow taxpayers to exercise an extraordinary degree of flexibility with regard to the allocation of trusts’ tax liabilities.
- Variation of the amount of distributable (or trust) income in the formula for taxing beneficiaries in ITAA36 Division 6 enables taxpayers to control the incidence of tax on trust income.
- Companies are (and can easily be) used by taxpayers in private groups to cap tax liabilities at the corporate rate.
- Tax and economic outcomes for trusts, beneficiaries and companies in private groups may be severely discrepant at the egregious end of the tax avoidance spectrum.

\(^{33}\) ATO *What attracts our attention* p 18

\(^{34}\) ATO *What attracts our attention* p 18; PS LA 2010/1, Example 2. After 2011, these facts are subject to ITAA36 ss100AA and 100AB.
- Income tax shuffles exploiting Division 6 ITAA 1936 income mismatches can result in significant revenue leakage.

- There is substantial range of behaviours when it comes to taxpayers engaging in schemes to minimise/avoid taxation.

**Case 1**

**Amount of mismatch:** $40m  
**Potential tax leakage:** $18.6m  
**Years:** 2010 to 2013

**Case summary:**

Trust A, Trust B and Company C are part of a closely held private group controlled by a wealthy resident individual.

Prior to 30 June 2010, the assets of Trust A and Trust B consisted of $40 million of net receivables (debts) owing by other trusts within the same private group. The debts were not in distress. On 30 June 2010, Trust A and Trust B forgave the $40 million debts owed to these trusts. Trust A and Trust B accounted for the debt forgiveness in the books of the trusts as a $40 million expense.

The debtor trusts accounted for the debt forgiveness in the books of the trust as $40 million in income. The income was both distributed to natural persons and retained in other entities associated with the wealthy individual who controls the group. The forgiven debt does not give rise to assessable income associated with the accounting income (i.e. no income according to tax principles). Hence no amounts were included in the assessable incomes of the natural persons who benefited from the $40 million. Tax-free wealth extraction occurred. The $40 million amount included in distributable income has no tax liability associated with it according to tax law.

In each of the 2011, 2012 and 2013 income years, $40 million of net income was distributed to Trust A and Trust B in order to absorb the $40 million accounting expenses of these trusts made in 2010.

Given there is no deduction associated with the trust accounting expense in the books of Trust A and Trust B, there is a total $40 million mismatch between the distributable income and net income of the trusts in the 2011, 2012 and 2013 years. In each of these years, the net (taxable) income is $40 million and the distributable (trust) income is a "token" amount chosen by the trustee.
Note that one of the trusts used its power to determine the character of its income to ensure that there was a token amount of distributable income in each year to avoid section 99A.

The token amount of distributable income was appointed to Company C. While the assessable income of Company C includes a total $40 million in the 2011, 2012 and 2013 income years, it has no taxable income due to deducting tax losses in these years. The tax liability attaching to the $40 million is extinguished.

Note: there is another perspective on the inappropriate tax outcome in this case. The facts of this case essentially allow the trusts to access the benefits of the company’s tax losses. The tax losses prevent the trust net income being subject to tax while the economic benefits of that income is ostensibly retained by the trusts.

**Case analysis:**

The non-arm’s length debt which is later forgiven in this case enabled the trust controller to introduce a difference between the distributable and taxable incomes of Trust A and Trust B. Economic outcomes and tax liabilities were separated in the trust income mismatch which followed. Natural persons received a $40 million trust distribution in 2010 and paid no tax on the amount. The company beneficiary which was made presently entitled to the $40 million over the 2011 to 2013 period also paid no tax on the amount — by reason of offsetting tax losses. This case provides a stark picture of what is possible. Income tax shuffles may use the income tax immunities of other parties with maximal efficiency.
Case 2

Amount of mismatch: $50m
Potential tax leakage: $23.25m
Years: 2012-2013

Case summary:

Trust A, Company B and Company C are members of the same closely held private group.

In the 2012 income year, Company B makes a $50 million payment to Trust A in respect of the shareholding of Trust A in Company B. This causes Trust A to make a $50 million capital gain.

The net income of Trust A is $51 million in the 2012 income year, being comprised of the $50 million net capital gain and $1 million other income.

The distributable income of Trust A is $1 million and is determined using ordinary trusts-law concepts which exclude capital gains from income amounts. Accordingly, the $50 million capital gain relates to a capital receipt of Trust A.

On 30 June 2012, Trust A apportions the $1 million distributable income to the beneficiary Company C. While the assessable income of Company C includes the $51 million net income of Trust A, the taxable income of Company C is nil due to deductions it claimed for tax losses.

In the 2013 income year, Trust A distributes the $50 million capital receipts to natural persons and other trusts in a tax-free form.

Note: the tax liability of Company C which results from the inclusion of $51 million net income in its assessable income is offset by Company C’s tax losses. Entities that effectively receive the tax benefit of the $51 million tax losses deducted by Company C are the natural persons and trusts who receive the $50 million tax-free distribution in 2013.
Case analysis:

The tax liability on a $50 million capital gain is attributed to a company with accumulated tax losses which does not enjoy the economic advantage which the gain represents. Trust A is able to create an income mismatch and liability transfer by using a definition of trust income according to ordinary concepts. The ATO accepts this definition. No tax avoidance is implied by what Trust A did. The concept of ordinary income defined in s 6-5 of ITAA 1997 does not include capital gains. Capital gains are assessable as statutory income under Division 100 of ITAA 1997. Company C is presently entitled to $1m in distributable income and has to bear the tax liability associated with $51m in assessable net income subject to the offset of $51 million in tax losses. This case is an example of the separation of tax and economic outcomes through manipulation of the current structure of Division 6 of ITAA 1936 and the allocation of trusts' tax liabilities to parties with tax immunities (tax losses).
Case 3

Amount of mismatch: $479m
Potential tax leakage: $116m
Year: 2015

Case summary:

Trust A, Company B and Company C are members of the same closely held private group. Trust A is the sole shareholder of Company B. Company B and Company C are beneficiaries of Trust A.

Company B sells its business and consequently makes a considerable capital gain on which it pays tax.

Following the sale of business, Company B is liquidated. A $479 million liquidation dividend is paid by Company B to its shareholder Trust A.

The net (tax law) income of Trust A for the 2015 income year is $684 million, made up of $479 million assessable under section 47 of the ITAA 1936 and franking credits of $205 million.

The distributable (trusts law) income of Trust A is a negligible amount. According to ordinary concepts, the $479 million liquidation dividend in the hands of Trust A is a capital receipt. Only a token amount of distributable income is appointed by Trust A to its beneficiary Company C. No other distribution is made.

Trust A's distribution to Company C carries with it a liability on the part of Company C to pay tax on Trust A's $684 million net (tax law) income.

Despite having a taxable income of $684 million, no tax is payable by Company C. The tax liability of $205 million on Company C's taxable income of $684 million is equal to the franking credits included in the net income of Trust A.

To date, Trust A has made no distributions sourced from the $479 liquidation dividend. The distributions, when made, will be tax-free in the hands of Trust A's beneficiaries.
Case analysis:

Tax liabilities of the group are capped at the corporate tax rate. The only tax paid by the group is paid at the outset when Company B makes a capital gain. The gain is transferred to Trust A as a liquidation dividend which includes a franking credit equal to the tax which Company B paid. Trust A calculates its distributable income under ordinary concepts, which excludes capital gains amounts. Economic outcomes and tax outcomes are separated at this stage. Only a token amount of distributable income is appointed by Trust A to Company C. However, the effect of Company C becoming presently entitled to the token distributable income amount is that Company C is liable to pay tax on Trust A’s taxable net income of $689 million. The liability that Company C is liable to pay tax on Trust A’s net (taxable) income of $684 million. Company C can rely on franking credits flowing from Company B’s payment of tax which equal the tax liability of Company C on a capital gain successively fed to Trust A and Company C. No further tax is paid. An undistributed amount of $479m is retained by Trust A. This is tax-free amount which Trust A could distribute to beneficiaries who or which are natural persons or other trusts.
**Case 4**

**Amount of mismatch:** $130m across 14 trusts  
**Potential tax leakage:** $55m  
**Years:** 2014-2015

**Case summary:**

Trust A, Trust B, Company C and Company D are members of the same closely held private group.

Trust A is the primary income producing entity in the group with Company C typically made entitled to the distributable income of Trust A. The shares in Company C are held by Trust B. As at 1 July 2014, there are $21 million in unpaid entitlements owed by Trust A to Company C which are subject to loan agreements that comply with Division 7A. Trust A has reinvested into its own business the money that Company C is entitled to.

In the 2015 income year, Company C initially pays an initial $7,000 fully franked dividend to Trust B and a subsequent $20,993,000 fully franked dividend to buyback 99% of the shares in Company C held by Trust B.

Immediately prior to the share buyback occurring, the definition of distributable income is changed in the trust deed of Trust B. Under the original definition, distributable income was equated to net income under section 95 of the ITAA 1936. Under the amended definition, distributable income is worked out using ordinary concepts. Accordingly, the distributable income of Trust B is $7,000, being the initial dividend paid by Company B. The dividend received under the share buyback is a capital receipt under ordinary concepts.

The net income of Trust B in the 2015 income year is $30 million. This amount consists of dividends totalling $21 million and franking credits totalling $9 million. The $7,000 distributable income of Trust B is appointed to Company D.

Company D’s assessable income includes $30 million as a consequence of it being entitled to the $7,000 distributable income of Trust B. As the $30 million includes $9 million franking credits, Company D is not required to pay any tax since the franking credits equals its tax liability.

The case is ongoing and the ATO is in the process of establishing how the $20,993,000 capital receipt of Trust B is being accounted for.

Note: the ATO is currently investigating 13 other private groups that share the same tax agent and have engaged in similar schemes.

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*This is an independent report commissioned by the Australian Tax Office. Interpretations and opinions expressed should be ascribed to the authors only.*
Case analysis:

As in Case 3, Case 4 also involves franking credits being used to cap tax at the corporate rate as well as an income tax shuffle. It is not uncommon for trusts to have unpaid present entitlements (UPE). In this case the existence of a UPE has been dealt with by the trusts in this group passing on the UPE amount through a company (Company C), then trust (Trust B), to another company (Company D). The purpose of splitting the $21m into a $7000 dividend and $20,993,000 capital receipt is to create a situation where Trust B (by amending the trust deed) could create an income mismatch and follow through with an income tax shuffle. The last part of the scheme involves using franking credits to limit tax to the corporate tax rate, and results in Company D not paying any further tax on its entitlement from Trust B. This case also illustrates the centrality of the trust deed and the extent to which it is malleable to meet tax planning needs. As with all the cases in this section, the economic outcome is that 20,993,000 is now a tax free amount which may be dealt with by Trust B, while the tax burden of this scheme rests with Company D, which eventually pays no further taxes due to the franking credits.
Case 5

Amount of mismatch: range of $5.3m to $30m
Potential tax leakage: range of $825,000 to $7m
Years: 2012-2015

Case summary:

Trust A and Company B are members of the same closely held private group.

Trust A carries on business activities and has a significant real property asset portfolio. The distributable income of Trust A is worked out using accounting concepts. In 2012, the distributable income of Trust A was negatively affected as a result of the trust writing down the value of one of its real properties in recognising unrealised losses.

In 2014 and 2015, the distributable income of Trust A was positively affected as a result of the accounting income including large unrealised capital gains of real property held in the Trust. These accounting treatments caused distributable income to be significantly different to the taxable net income of the trust.

The following table sets out the distributable income and net income of Trust A for the various years, and provides details of the beneficiary that was made entitled to the distributable income.

<table>
<thead>
<tr>
<th>Year</th>
<th>Net income</th>
<th>Accounting profit</th>
<th>Beneficiary</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$9.5 million</td>
<td>$2 million</td>
<td>Private company</td>
</tr>
<tr>
<td>2013</td>
<td>$16.1 million</td>
<td>$18.3 million</td>
<td>Private company</td>
</tr>
<tr>
<td>2014</td>
<td>$912,000</td>
<td>$13 million</td>
<td>Natural person</td>
</tr>
<tr>
<td>2015</td>
<td>$58,000</td>
<td>$19.6 million</td>
<td>Natural person</td>
</tr>
</tbody>
</table>

The pattern of distribution illustrates how differences between distributable income and net income may influence whether a company or natural person is made entitled to distributable income. Where distributable income is less than net income (excluding franking credits), this increases the ‘behavioural bias’ of distributing to companies. Where the opposite is true, this increases the ‘behavioural bias’ of distributing to natural persons.

The example also highlights how realised capital losses can be used to exacerbate the differences between distributable income and net income.
Case analysis:

This case points to the ease with which the use of trusts can result in different tax outcomes. The source of the income mismatch in this case was asset revaluation which has no consequences for net income computation. The ability to define income for the purposes of computing distributable income affords taxpayers great flexibility as shown by this case. Noteworthy are the differences in income in 2014 ($12.088m) and 2015 ($19.542) which can essentially be distributed to beneficiaries tax-free following an income tax shuffle. The dysfunctionality of the proportionate approach is also illustrated by this case where the type of beneficiary is chosen based on the difference between income definitions. Also note that in the latter two years, the natural person beneficiary might receive for example: a distribution of $19.6m and yet have their tax liability calculated on $58000 (2015). This case and the others presented in this section also highlight the numerous ways in which an income mismatch can be created and followed through with an income tax shuffle.

3.3.1 LINKING THE CASE STUDIES TO THE QUANTITATIVE ANALYSIS

The cases presented above demonstrate the ease with which an income tax shuffle can be enacted and economic benefits and tax outcome separated. The main pre-requisite for any of these schemes is the existence of an income mismatch. This is therefore the first question that is addressed in the quantitative analysis presented in the next section. More specifically, the quantitative analysis attempts to uncover whether income mismatches (natural occurring or artificially contrived) are commonplace in the dataset, as well as examining the range of mismatches and the association with capital gains.

The use of franking credits to limit tax paid to the corporate tax rate was present in several cases presented in this section. This is an important way in which taxpayers, particularly those on the top marginal tax rate can reduce their tax liabilities. The quantitative analysis therefore sought to examine whether distributions from trusts to companies are accompanied with franking credits equal to the tax liability on the distributable income the company beneficiary receives.
As illustrated in the cases presented in this section, another common method of limiting the tax paid is to distribute trusts income to companies that have current or prior year losses which absorb the tax liabilities from trusts distributions. The qualitative data examines this issue across the dataset to examine whether distributions to loss-making company beneficiaries are preferred over distributions to break-even or profitable companies.

3.4 QUANTIFYING INCOME TAX SHUFFLES AND DIVISION 6 MISMATCHES

This section is concerned with the extent to which trusts may have been used to avoid tax, particularly to limit the rate of tax paid to the corporate tax rate. Quantitative investigation focused on the following three issues:

1. What is the magnitude of the differences between distributable income and net income of trusts and what role do capital gains/losses play?

2. Do companies receiving distributions from trusts also become entitled to franking credits equal to the companies' tax liability on their shares of trusts' net income?

3. Are liabilities to pay tax on trusts' net income directed to company beneficiaries who do not have the financial capacity to fulfil those liabilities? (i.e., current loss-making, carry forward loss-making and bucket companies)

In summary, our investigation of those three areas reveals:

1. There is evidence of Division 6 income mismatches and the association of mismatches with capital gains. The association between capital gains made in the relevant year and the differences between distributable income and net income of trusts vary across each group type (HWI, Potential High Wealth Individuals (PHWI), Wealthy Australians and Others).35

2. Trusts distribute company dividends to company beneficiaries together with franking credits which limits the tax payable on the trust distribution to an effective rate of 30%; and

3. Current loss making and carry forward loss company beneficiaries are used to limit tax liabilities associated with trust distributions.

35 At time of data analysis, the following acronyms were in use - HWI: High Net Wealth Individuals; PHWI: Potential High Wealth Individuals. However, the ATO has recently changed its classification system and now combines these two categories into one. For the purposes of this report the former method of classification is retained.
In particular, our investigation shows that the magnitude of the income mismatch is significant. At least 25 per cent of trusts show a mismatch in excess of $10,000. This increases to amounts in excess of $10 million. Further, we demonstrate that as the mismatch increases so does the capital gain amount. A substantial number of beneficiaries defined as “HWIs” and “Wealthy Australians” in 2012 record comparatively smaller negative income differentials. From 2013 onwards this imbalance disappears and the size and number of negative income differentials follows a similar pattern to positive income differentials.

Our analysis shows interesting patterns in relation to franking credits associated with trust distributions with the potential for effective tax rates to be capped at the corporate tax rate. Particularly there appears to be a significant proportion of the data set where the franking credits are 30% of the trust net income to which the company beneficiary is made presently entitled. The use of bucket companies appears to be less prevalent and these companies receive on average a smaller share of total distributions.

Finally, we also found that on average trusts distribute a larger proportion of their income to loss making company beneficiaries. Specifically, we estimate loss making company beneficiaries receive 20% of total trust distributions compared with 14% for profit making company beneficiaries. Loss-making companies, on average, receive 22.05% of trust total distributions while non-loss-making companies receive only 14.37%.

In the next section we provide details of how the above conclusions were reached, particularly in relation to the three key questions under investigation.

3.4.1 Detailed Investigation of Three Trust Income Shuffle Indicators

The following comparisons investigate the potential existence and scale of the indicators of Income Tax shuffles. These indicators are the necessary pre-conditions which may give rise to an Income Tax shuffle arrangement. In essence any such schemes seek to manipulate the present entitlement formula as described in the previous section. The analysis in this section does not claim to uncover the existence of income tax shuffle or tax avoidance. Tax avoidance through the use of trusts, particularly those involving income tax shuffles may require tax audits and detailed case by case investigation. Hence, the conclusions in this section point to the possibility for income tax shuffles in the trust population by examining if the underlying preconditions for income tax shuffles exist. There are, however, many different permutations and combinations of factors which point to the existence of income tax shuffle arrangement. In the analysis carried out in this report, the focus is on three fundamentally important indicators as outlined in the previous section. The importance of each of these indicators is briefly explained next.
Key Indicator 1: Differences in trusts law and tax law interpretations of income, and, association with capital gains

Income mismatches can occur naturally or be contrived. The concept of an income mismatch was explained above in section 3.1. We do not distinguish between “natural” and contrived income mismatches as the data does not allow for this segregation. Given that the existence of a Division 6 mismatch is an indispensable feature of income tax shuffles, the following questions are investigated:

Q1: What is the magnitude of the differences between distributable income and net income of trusts?

As the differences between distributable income and net income might be significantly related to capital gains made in the same year by the trust, we also investigate:

Q1a: Are the differences between distributable income and net income of the trust associated with capital gains made in the relevant year?

The magnitude of the differences between distributable income and net income of the trust might also vary for each group type (i.e., High Wealth Individual (HWI), Potential High Wealth Individual (PHWI), Wealthy Australians and Others). As a result, a question is:

Q1b: What is the magnitude of the differences between distributable income and net income of trusts for each group type?

Finally, the analysis also includes consideration of any association between capital gains made in the relevant year and the difference between distributable income and net income of the trust for each group type. The question is therefore:

Q1c: What is the association between capital gains made in the relevant year and the differences between distributable income and net income of the trust for each group type?

Key Indicator 2: Using franking credits to reduce tax payable by company beneficiaries

The second of the income tax shuffle indicators looks at the distribution of trusts’ dividend income to companies together with franking credits sufficient to absorb the companies’ tax liabilities. The result is capping the tax liability on the distribution at the rate of 30 cents in the dollar.
When combined with income tax shuffles, company beneficiaries may be made presently entitled to a small amount, but large proportion, of trusts’ distributable income and then paid that entitlement. The entitlement carries with it a liability to pay tax on a corresponding share of the net income of the trust. In this section we specifically investigate the degree to which distributions to company beneficiaries are accompanied by franking credits that effectively extinguish the tax liability that arises from that beneficiary’s share of net income of the trust. We therefore explore:

**Q2: Do companies receiving distributions from trusts also receive franking credits equal to their tax liability on the trust income?**

**Key Indicator 3: Trust distributions to company beneficiaries with current or prior-year losses**

The third scenario involves entities which have no or insufficient financial capacity becoming presently entitled to all or most of the distributable income of a trust. In such cases, the beneficiary (assuming that net income of the trust is greater than distributable income) who also receives the tax liability associated with the distribution either has current or prior years losses. The result is that no or little tax is paid on the distribution. As noted in 3.2 above, the beneficiary company may or may not receive the amounts to which they are made presently entitled, but is able to discharge its tax liability for the trust distribution through carry forward or current year income losses. In such cases, we ask two questions.

**Q3a: Do trusts distribute the tax liabilities associated with trust income to loss-making company beneficiaries which have current year income losses?**

**Q3b: Do trusts distribute the tax liabilities associated with trust income to loss-making company beneficiaries which have carry forward income losses?**

Trusts might also distribute the tax liabilities associated with trust income to “bucket” company beneficiaries who have no economic activity aside from receipt of trust income distribution. These bucket companies are established to cap the tax rate on the trust’s income to the flat company rate of 30%. We therefore explore:

**Q3c: Do trusts distribute the tax liabilities associated with trust income to bucket company beneficiaries?**

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36 Failure to pay the amounts to which a company beneficiary is made presently entitled may constitute a Division 7A (ITAA36) loan, see PS LA 2010/4.
3.4.2 DATA AND METHODOLOGY

Details of the data used for this investigation and the methodology employed are shown in Appendix B. In summary, two datasets used for this report were provided to the research team by the ATO. The first contained information on trusts and beneficiaries using the ATO’s Division 6 risk classification rules while the second contained only the top 20% of income mismatches which was then used only for the scenario analysis in Section 3.5. In total, the number of unique trusts used in this analysis was 17,529 and the number of companies was 20,515. The final sample covered 23.51% of the initial sample’s observations, after removing duplicates.

3.4.3 EMPIRICAL ANALYSIS AND RESULTS

To examine the indicators of possible income tax shuffle activity, a number of variables were selected. Their descriptive statistics are presented in Table 1. We find that all variables exhibit a large range with both significant positive and negative extreme values. Surprisingly, the average net income of trusts is less than those trusts’ distributable income, resulting in a negative difference in income reported (as reflected in Figure 7a below). There are also small numbers of the company-year observations for franked distributions and franking credits in the companies as beneficiaries’ tax returns (being only 2.9% of the total number of observations).
<table>
<thead>
<tr>
<th>Variables</th>
<th>Label</th>
<th>Entity-Year Obs.</th>
<th>Mean</th>
<th>St. Dev.</th>
<th>Min</th>
<th>Pctl(25)</th>
<th>Median</th>
<th>Pctl(75)</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trust Total Income</td>
<td>N/A</td>
<td>73,385</td>
<td>791,805</td>
<td>5,721,917</td>
<td>-244,338,231</td>
<td>5,080</td>
<td>78,932</td>
<td>363,889</td>
<td>332,865,309</td>
</tr>
<tr>
<td>Net income of the Trust</td>
<td>28</td>
<td>78,837</td>
<td>770,444</td>
<td>6,086,314</td>
<td>-244,338,231</td>
<td>0</td>
<td>53,142</td>
<td>311,617</td>
<td>735,883,671</td>
</tr>
<tr>
<td>Capital gains</td>
<td>21A</td>
<td>13,997</td>
<td>653,374</td>
<td>6,108,262</td>
<td>0</td>
<td>0</td>
<td>5,693</td>
<td>111,074</td>
<td>511,616,168</td>
</tr>
<tr>
<td>Distributable Income</td>
<td>53A</td>
<td>48,833</td>
<td>873,279</td>
<td>8,079,708</td>
<td>0</td>
<td>0</td>
<td>34,539</td>
<td>276,933</td>
<td>1,115,226,887</td>
</tr>
<tr>
<td>Distributed income</td>
<td>54W</td>
<td>35,562</td>
<td>1,118,623</td>
<td>6,621,714</td>
<td>0</td>
<td>17,892</td>
<td>108,165</td>
<td>484,445</td>
<td>462,117,761</td>
</tr>
<tr>
<td>Franked Distributions</td>
<td>54U</td>
<td>1,271</td>
<td>187,598</td>
<td>1,391,452</td>
<td>0</td>
<td>490</td>
<td>6,352</td>
<td>39,716</td>
<td>23,590,100</td>
</tr>
<tr>
<td>Franking Credits</td>
<td>54D</td>
<td>1,867</td>
<td>52,311</td>
<td>37,5766</td>
<td>0</td>
<td>117</td>
<td>1,519</td>
<td>11,817</td>
<td>7,077,030</td>
</tr>
<tr>
<td>Company Tax Return</td>
<td>7T</td>
<td>47,421</td>
<td>2,511,342</td>
<td>111,293,495</td>
<td>-363,229,847</td>
<td>-386</td>
<td>555</td>
<td>231,056</td>
<td>8,673,609,240</td>
</tr>
<tr>
<td>Company distributions received from trusts</td>
<td>6E</td>
<td>10,840</td>
<td>2,965,068</td>
<td>70,557,883</td>
<td>0</td>
<td>19,026</td>
<td>176,821</td>
<td>693,355</td>
<td>4,183,613,505</td>
</tr>
<tr>
<td>Difference between Label 26 and 53A</td>
<td>N/A</td>
<td>48,833</td>
<td>-34,854</td>
<td>4,163,814</td>
<td>-379,343,216</td>
<td>-440</td>
<td>0</td>
<td>20,560</td>
<td>217,398,111</td>
</tr>
<tr>
<td>Total Income Declared</td>
<td>N/A</td>
<td>1,177</td>
<td>253,923</td>
<td>1,879,608</td>
<td>0</td>
<td>1,281</td>
<td>11,134</td>
<td>58,106</td>
<td>30,667,130</td>
</tr>
<tr>
<td>Proportion Franked Income</td>
<td>N/A</td>
<td>1,168</td>
<td>0.255</td>
<td>0.079</td>
<td>0</td>
<td>0.231</td>
<td>0.231</td>
<td>0.251</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: Prepared by RMIT University using ATO data
**Numbers of beneficiaries from each client type**

The majority of client types are Trusts (42.908%) and Individuals (33.286%).

<table>
<thead>
<tr>
<th>Client Type</th>
<th>Data Label</th>
<th>Percent</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-</td>
<td>6.310%</td>
<td>33.554</td>
</tr>
<tr>
<td>Company</td>
<td>C</td>
<td>11.992%</td>
<td>63,768</td>
</tr>
<tr>
<td>Government</td>
<td>G</td>
<td>0.002%</td>
<td>10</td>
</tr>
<tr>
<td>Individual</td>
<td>I</td>
<td>33.486%</td>
<td>178,060</td>
</tr>
<tr>
<td>Partnership</td>
<td>P</td>
<td>0.120%</td>
<td>637</td>
</tr>
<tr>
<td>Self-Managed Super Fund</td>
<td>S</td>
<td>5.182%</td>
<td>27,553</td>
</tr>
<tr>
<td>Trust</td>
<td>T</td>
<td>42.908%</td>
<td>228,159</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>-</strong></td>
<td><strong>100%</strong></td>
<td><strong>531,741</strong></td>
</tr>
</tbody>
</table>

Source: Prepared by RMIT University using ATO data

**Key indicator 1 (Q1): Income of the trust estate (53A) vs Taxable income (26)**

As mentioned earlier, the possible existence of income tax shuffle activity occurs when there is an income mismatch between distributable income (i.e. trusts law income Label 53A) in the trust tax return and Label 26 which refers to net income of the trust (i.e. tax law income). The box-plot is a way of graphically depicting data through quartiles (four equal groups, each group comprising a quarter of the data). The right and left sides of the box represent the first and third quartiles (respectively, the observation that splits off the lowest 25% of data from the highest 75% and the observation that splits off the highest 25% of data from the lowest 75%). The band inside the box is the second quartile (the median or middle value). The data exhibit extraordinary range and are characterised by positive and negative extreme values. For the scales of this and other plots, an inverse hyperbolic sine transformation is used to display the full breath of the data in question. Hence, careful attention should be paid to these scales when interpreting figures.

Only 22.36% of entries for Tax Law Income (Label 26) and 14.26% of entries for Trusts Law Income (Label 53A) are non-missing and available for analysis. Those values present in both labels are then matched and Label 53A is subtracted from Label 26 for each trust in each year to calculate 48,833 values which accounts for 14.26% of total sample. The variation and range of each of these variables as well as Label 21A are depicted by box-and-whisker plots in Figure 6.
Within given income years (from 2012-2015), the difference in trusts law (distributable income) and tax law income (net income) exhibited large variability with a minimum value of -$379,343,216 and maximum value of $217,398,111. However, 50% of the values lay within the narrow range of -$4,895 to $9,985 and include 52,288 incidences of $0. If we quantify the difference between distributable income and net income of the trust in terms of the extent of difference between the two labels (53A and 26), there is clear evidence that there are a significant proportion of trusts where such a difference exists.

**Key indicator 1 (Q1a): Association between income mismatch and capital gains**

To better understand the income mismatch between trust law income and tax law income and the role of capital gains, the difference in Trusts Law and Tax Law Income reported is graphed in a scatter plot against the Trust Net Capital Gains (Label 21A) presented in Figure 7a, while the same variables are graphed by year and with the $0 observations removed in Figure 7b.
Figure 7a Difference in Income Reported and Capital Gains

Source: Prepared by RMIT University using ATO data.
Note: extreme values are not pictured.

Figure 7b Difference in Income Reported and Capital Gains by Year with $0 observations removed

Source: Prepared by RMIT University using ATO data.
Figures 7a and 7b demonstrate that the relationship between Capital Gains and Difference in Income Reported is not altogether straightforward. Figures 7a and 7b show that when the difference between net income of the trust and distributable income is positive (i.e. net income > distributable income) increasing differences are associated with increasing capital gains. This provides strong evidence to support the assertion that the income mismatch is closely associated with capital gains made by the trust. 37 This indicates that there is a strong incentive to engage in an income tax shuffle by excluding capital gains/losses from the definition of income of the trust estate (i.e. distributable income), and potentially following through with the second and third steps as outlined in Section 3.2.

The perplexing result is that as the difference between net income of the trust and distributable income becomes negative (i.e. tax income < trust income), this is still associated with increasing capital gains. This can occur where amounts recognised as deductions/expenses under tax law (i.e. for net income), but not recognised by trusts law (i.e. for distributable income) are prevalent. For instance, Division 40 capital allowances and Division 43 capital works deductions are recognised as deductions for the purposes of calculating net income, but not typically included in distributable income. It may also be the case that a negative mismatch (i.e. where distributable income > net income) may reverse in subsequent years, and yet may be associated with capital gains. This is evidenced by the almost symmetrical pattern in Figures 2a and 2b.

**Key indicator 1 (Q1b): Income of the trust estate (53A) vs Taxable income (26) for each individual group**

The magnitude of the differences between distributable income and net income of trusts for each of group type (HWI, PHWI, Wealthy Australians and Others) is shown in Figure 8.

The analysis for Key indicator 1 (Q1) suggests that the difference between the distributable income and net income of trusts is evenly distributed for both negative and positive values. As an additional step, the data was examined to check if this pattern applied to different group types when taken individually. Box-plots for each of the pre-classified beneficiary groups in the dataset; HWI, PHWI, “Wealthy Australian” and “Other” are presented in Figure 3. The key observed difference is that beneficiaries associated with the “Other” category appear to report more positive income differentials than other beneficiary groups.

---

37 Please note: the data shows association, there is no claim of causation. That is, the data does not show whether or not capital gains cause the income mismatch.
The association between capital gains made in the relevant year and the differences between distributable income and net income of the trust for each of the group type (HWI, PHWI, Wealthy Australians and Others) was also analysed. Graphing box-plots for the different beneficiary classifications over the years 2012-2015 in Figure 9 also reveals several interesting patterns.

- The positive-bias in the “Other” group is retained, but occurs most strongly in 2012, with the proportion of beneficiaries reporting a positive income difference declining through to 2015.
- A substantial number of beneficiaries for both HWI and “Wealthy Australian” in 2012 record comparatively smaller negative income differentials, with this imbalance disappearing from 2013 onwards such that the size and number of negative income differentials follows a similar pattern to positive income differentials.

In both cases this is likely to be the effect of Label 53a “distributable income” being introduced into trust tax returns in 2012.
Analysis was also carried out to examine the relationship between the income mismatch and capital gains for each of the taxpayer groups. In general, they exhibit a pattern that is similar to that which is shown in Figure 7a and 7b. Scatter plots for each of the taxpayer groups in aggregate and by year are shown in Appendix 1.

**Key Indicator 2: Using franking credits to reduce tax payable by company beneficiaries**

Another possible indicator of the existence of income tax shuffle activity is where a trust makes a distribution to a company beneficiary as well as passing on franking credits that equal the tax liability on the distributions from a trust. Essentially such an arrangement caps the tax rate at 30% for wealth accumulation. Figure 10 presents the boxplots of the relevant variables and Figure 11a and 11b present the density plot for “Proportion Franked Income” in aggregate and by taxpayer group respectively. Here, total net income is the total primary net income (Label...
54A) and the total non-primary net income (Label 54B). The density plot of the proportion is characterised by a large spike at 30% suggesting that companies receiving distributions from trusts also receive franking credits equal to their tax liability on the trust income. The purpose of the analysis in this section is to uncover whether there is wide-spread use of companies in structures such that the tax liability on trust net income is limited to the corporate tax rate.

Figure 10 Box and Whisker Plots for Franked Distribution and Franking Credits

Source: Prepared by RMIT University based on ATO data

This is an independent report commissioned by the Australian Tax Office. Interpretations and opinions expressed should be ascribed to the authors only.
Figure 11a Proportion Franked Income

Source: Prepared by RMIT University based on ATO data.

Figure 11a shows that when the franking credits are divided by the franked distributions made from a trust to a company beneficiary, there are two points that the data clusters. At 30% there is a large spike, indicating that in many cases the franking credits to which a company is made entitled are 30% of the trust distribution. We have confirmed with a high degree of certainty that companies receiving distributions from trusts also receive franking credits equally to their tax liability on the net income. This provides evidence to suggest that use of franking credits to offset the company’s tax liability associated with trust distributions is occurring, hence allowing wealth to be accumulated at 30 cents in the dollar as opposed to 47 cents in the dollar if the income was taxed in the hands of individual taxpayers, or if the amount was accumulated and the trustee pays tax at the top marginal tax rate.

The data presented above also clearly illustrates that the use of companies in private groups is widespread. Use of companies to reduce tax on wealth accumulation to the corporate tax rate is the simplest form of tax minimisation and does not involve contravention of tax laws. However, the relative ease with which effective tax rates can be capped at the corporate tax rate using trusts and companies points to a serious deficiency within the current structure of Division 6.

Subsequently, the dataset was analysed to reveal which taxpayer groups were prevalent in terms of the Figure 11b. The graph below shows that wealthy Australians and the ‘other’ category of taxpayers show the most significant trend of attaching franking credits to trust distributions at 30%.
Figure 11b Proportion Franked Income by Income Group

Source: Prepared by RMIT University based on ATO data

From the preceding analysis we can conclude that there is clear evidence that certain taxpayer groups, namely Wealthy Australians and the “Other” group are utilising companies to limit tax paid on trust net income to 30%. The presence of the patterns we have identified in this section indicates the possibility that companies are being used in private groups to cap tax at 30%.

The implications of this finding grow in significance when seen in light of how such an arrangement could be combined with income tax shuffle mismatch arrangements. For instance, a company could be made presently entitled to all, or a large share, of distributable income — albeit a small amount — as a consequence of an artificially contrived income mismatch. The company then receives franking credits associated with the distribution and a tax liability that equals the franking credits. The trust actually pays the company the amounts to which the company is presently entitled to avoid Division 7A ITAA36 consequences. The balance of the difference between distributable income and net income of the trust is later distributed as a tax-free amount to other beneficiaries whose marginal tax rates exceed the 30% rate of tax paid on the original trust net income distribution.
**Key Indicator 3 (Q3a): Trust distributions to loss company beneficiaries (current year)**

We investigate the phenomenon of trust distributions with associated tax liabilities being made to loss-making or break-even company beneficiaries which do not pay any further tax on the distributed amounts. The data used for this analysis was the data on trusts and beneficiaries identified using the Division 6 risk classification rules. Further details of the process undertaken for this analysis is in Appendix B under the heading “Trust distributions to loss company beneficiaries”. The results for these companies are graphed in a histogram for comparison in Figure 12.

**Figure 12: Histogram and Density Proportion of Distributions to Companies**

![Histogram and Density Proportion of Distributions to Companies](image)

Source: Prepared by RMIT University using ATO data

In Figure 12, the curves show the density of the proportion of trust's distribution to a company. The first graph is for loss-making companies while the second represents profitable or break-even companies. Roughly, this equates to the percentage of how often these proportions are observed in the data. The red dotted line in Figure 12 represents the average proportion for a given company type. The graphs indicate that while, in general, most trusts distribute a small proportion of trust income to companies, this value is higher when trusts distribute to a loss-making companies. On average, loss-making companies will receive 20.1% of trust total distributions while break-even or profit companies will receive only 14.4%. Further, as per Table 3, the percentage of loss-making companies that receive total trust distributions is consistently higher for total trust distribution proportions over 0.25 with the highest difference observed for proportions over 0.75 (5% for break-even or profit companies versus 7.6% for loss-making companies).
Data presented in this section alone does not directly indicate that income tax style mismatches are occurring. However, the data shows that a significant number of trusts are utilising loss-making companies as beneficiaries to which to distribute trust income. Income tax shuffle activity of the following type may be occurring. Trustee in year 1 appoint all or substantially all trust income to selected company beneficiaries which have tax losses. The appointments either become “unpaid present entitlements” in the books of the trusts, or, if paid, are very small in amount. Tax losses possessed by company beneficiaries to whom the appointments are made extinguish tax liabilities attributed to those companies for all or substantially all of that year’s trust income. In year 2, the unappointed trust income from year 1 is distributed tax-free to other beneficiaries.

A useful extension of this analysis would be to detect whether there is widespread occurrence of distributions being made to companies that do not have financial capacity or are wound up soon after the distribution (i.e. present entitlement) is made. However, the data we were provided with did not facilitate this analysis.

| Table 3 Percentage Incidence of Trust Distributions to Companies by Size of Proportion |  |
|---|---|---|
| Proportion | Loss | Profit or Breakeven |
| 0.25 or more | 29.7% | 19.3% |
| 0.50 or more | 11.4% | 10.8% |
| 0.75 or more | 7.6% | 5.0% |

Source: Prepared by RMIT University using ATO data

**Key Indicator 3 (Q3b): Trust distributions to carry forward loss company beneficiaries**

In Figure 13 the curves present the density of the proportion of trust’s distribution to a company. Roughly this equates to the percentage of how often these proportions are observed in the data. The red dotted line represents the average proportion for a given company type. The graph indicates that while in general most trusts distribute a small proportion of trust income to companies, this value is higher to a loss-making company with losses carried forward compared to a non-loss-making company without losses carried forward. On average, a loss-making company will receive 22.05% of trust total distributions while a non-loss-making company will receive only 14.37%. Further, as per Table 4, the proportion of companies that receive total trust distributions is consistently higher for companies with carry forward losses and this difference is more evident when a higher proportion of total distributions are received. This is in line with the argument that trusts are more likely to distribute tax liabilities associated with trust income to loss-making company beneficiaries who have carry forward income losses.
Figure 13: Density of Proportion of Trust Distributions to Companies, Companies with Losses Carried Forward vs Companies with No Losses Carried Forward

Comparative Density of Proportion of Distribution to Companies

Source: Prepared by RMIT University using ATO data

Table 4: Percentage incidence of Trust Distributions to Companies by Size of Proportion

<table>
<thead>
<tr>
<th>Proportion</th>
<th>No Losses Carried Forward</th>
<th>Losses Carried Forward</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.25 or more</td>
<td>18.5%</td>
<td>29.8%</td>
</tr>
<tr>
<td>0.50 or more</td>
<td>11.3%</td>
<td>17.4%</td>
</tr>
<tr>
<td>0.75 or more</td>
<td>5.1%</td>
<td>8.6%</td>
</tr>
</tbody>
</table>

Source: Prepared by RMIT University using ATO data
**Key Indicator 3 (Q3c): The use of ‘bucket companies’**

Additional analysis was undertaken to investigate whether trusts distribute trust income to companies with no economic activity aside from receipt of trust distribution. Companies where information from Label 6E: Company distributions received from trusts equals information from Label 7T: Company Tax Return were identified as “Bucket Companies”.

In Figure 14, the box and whisker plots show the density of the proportion of trust’s distribution to a company. Roughly this amounts to the percentage expression of how often these proportions are observed in the data. The red dotted line represents the average proportion for a given company type.

**Figure 14 Box and Whisker Plots for Franked Distribution and Franking Credits**

![Box and Whisker Plots](image)

Source: Prepared by RMIT University based on ATO data
The graph indicates that while in general most trusts distribute a small proportion of trust income to both types of companies, this value is higher when the trust distribution is to a “non-bucket-company”. On average, a bucket company will receive 12.39% of total trust distributions while other companies will receive 19.69%. However, unlike previous analysis, we only observe 59 bucket companies, too few to draw reliable conclusions. Table 5 shows that the use of bucket companies does not appear to be prevalent and these companies receive a smaller share of total distributions on average.

<table>
<thead>
<tr>
<th>Proportion</th>
<th>Non Bucket Company</th>
<th>Bucket Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.25 or more</td>
<td>26.3%</td>
<td>18.6%</td>
</tr>
<tr>
<td>0.50 or more</td>
<td>15.6%</td>
<td>8.5%</td>
</tr>
<tr>
<td>0.75 or more</td>
<td>7.6%</td>
<td>1.7%</td>
</tr>
</tbody>
</table>

Source: Prepared by RMIT University using ATO data
3.5 Estimating Tax Revenue Sheltered - Scenario Analysis

In order to gauge the impact of various scenarios of the prevalence of income tax shuffles, we conducted a bootstrap resampling exercise to investigate the extent of tax revenue being sheltered through the use of trusts. In the absence of direct identification of income tax shuffles, we assessed the tax revenue sheltered by setting a series of scenarios for the prevalence and the rate of revenue reduction due to income tax shuffles among the largest income mismatches. RMIT was provided with the top 20% of income mismatches between trust income and tax income. From this data, it was not possible to directly examine the income tax sheltered and the resultant tax and economic outcomes. Such analysis would necessitate the identification of an income tax shuffle; following the subsequent distributions to various beneficiaries; and lastly calculating the tax consequences for the beneficiaries taking into account all the other tax affairs of each beneficiary. As previously discussed in section 3.2.1 such detailed analysis would be best undertaken on a case by case basis and would most likely necessitate a tax audit. Hence the analysis in this section focuses on the first step in the process, i.e. an income tax shuffle and makes estimates of income being sheltered from tax as described below.

Examining data on income mismatches (where net income > distributable income) as an indicator of potential income tax shuffles, we consider the following scenario parameters for the top 5%, 10% and 20% of the largest income mismatches:

- **Prevalence**: Acknowledging that not every income mismatch involves an income tax shuffle, we set three levels of income tax shuffle prevalence of 25% (1 income tax shuffle in every 4 income mismatches), 50% (1 in 2) and 75% (3 in 4). We assume that for each group (top 5, 10, and 20% of income mismatches) only 25%, 50% or 75% of the cases involve an income tax shuffle. For instance, the most conservative estimate of tax avoidance is where only 25% of the top 5% of cases employ the income tax shuffle, and the least conservative is when 75% of the top 20% engage in tax avoidance behaviours. It is important to note that these are our assumptions about the prevalence of income tax shuffles and is required in order to generate estimates of the range of tax revenue sheltered. Our most conservative estimates are therefore far more likely to represent the current state of affairs, whereas our least conservative estimates are less likely.

- **Tax revenue sheltered scenario analysis**: We explore a particular tax revenue shelter case when the tax avoided is 17% which is the difference between the top marginal rate and the company tax rate. The 17% rate reflects efforts by taxpayers to avoid the top marginal rate and allows them to accumulate wealth at 30 in the dollar. This also represents the least egregious arrangements where the intent of the taxpayers is not to avoid tax but minimise it. It is important to interpret this tax rate and the prevalence rates (see previous bullet point) as an attempt to generate a range of estimates for tax sheltered. Decision-makers can then use this analysis as a basis for assessing the probability of these scenarios playing out across the trust population as whole and the consequences for tax collection.

This is an independent report commissioned by the Australian Tax Office. Interpretations and opinions expressed should be ascribed to the authors only.
The procedure to calculate tax revenue sheltered is as follows:

- We start by taking the top 5%, 10% and 20% of income mismatch cases (where net income > distributable income) as separate subsamples on which to base analysis.

- For each of these subsamples (i.e. 5%, 10% and 20% largest mismatches), we assume that the level of tax avoided is 17%. This is done by randomly choosing trusts from a given subsample to be ‘flagged’ as an income tax shuffle case in line with the hypothesized prevalence rate of a given scenario. For example, for a prevalence scenario of 50%, half of all trusts in a subsample are flagged as income tax shuffle. The total income tax shuffle related income mismatch is calculated from those flagged. Since the selection as income tax shuffle or not is a random outcome, the size of the total income mismatches may differ each time this procedure is repeated. To account for this we repeat the sampling procedure 1000 times to create a distribution of possible outcomes. The prevalence scenario is then applied to each of the three income mismatch subsamples (top 5%, 10% and 20% of income mismatch cases) to produce three separate distributions of total income mismatch each containing 1,000 simulated outcomes.

- For each of these distributions, we estimate the income sheltered from tax by multiplying the total income mismatch for each of the simulated outcomes by the scenario when the tax avoided is 17%.

- To account for uncertainty in estimating tax revenue sheltered for each of these scenario outcomes, we present the range of losses that is likely with 95% certainty for each scenario by reporting the revenue loss at the 5th and 95th percentile. This analysis was repeated separately for the years 2013, 2014, 2015. Probability density graphs showing the various simulations are presented in Appendix 1.

The tables below show the results of our analysis. For example, in Table 6, using data from 2015, the 95% confidence interval for the amount of tax sheltered under a 25% income tax shuffle prevalence and 17% effective tax loss differential among the 10% largest income mismatches is between $1b and $1.2b. At the extreme, this is as high as $3.02b-$3.37b (Table 8: 75% prevalence, 17% effective tax loss among top 20% mismatches in 2013) or as low as $672m-$853m (Table 6: 25% prevalence, 17% effective tax loss among top 5% mismatches in 2015).
<table>
<thead>
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<th>Year</th>
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<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
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<td>Tax rate</td>
<td>5%</td>
<td>10%</td>
<td>20%</td>
</tr>
<tr>
<td>Lower Bound</td>
<td>$828.80</td>
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<td>$1,191.69</td>
</tr>
<tr>
<td>Upper Bound</td>
<td>$1,013.46</td>
<td>$1,190.78</td>
<td>$1,394.10</td>
</tr>
</tbody>
</table>

Source: Prepared by RMIT University using ATO data

<table>
<thead>
<tr>
<th>Year</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
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<tbody>
<tr>
<td>Tax rate</td>
<td>5%</td>
<td>10%</td>
<td>20%</td>
</tr>
<tr>
<td>Lower Bound</td>
<td>$1,690.97</td>
<td>$2,039.06</td>
<td>$2,432.78</td>
</tr>
<tr>
<td>Upper Bound</td>
<td>$1,957.69</td>
<td>$2,313.72</td>
<td>$2,710.34</td>
</tr>
</tbody>
</table>

Source: Prepared by RMIT University using ATO data

<table>
<thead>
<tr>
<th>Year</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax rate</td>
<td>5%</td>
<td>10%</td>
<td>20%</td>
</tr>
<tr>
<td>Lower Bound</td>
<td>$2,568.20</td>
<td>$3,088.69</td>
<td>$3,690.07</td>
</tr>
<tr>
<td>Upper Bound</td>
<td>$2,911.86</td>
<td>$3,428.06</td>
<td>$4,024.68</td>
</tr>
</tbody>
</table>

Source: Prepared by RMIT University using ATO data

This is an independent report commissioned by the Australian Tax Office. Interpretations and opinions expressed should be ascribed to the authors only.
3.6 SUMMARY

In this chapter income tax shuffles were investigated from legal and quantitative perspectives. Income tax shuffle activity involves several features and variants as illustrated by the legal analysis and ATO case studies. The key requirement is that a mismatch exists between net income (income according to tax law principles) and distributable income (income according to trusts law principles). Legal analysis shows that the current form of Division 6 ITAA 1936 has a number of risk/deficiencies which potentially impacts on the effectiveness of the current taxation regime concerning trusts.

The quantitative data analysis examined three key questions related to the indicators of the possible existence of income tax shuffles. Specifically, we examined whether:

- There is evidence of an income mismatch across the dataset and whether this mismatch is associated with capital gains;
- Distributions to company beneficiaries are accompanied by franking credits to limit the tax liability and cap the effective tax rate at 30%; and
- Current and carry forward loss-making company beneficiaries are used to limit tax liabilities associated with trust distributions.

It is important to note that the analysis in this chapter was not designed to uncover the existence of income tax shuffles. This can only be achieved through audit activity. The purpose of the analysis was to highlight the existence of indicators and pre-conditions for broad based exploitation of income tax shuffles. The estimates of “income sheltered from tax” (see section 3.5.) show the various possibilities that may eventuate if income tax shuffles were to become more prevalent given the deficiencies of the current Division 6 ITAA 36. At the most conservative levels the amount of tax sheltered is likely to be between $672m and $1.2bn.

The analysis presented in this chapter shows that there is significant evidence of income mismatches (i.e. mismatch between distributable income and income) particularly in the 75th percentile and above range. The existence of an income mismatch (naturally occurring or artificially contrived) is the most significant pre-condition for income tax shuffles. The average mismatch is negative ($34,654), however this should not lead to the conclusion that on average the mismatch is negative since the standard deviation is very large (over $6 million, see Table 3). Hence we focus on the data in terms of quartiles rather than averages.

Our results also show a correlation between capital gains/losses and the income mismatch. The results present an interesting picture of a relationship which is positive for mismatches where net income > distributable income and vice versa. This perplexing finding requires further investigation. We also find that distributions to company beneficiaries are accompanied by franking credits to limit the tax liability and cap the effective tax rate at 30%.
Finally, in relation to distributions to loss-making companies, we find clear evidence to suggest that trusts distributed a greater proportion of their distributable income to loss-making company beneficiaries, as opposed to company beneficiaries that had break-even or profitable positions. This provides initial indications that loss-making companies when used in groups can be effectively reduce or extinguish tax liabilities arising from trust distributions.

In all cases the key element that facilitates the income tax shuffle is the proportionate view of present entitlements and the associated tax liabilities. Our analysis does not directly examine the effect of the present entitlement system since such data is not reported. However, the analysis does show that the necessary pre-conditions for exploitation of the present entitlement system to create income tax shuffles does exist.

There are certain limitations that need to be considered when interpreting the results.

1. Due to data availability from the ATO, we had only the top 20% for the scenario analysis.
2. We did not trace capital gain distributions and we do not know the proportion of beneficiaries who were specifically entitled to capital gains as this data was not present in our dataset.
3. Due to data limitations on company liquidation, we could not access whether a company making the distribution to the trust was subsequently wound up.
4. For the purpose of the scenario analysis we did not (and could not, using the data) distinguish between naturally occurring mismatches and contrived arrangements. If different thresholds (i.e. assumptions about extent of income tax shuffles) were chosen for the scenario analysis the amount of income sheltered from tax would be different.
4 COMPLEX DISTRIBUTIONS

This chapter examines the notion of complex distributions. There are several issues that arise from the myriad of ways in which trusts can distribute their income (or the entitlement to income); these are broadly referred to as complex distributions for the purpose of this report. The previous chapter outlined the fundamental issues associated with the current design of Division 6 ITAA 1936 and the resultant issues arising in the form of “income tax shuffles”. While the ability to create (naturally or artificially) income mismatches remains at the core of most trust taxation issues, there are several auxiliary issues that also arise including complex distributions and non-lodgment (see Chapter 5 for the latter).

This chapter is structured as follows: first the features and key identifiers of complex distributions are presented. This discussion highlights the difficulties in clearly demarcating a complex distribution arrangement. It also shows the interrelationships between complex distributions and the core Division 6 issues highlighted in Chapter 3. The next section of this chapter presents empirical data showing several levels of distributions made by trusts to other trusts over the period of 2012-15. The chapter concludes with implications of complex distributions for tax administration.

4.1 IDENTIFIERS OF COMPLEX DISTRIBUTIONS

Recurrent identifiers of complex distributions may not exist. Complex trust distributions which lead to the separation of tax outcomes and economic benefits are greatly varied and often ingenious. However, common themes have been identified by analysing ten “Complex Distributions Case Studies” provided to the RMIT University team by the ATO.\(^{38}\)

4.1.1 MULTIPLE TRUST STRUCTURES

Multiple trust structures are the first theme identified in the complex distributions case studies. One example where this type of structure can be exploited is through a chain of trusts whereby a trust distributes to successive trustees. Arrangements such as these make it difficult for the ATO to identify the ultimate beneficiary(ies) to whom tax liabilities should attach. In the Explanatory Memorandum for A New Tax System (Closely Held Trusts) Bill 1999 (Australian

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\(^{38}\) Case studies were headed: “Capital gains and Division 855”, “Foreign source income of trusts”, “Asset revaluation”, “Circular Entitlements”, “Conduit foreign income”, “Corporate loss beneficiary”, “Interest income”, “Exploit mismatches between distributable and taxable income”, “Creation of a mismatch through the use of a share buy-back vs the payment of a dividend” and “Converting trust income into a franked distribution”.

---
Parliament, 1998) (EMCHTA), it was estimated that "60,000 trusts . . . made a distribution to another trust."

In the case study “Circular entitlements”, a trust distribution was made to a trustee beneficiary (TB) that was one of a number of TBs which successively distributed the same income amount. Each TB became presently entitled when the income amount was distributed by the preceding trust.39 Subject to Division 6D, this creates inappropriate tax outcomes in a financial year as no beneficiary can be identified as liable to pay the tax liability for income distributed to beneficiaries and trustees are not liable to tax under section 99A as beneficiaries are presently entitled to all trust income.

4.1.2 QUESTIONABLE PRESENT ENTITLEMENTS

False present entitlements are the second common theme. Tax advantaged third parties (charities, tax exempts, non-resident beneficiaries, loss entities and “bucket companies”) agree with existing trust beneficiaries (or related persons) to become trust beneficiaries and receive trust income distributions. Distributed amounts are then transferred tax-free to the existing trust beneficiaries (or related persons), less expenses. Unlikely distributions of this kind exploit the proportional approach to income distribution under Division 6.

In the case study “Asset revaluation”, a family trust re-valued units held in a unit trust in order to make an advance of capital to a High Net Wealth Individual (HWI) beneficiary. The unit trust funded the arrangement by distributing taxable funds to the family trust, which were in turn distributed by the family trust to a “bucket company”. Only a margin equal to the 30% rate of corporate tax was paid to the bucket company. The HWI received the balance of the amount tax free.40

39 A circulis inextricabilis, or self-perpetuating cycle? There are at least two responses. Joint and several liability for the distribution at the highest marginal rate might be imposed on each TB pursuant to the Taxation (Trustee Beneficiary Non-disclosure Tax) Act 2007 by ITAA36 s-102UM(2). Alternatively, ITAA36 s-s99A(4) could apply to the TBs, given that the relevant part of net income of a trust estate is not included in the assessable income of a beneficiary pursuant to s97. See discussion in Bernard Marks Trusts & Estates: Taxation and Practice 2nd edn (Taxation Institute of Australia, 2009) (Marks Trusts & Estates) at ¶30-105.

40 The ATO response was to allege a “reimbursement agreement” to deny the company’s present entitlement under ITAA36, s100A and assess the trustee to tax on the undistributed amount pursuant to s99A. Though the HWI was a family member, the “agreement” with the bucket company was arguably not an “ordinary family or commercial dealing” of the type excepted in the s100A(13) definition of “agreement”. ITAA36 s109C might also apply, on the hypothesis that the amount transferred to the HWI was a deemed dividend paid him or her by the bucket company.
The case study “Foreign source income of trusts” also involved false present entitlements. Trust distributions of foreign-source income were made but not paid to non-resident (minor) children. Unpaid present entitlement amounts were retained tax-free by an Australian trustee. The “Reimbursement agreement” anti-avoidance rule is inapplicable in this event. ITAA36 s100A(1)(a) is restricted to advantages obtained by “a beneficiary of a trust estate who is not under any legal disability”. Nor is the penal Division 6AA applicable. The correct response could be a straightforward correction of lacunae in ITAA provisions for minors. No mode of distribution problem is suggested.

4.1.3 MISMATCHING OF DISTRIBUTABLE AND TAXABLE INCOME

Mismatching of distributable and taxable income is the third common theme. Referred to as "the income tax shuffle" (covered in detail in Chapter 3) with specific reference to the ITAA36 trusts taxing mechanism, some taxpayers enter transactions intended to separate standard tax and economic outcomes. Tax liabilities for distributed income may be reduced or extinguished when directed to tax-exempt or concessionally taxed taxpayers. In other cases, tax liabilities for distributed income become uncollectable when directed to parties who do not enjoy the benefit of income distributed. There are several ways that this can be achieved.

In Taxpayer Alert TA 2016/12: Distributable income reduction arrangements, Example 1 is a simple illustration of how the proportionate approach to trust taxation can be exploited in trust distributions. In this case, the proportionate approach was used in order to provide tax-free income benefits to individual trust beneficiaries.

The net income of a discretionary trust for 2015-2016 was business income of $1,000,000. Accounting records of the trust show a profit of a similar amount. The trustee determined the distributable income of the trust for the 2015-2016 year to be 30% of the net income of the trust. The trustee cited a power in the deed in support of this determination. The remaining $700,000 was treated as trust capital in the books of the trust.

41 ITAA36 s102AC states that Div 6AA applies to a “prescribed person” defined to include a person less than 18 years of age who is not an “excepted person” defined in s102AC(2) to include a “minor engaged in a full-time occupation” etc. Trustees for minor beneficiaries and not minor beneficiaries themselves are liable for tax under the ITAA36 s98(1), which states that trustees shall be liable to pay tax for minors who are either Australian residents or in receipt of income with an Australian source. Facts of the Case Study are outside s98 and Division 6AA because they involved a non-resident beneficiary who was in receipt of foreign-source income.

42 Subject to ITAA36 ss100AA and 100AB.
The trustee resolved to make a company presently entitled to all of the trust’s distributable income ($300,000). The company’s tax return disclosed all the income of the trust ($1,000,000) as its assessable income. The whole of the company’s trust income entitlement of $300,000 was used to meet this tax liability.

The trust retained the remaining $700,000 that was treated as trust capital and subsequently distributed it in that character to an individual beneficiary. The individual treated the distribution as tax-free in its hands.

Other instances of proportional approach exploitation involve far more complex distributions, for example, the case study headed “Creation of a mismatch through the use of a share buy-back vs the payment of a dividend”.43

### 4.1.4 INCOME RE-CHARACTERISATION ARRANGEMENTS

Income re-characterisation arrangements are evident in a number of complicated transactions which involve trusts. For example, the manipulation of income character to achieve a lower rate of withholding tax payable by a non-resident beneficiary. Tax rates applicable to withholding tax liabilities under ITAA36 s128B vary between 10 and 30 per cent according to the type of income derived, which may be lower than the higher marginal tax rates applicable to individual taxpayers or the corporate tax rate.44 For the purposes of s128B, income distributed by trusts to non-resident beneficiaries is assumed to retain the character which it had when derived by the trusts concerned.

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43 Taxpayers’ misalignment of distributable income and taxable income in the ITAA36 s97 trusts’ taxing mechanism is a challenge for the ATO. Section 99B or Part IVA might be applied to facts of these kinds.

4.2 Closely Held Trusts, Trust Beneficiaries and Trust Beneficiaries
Non-Disclosure Tax

Division 6D of the ITAA36 "Provisions relating to certain closely held trusts" is an anti-avoidance measure as well as an information-collecting mechanism which assists the ATO when auditing distributions made through chains of trusts. The Division potentially applies to nearly all private trusts in Australia which have not made a family trust election. These trusts are known as 'closely held trusts'.

Trustees of closely held trusts which distribute a share of untaxed or tax-preferred income to a trustee beneficiary (TB) are required to provide a "correct TB statement" to the ATO pursuant to s102UT. A correct TB statement must include details of the distribution and address of its recipients. If a correct TB statement is due and not provided, the distributing trustee or members of a trustee group are jointly and severally liable for tax on unpaid income pursuant to the Taxation (Trustee Beneficiary Non-disclosure Tax) Act 2007 (TBNDT) and/or commit an offence to the extent that non-provision of a TB statement relates to tax preferred income. Liability under the TBNDT is imposed at the highest marginal rate and excludes any further taxation on the distribution.

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45 See EMCHTA at [1.92]:

While there are many legitimate reasons for trust structures containing multiple trusts, some taxpayers are using multiple trust arrangements to avoid or indefinitely defer tax.

Division 6D was substantially amended in 2007: See Marks Trusts & Estates at ¶30-100.

46 "Closely held trust" is defined in s-s102UC(1) to include all discretionary trusts and other trusts where 20 or fewer people are entitled to 75% or a greater share of the trust income or capital.

47 Disclosure requirements are set out in ITAA36, s-s102UK(1).

48 Section 102UG provides that, for a resident TB, the trustee must set out the TB's tax file number and the amount of the untaxed or tax preferred distribution. For a non-resident TB, the trustee must set out the TB's name and address and the amount of the untaxed or tax preferred distribution. Section 102UH describes the "TB statement period" or due date for the making of the statement as when the trust's tax return is due.

49 Directors of corporate TBs in a trustee group are personally liable: s-s102UK(3). The "untaxed part" of a trust distribution refers to an amount not included in a TB's income under s97, subject to the specific application of ss99, 99A, 99B and Division 6D. Tax under the TBNT is imposed at the rate of 48.5%: see EMCHTA at [1.57]. Sub-section 102UT provides that the offence in respect of tax preferred income is contrary to s8C of the Tax Administration Act 1953.

50 See ITAA36, paras 102UK(2)(b) and 102UM(2)(b).
Where the ATO is unaware in respect of a particular distribution whether there is or are any ultimate beneficiaries or not, tax can be assessed both on distributing TB(s) pursuant to the TBND and also on particular TBs pursuant to ITAA36, s97.\footnote{See EMCHTA at [1.56]. This is particularly useful with circular distributions.}

Distributions of trust capital to TBs are treated stringently. ITAA36 s102UI defines a "tax-preferred amount" as "capital of the trust" and "income of the trust that is not included in its assessable income in working out its net income." Sub-section 102UT(1) requires trustees of closely held trusts to provide a correct TB statement if a TB is presently entitled to a share of a tax-preferred amount of the trust. A criminal offence is committed by a trustee pursuant to s-s102UT(2) in the event that the trustee fails to provide a correct TB statement pursuant to s-s102UT(1).

Division 6D has limited application to non-resident TBs. Australian-source income distributed to non-resident TBs will not be "untaxed" triggering s-s102UK(1) because the trustee will be liable for tax on the distribution under s-s98(4). However, the trustee of a closely held trust which makes a non-taxable Australian property gain and distributes it to a non-resident TB, must either provide a correct TB statement under s-s102UT(1), or commit a criminal offence.\footnote{A construction suggested by EMCHTA at [1.79]. The s102UI definition of "tax preferred amount" would seem to be applicable on the basis that foreign-source capital gain was derived by the trust as income which was not included in the working out of its net income. Subsection 102UT(2) provides criminal sanction for non-compliance with s-s102UT(1) in the circumstances.}

4.3 LEGAL OVERVIEW - COMPLEX DISTRIBUTIONS

Analysis of legal issues surrounding the concept of complex distributions discloses that there are many types of distributions that can be characterised "complex" and several avenues through which the ATO can deal with the phenomenon. Anti-avoidance measures such as ITAA36 sections 10AA, 100AB, 100A and Division 6D deter particular species of complex distribution. The measures often require resource-intensive audits to uncover relevant tax avoidance activity. Other practical difficulties which arise include how it may be difficult for the ATO to establish whether or not a Division 6D TB statement should have been lodged in circumstances where the subject trust deeds are not required to be registered or otherwise available. The ATO may also find it difficult to establish whether trust beneficiaries have adequately disclosed their entitlements to trust income without having access to the trust deed wherefrom the entitlements arose. The next section presents some empirical evidence of complex distributions.
4.4 QUANTIFYING COMPLEXITY

It is important to note that the empirical evidence presented in this section does not set out to link complex distributions to tax avoidance. Such direct links can only be established through tax office audits. The empirical evidence does show however that there are several trusts that make distributions to several layers of other trusts. While this is not direct evidence of tax avoidance behaviour, it does indicate that complex structures may potentially be utilized by the taxpayer to gain a tax advantage.

It is also important to note that the evidence presented in this section only pertains to distributions from trusts to trusts. It does not include complex distributions that involve the full range of beneficiaries, i.e. companies, individuals, partnerships, etc. The reasons for this analysis being limited to trust to trust distributions are threefold. First, the data provided by the ATO was only in relation to trust to trust distributions. Second, as indicated in Table 2, Chapter 3, the largest beneficiary group for trusts in our sample was other trusts (42%). Third, the analysis in this section is intended to highlight the complexity of distributions when multiple trusts are involved and this level of complexity would only rise as the variety of entities (i.e. companies, individuals, etc.) within structures increases. Hence analysis of trust to trust distributions can be seen as a baseline for complex distributions. Finally, distributions from trusts to other entities have been covered in Chapter 3 albeit in the context of income tax shuffles rather than complex distributions.

Given the complexities in identifying trust beneficiaries, there are several compliance challenges that arise from complex distributions. The compliance issues result from difficulties in tracing distributions through multiple trusts, especially where reciprocal distributions occur. Some of the case-based evidence in regards to such arrangements and the compliance difficulties were outlined in section 4.2. In this section the empirical data illustrates the extent to which trusts distribute to other trusts and how income flows through such structures.

4.4.1 DATA AND METHODOLOGY

This section describes the data sources, sample units and sample coverage used to investigate complex distributions.

The ATO provided aggregate data on key indicators for chains of trusts across four consecutive years (2012-2015). The data comprises all the available data in relation to trusts that made distributions to at least one other trust in the abovementioned period. Data on trust chains were five tiers deep such that: trust 1 distributes to trust 2; trust 2 distributes to trust 3; trust 3...
distributes to trust 4; trust 4 distributes to trust 5; and trust 5 distributes to trust 6. In this section each of these layers is described as a ‘tier’. These chains of trusts are illustrated in Figure 15 below:

Figure 15: Trust chains

Source: Prepared by RMIT University

The ATO also provided data in relation to reciprocal distributions. These occur when trust 1 distributes to another trust and that trust then distributes back to trust 1. These scenarios include the following: trust 1 distributes to trust 2, trust 2 distributes to trust 3 which then trust 3 distributes back to trust 1 (as illustrated on Figure 16). In some cases the re-distribution can occur at any level, for example where trust 4 after receiving distribution from trust 3 will distribute back to trust 2 (as shown in Figure 17).

53 Additional data provided includes: unique count of trusts at each level, count of the trusts being distributed to at each level, share of income of trust estate, share of income PP, share of income NPP, net capital gains, franked distributions, franking credits, attributed foreign income, other foreign source income.
Sample unit and coverage

Tables 9 and 10 outline the number of trusts in each distribution tier as well as the annual percentage of trusts per tier by year. More specifically, Table 9 shows the number and percentage of distributing trusts, whereas Table 10 accounts for the receiving trust. It is evident from both Tables 9 and 10 that approximately 80% of inter-trust complex distributions are only one tier deep (i.e. Trust 1 distributes to Trust 2 and Trust 2 does not distribute to any other trust), while 13% engage in a further third tier distribution (Trust 2 engages in a further distribution to a Trust 3). Further complexity is progressively rarer with fifth tier distributions comprising only 1% of trust to trust distributions. This pattern is also stable over the four-year period.
4.4.2 **EMPIRICAL ANALYSIS**

4.4.2.1 **MEAN VALUES OF SELECTED VARIABLES PER TIER PER YEAR**

While it is unsurprising that highly complex distributions are rare, the nature and magnitude of the transactions with fewer distributional tiers may be useful indicators of the purpose and characteristics of these trusts. Table 11 presents aggregate trust data as total dollars by year and tier. Table 12 exhibits the aggregate divided by the information in Table 10 to produce average annual per trust values for these items. Table 13 presents this information in percentage terms, providing the average percentage weight per trust of each accounting item by year and complexity tier (column percentages for a given year total 100%).

It is observable in Table 11 that the further down the levels, the greater the amount of money being distributed to trusts. This is based on the average distribution per trust at each tier. Specially, the amount of ‘income of the trust estate’ distribution for each tier has almost doubled over 2012-2015. For example, the amount of income trust estates distribute from Trust 1 to Trust 2 has increased from $21,216.90 million to $50,559 million from 2012 to 2015. Similar patterns are also obtained at deeper levels of income distribution.

It is important to note that there is great variability in trust size and distributions across the dataset, hence averages must be interpreted with caution. However, the pattern of increasing percentages of distributions as the number of levels/tiers of distribution increase does provide some evidence that taxpayers are utilizing several layers of trusts in their structures. No conclusions can be made about whether this is for tax avoidance purposes, however increasing complexity of distribution patterns does cause difficulties in effectively administering the law.
<table>
<thead>
<tr>
<th>Absolute Count of Trusts Per Tier</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>Grand Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trust 1 distributes to trust 2</td>
<td>83,819</td>
<td>85,975</td>
<td>88,882</td>
<td>89,279</td>
<td>347,955</td>
</tr>
<tr>
<td>Trust 2 distributes to trust 3</td>
<td>13,845</td>
<td>14,081</td>
<td>14,785</td>
<td>14,733</td>
<td>57,444</td>
</tr>
<tr>
<td>Trust 3 distributes to trust 4</td>
<td>3,675</td>
<td>3,691</td>
<td>4,062</td>
<td>4,149</td>
<td>15,577</td>
</tr>
<tr>
<td>Trust 4 distributes to trust 5</td>
<td>1,609</td>
<td>1,556</td>
<td>1,807</td>
<td>1,900</td>
<td>6,872</td>
</tr>
<tr>
<td>Trust 5 distributes to trust 6</td>
<td>1,081</td>
<td>1,025</td>
<td>1,179</td>
<td>1,237</td>
<td>4,522</td>
</tr>
<tr>
<td>Grand Total</td>
<td>104,029</td>
<td>106,328</td>
<td>110,715</td>
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<td>432,370</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Annual Percentage of Trusts Per Tier</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Trust 1 distributes to trust 2</td>
<td>80.57%</td>
<td>80.86%</td>
<td>80.26%</td>
<td>80.22%</td>
<td>80.48%</td>
</tr>
<tr>
<td>Trust 2 distributes to trust 3</td>
<td>13.31%</td>
<td>13.24%</td>
<td>13.35%</td>
<td>13.24%</td>
<td>13.29%</td>
</tr>
<tr>
<td>Trust 3 distributes to trust 4</td>
<td>3.53%</td>
<td>3.47%</td>
<td>3.67%</td>
<td>3.73%</td>
<td>3.60%</td>
</tr>
<tr>
<td>Trust 4 distributes to trust 5</td>
<td>1.55%</td>
<td>1.46%</td>
<td>1.63%</td>
<td>1.71%</td>
<td>1.59%</td>
</tr>
<tr>
<td>Trust 5 distributes to trust 6</td>
<td>1.04%</td>
<td>0.96%</td>
<td>1.06%</td>
<td>1.11%</td>
<td>1.05%</td>
</tr>
<tr>
<td>Grand Total</td>
<td>100.00%</td>
<td>100.00%</td>
<td>100.00%</td>
<td>100.00%</td>
<td>100.00%</td>
</tr>
</tbody>
</table>

Source: Prepared by RMIT University using ATO data

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Table 10 Number of downstream trusts per complex distribution tier

<table>
<thead>
<tr>
<th>Absolute Count of Trusts Downstream</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>Grand Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trust 1 distributes to trust 2</td>
<td>131,782</td>
<td>133,371</td>
<td>137,081</td>
<td>137,874</td>
<td>540,108</td>
</tr>
<tr>
<td>Trust 2 distributes to trust 3</td>
<td>20,960</td>
<td>20,709</td>
<td>21,497</td>
<td>21,382</td>
<td>84,548</td>
</tr>
<tr>
<td>Trust 3 distributes to trust 4</td>
<td>5,515</td>
<td>5,328</td>
<td>5,915</td>
<td>5,953</td>
<td>22,711</td>
</tr>
<tr>
<td>Trust 4 distributes to trust 5</td>
<td>2,334</td>
<td>2,215</td>
<td>2,511</td>
<td>2,650</td>
<td>9,710</td>
</tr>
<tr>
<td>Trust 5 distributes to trust 6</td>
<td>1,603</td>
<td>1,499</td>
<td>1,633</td>
<td>1,730</td>
<td>6,465</td>
</tr>
<tr>
<td>Grand Total</td>
<td>162,194</td>
<td>163,122</td>
<td>168,637</td>
<td>169,589</td>
<td>663,542</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Annual Percentage of Trusts Downstream</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>Grand Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trust 1 distributes to trust 2</td>
<td>81.25%</td>
<td>81.76%</td>
<td>81.29%</td>
<td>81.30%</td>
<td>81.40%</td>
</tr>
<tr>
<td>Trust 2 distributes to trust 3</td>
<td>12.92%</td>
<td>12.70%</td>
<td>12.75%</td>
<td>12.61%</td>
<td>12.74%</td>
</tr>
<tr>
<td>Trust 3 distributes to trust 4</td>
<td>3.40%</td>
<td>3.27%</td>
<td>3.51%</td>
<td>3.51%</td>
<td>3.42%</td>
</tr>
<tr>
<td>Trust 4 distributes to trust 5</td>
<td>1.44%</td>
<td>1.36%</td>
<td>1.49%</td>
<td>1.56%</td>
<td>1.46%</td>
</tr>
<tr>
<td>Trust 5 distributes to trust 6</td>
<td>0.99%</td>
<td>0.92%</td>
<td>0.97%</td>
<td>1.02%</td>
<td>0.97%</td>
</tr>
<tr>
<td>Grand Total</td>
<td>100.00%</td>
<td>100.00%</td>
<td>100.00%</td>
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Source: Prepared by RMIT University using ATO data
Table 11 Aggregate trust related data by year and complexity tier (total million $)

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<th>Net Capital Gains</th>
<th>Share of Income NPP</th>
<th>Share of Income of Trust Estate</th>
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Source: Prepared by RMIT University using ATO data

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Source: Prepared by RMIT University using ATO data

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<th>Attributed Foreign Income</th>
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<th>Net Capital Gains</th>
<th>Share of Income NPPAmt</th>
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<td>33.15%</td>
<td>33.32%</td>
<td>19.17%</td>
<td>23.97%</td>
<td>24.36%</td>
<td>33.08%</td>
</tr>
<tr>
<td>2014: -</td>
<td>9.64%</td>
<td>25.83%</td>
<td>25.95%</td>
<td>30.92%</td>
<td>22.76%</td>
<td>24.55%</td>
<td>54.27%</td>
</tr>
<tr>
<td>2015: 13.10%</td>
<td>31.58%</td>
<td>32.44%</td>
<td>29.15%</td>
<td>26.09%</td>
<td>26.96%</td>
<td>26.96%</td>
<td>83.36%</td>
</tr>
</tbody>
</table>

Source: Prepared by RMIT University using ATO data
Figure 18 Proportion of Income of Trust Estate Distribution from each tier each year

![Bar chart showing distribution across years](chart)

Source: Prepared by RMIT University using ATO data

As shown in Figure 18, in 2012 the proportion of 'income of trust estate' distributed from trusts in tier 1 to trusts in tier 2 (i.e. trust 2 to trust 3 divided by trust 1 to trust 2) is only 38%\(^54\) while the proportion of income of trust estate distributed from trusts in tier 4 to trusts in tier 5 (i.e. trust 5 to trust 6 divided by trust 4 to trust 3) is 69% suggesting that there may be a higher incentive to distribute to further levels, especially after tier 3. A similar pattern is prevalent across the years. This simply means that the proportion of trusts that distribute further drastically increases once they reach tier 3 distributions. This is of particular concern because the more levels of distributions the more difficult it is for the ATO to determine who the appropriate beneficiaries are, and thus who should bear the final burden of tax.

Large annual variations are observed for accounting items Attributed Foreign Income and Share of Income Primary Production due to the small values and also potentially because of the very small number of trusts that have a non-zero reportable amount for these items. This makes it difficult to analyse these variables further in aggregate form. As for the remaining data, the average per trust size of accounting items increases along the distribution chain perhaps indicating that the down-chain trusts are larger trusts used to pool income. Average tier 1

\(^{54}\) This proportion is obtained by using share of income of trust estate for Trust 1 to Trust 2 in 2012 divided by share of income trust estate for Trust 2 to Trust 3 (data are provided in Table 10).
distributions per trust consistently represent around 5% of distributions for a given item. In contrast, a tier 5 distribution is six times greater, representing around 30% of total average distributions for a given item. The exception is Other Foreign Source Income which is more evenly distributed across tiers and has its peak average value at tier 3 distributions. There are no obvious explanations for this finding with regards to Other Foreign Source Income.

4.4.3 DISTRIBUTIONS BACK TO THE ORIGINAL TRUST

Table 14 shows the number of trusts that distribute to another trust and then that trust distributes back to the original trust. It is apparent that a comparatively small number of trusts engage in these reciprocal distributions. Existing statutory provisions may be adequate to enable the ATO to investigate and discipline tax avoidance in this area. In particular, ITAA36 s-ss102UM(2) is applicable where the trustees of closely held trusts become presently entitled to amounts that are reasonably attributable to the untaxed parts of shares of the net income of closely held trusts and non-disclosure tax is not payable by trust beneficiaries. Liability on trustees and members of trustee groups is imposed under the Taxation (Trustee Beneficiary Non-disclosure Tax) Act 2007.55

<table>
<thead>
<tr>
<th>Income Year</th>
<th>Trust1&lt;&gt;Trust3</th>
<th>Trust1&lt;&gt;Trust4</th>
<th>Trust1&lt;&gt;Trust5</th>
<th>Trust1&lt;&gt;Trust6</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>482</td>
<td>444</td>
<td>154</td>
<td>508</td>
</tr>
<tr>
<td>2013</td>
<td>512</td>
<td>463</td>
<td>129</td>
<td>520</td>
</tr>
<tr>
<td>2014</td>
<td>526</td>
<td>480</td>
<td>116</td>
<td>521</td>
</tr>
<tr>
<td>2015</td>
<td>454</td>
<td>420</td>
<td>158</td>
<td>455</td>
</tr>
</tbody>
</table>

Source: Prepared by RMIT University using ATO data

55 In a complementary way, trustees are liable under ITAA36 s-s99A(4) in respect of income not assessed under s97 or s98 to which beneficiaries are presently entitled that is attributable to ex-Australian sources and periods when the beneficiaries were not resident.
4.5 SUMMARY

The preceding analysis shows that as the number of levels of trusts distributions increases the amount of income being distributed increases. This suggests that trusts distribute their income sparsely through complex structures in the initial levels to several other trusts (in reality this may include other beneficiary types as well). Following this initial distribution, they are able to pool income after several levels of distributions from various trusts at higher levels in the chain. This approach can be described as a “spread thin then thick” strategy, where the intention and the outcome of such structures are to create a degree of opacity around trust income and the ultimate beneficiaries to which the funds flow. It follows that complex structures, resulting in complex trust distributions, make it difficult from an administration viewpoint to levy the correct tax burden on the appropriate ultimate beneficiary or entity.

While there are some legislative tools at the ATO’s disposal, these mechanisms rely on self-reporting on the part of the taxpayer and require resource intensive audits to fully uncover the type and extent of distributions. The difficulties associated with tracing income through complex distribution structures are further exacerbated by the various issues pertaining to the nature of trusts and trust deeds explicated in Chapters 2 and 3. In particular, trusts are a largely unregulated entity/fiduciary relationship and trust deeds may be amended at the trustee’s will, provided the deed provides such liberty to the trustee. The lack of transparency surrounding the ownership of trust assets in discretionary trusts further complicates matters. Finally, some trusts may exist but not come into purview of the taxation system until such time as they earn or receive income and lodge tax returns. If however, trusts do not participate in the tax system by lodging tax returns, there is limited ability at present to identify such entities/taxpayers. The issue of non-lodgment, trusts lodgment-patterns are examined in the next chapter.
5 NON LODGMENT AND TRUST LODGMENT PATTERNS

Non-lodgment of trusts’ tax returns is a significant difficulty faced by the ATO in the effective administration of tax law. This chapter begins with a legal analysis of the issues surrounding non-lodgment of trust tax returns. The purpose of this is to highlight the inadequacy of current law, particularly the problem of identifying the “trusts demographic” or body of existing trusts in Australia and its members from year to year. Sources of trusts data available to the ATO largely rely on self-reporting and resource intensive audits conducted by the ATO. In contrast, there is a body of easily accessible information applicable to companies and charitable entities (including trusts). The experience of overseas jurisdictions with trusts registration is considered in Appendix D to the report.

Quantitative analysis presented in this chapter is intended to highlight the difficulty in accurately identifying the population of trusts in Australia and the proportion of non-lodging trusts.

5.1 NON-LODGMENT

5.1.1 INFORMATION ABOUT AUSTRALIAN TRUSTS

A question of primary importance is whether the Income Tax Assessment Acts can be adequately enforced with current sources of information about trusts.

The role and significance of the trust in Australian jurisdictions has no parallel in other states and countries. A large proportion of Australian business enterprise is conducted through trusts which substantially contribute to national economic performance indices.

Trusts are governed primarily by an unwritten code forming part of state and territory law. The constitutions and terms of trusts are not publicly recorded or accessible. Many enforceable trusts arise from oral transactions, about which nothing need be recorded in written form. Only

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56 See [Introductory data]


58 Apart from (minimal) statutory writing requirements for trusts of land and sub-trusts, there is no general law requirement that trusts be created or evidenced in writing: see Ford & Lee: The Law of Trusts 5th edn (Thomson Reuters, looseleaf and online) (Ford & Lee) at [6.1070]-[6.1270]. Other statutory writing requirements are diverse and few. For example, the Mining Act 1978 (WA), s-s119(2) (mining tenements), Petroleum (Submerged Lands) Act 1982 (WA), s81 (exploration permits) and Corporations Act 2001 (Cth), s601GB (public unit trusts which conduct managed investment schemes): see Ford & Lee at [6.1290]-[6.1310].
persons with appropriate standing under a trust’s deed (or constitution) can compel the trustee to provide the trust’s constituent documents or information, to account for trust property, or to act or refrain from acting. The Commissioner has no such standing. Trusts are largely opaque for the ATO under trust law.

5.1.2 THE COMMISSIONER’S CURRENT SOURCES OF INFORMATION ABOUT TRUSTS

There are four sources of information about trusts available to the Commissioner:

1. **Trust income tax returns**

   This information source is comprised of data which taxpayers voluntarily disclose in trusts tax returns. This is likely to be the primary source of the Commissioner’s intelligence about trusts in the tax system.

2. **Public and governmental information**

   Public and governmental sources provide information on whether specific property is held in trust and the affairs of identified trustees, beneficiaries and other persons of interest. Sources include: (1) internal ATO cross-checks against third party data (“data-matching”); (2) referrals from other government bodies and public entities such as Royal Commissions; and (3) entries in public registries of land titles (in some states), boats and aircraft, customs and immigration information.

3. **Taxpayer record-keeping**

   This information source is based on taxpayer record-keeping obligations. Access to these records is obtained through taxation law powers discussed in the following section. All taxpayers are required to make and retain tax-related records. Proper officers of the Commissioner may be empowered to access tax records and other material specific to

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59 See Ford & Lee at [1.270], [1.8330], [17.1010]; Uniform Civil Procedure Rules 2005, r6.24; (Vic) Supreme Court (General Civil Procedure Rules) 2005 r9.06(b)(i).

60 See PGH Trusts Taskforce Trusts Risk Demographics—Excerpt (ATO 21 December 2016) (Trusts Risk Demographics) at [1.1]. The data is associated with TFNs specific to individual trusts.

61 Discussed generally in Miscellaneous Taxation Ruling MT 2008/1 and ATO Practice Statement Law Administration PS LA 2005/2.
taxpayers (and others). Usually, a field audit is necessary to activate the access to information powers.\(^{62}\) The exercise is resource-intensive.

The scope of the record-keeping obligation is problematic where trusts are concerned. Several provisions in the Income Tax Assessment Acts are applicable.

First, ITAA36 s-s262A(1) requires “a person carrying on business” to “keep records that record and explain all transactions and other acts engaged in by the person that are relevant for any purpose of this Act.” Sub-section 262A(2) specifies that “records” for the purpose will include documents relevant to ascertaining a person’s income and expenditure and “particulars of any “election, choice, estimate, determination or calculation made by the person under this Act.”\(^{63}\) ITAA36 s262A is applicable to trusts engaged in business activities, as opposed to passive investment and other trust uses. Non-business trusts are not affected.

It is doubtful whether s-s262A applies to and requires taxpayers to record and explain a trust’s constituent documents. On the one hand, s-s262A(1) is expressed widely enough to require the keeping of documents which, for the purposes of the Act, “explain” the acts in which trusts engage. On the other hand, the “records” referred to in the first paragraph of s-s262A(2) only relate to “ascertaining the person’s income and expenditure”. Information about the identity and fiduciary responsibilities of persons who derive the income or incur the expenditure are not included.

Further, the second paragraph of s-s262A(2) expressly includes “particulars of any election, choice, estimate, determination or calculation made by a person under this Act”. The decision of the High Court of Australia in \textit{Spotless v FCT} (1996) 186 CLR 404, 415 confirmed that similar words used in s-s177C(2) of the Act did not extend to a taxpayer choosing to structure their tax affairs through a trust.\(^{64}\) On balance, it might be concluded that the information-keeping obligation in s-s262A does not extend to keeping information about trusts.


\(^{63}\) See ITAA36 s262A(2)(a), (b), (3)(b), (4AL); discussed in \textit{Baini v FCT} (2012) ATC ¶10-259, 5121 (pillow manufacturer carrying on business as a sole trader).

\(^{64}\) ITAA36 para s177C(2)(b)’s definition of a “scheme” for the avoidance of tax excludes “the giving of a notice, or the exercise of an option by any person being a declaration, agreement, election, selection, choice notice or option expressly provided by [the ITAAs]”.

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Secondly, Division 121 of the ITAA97 requires taxpayers, including the trustees and beneficiaries of trusts, to keep records of matters that affect the capital gains and losses. Penalties are imposed for non-compliance. Records must be retained for 5 years after it becomes certain that no CGT event, or no further event, can happen. As an alternative to keeping records, taxpayers can make entries in an asset register, in English, certified by a registered tax agent or person approved by the Commissioner, which set out (some or all of) the information contained in the obligatory records. The s121-20 record-keeping obligation is about as stringent as ITAA s-s262A. Probably does not extend to taxpayers keeping information about trusts.

Thirdly, section 102AAZG of the ITAA36 makes specific provision for certain non-resident trust estates which are subject to accruals taxation. Attributable taxpayers in relation to such trusts (including the transferors of property to controlled trust estates that are discretionary trusts) must keep records of “acts, transactions and other circumstances that resulted in a person being an attributable taxpayer”. Penalties are imposed for non-compliance. Transferors are not required to keep records if they did not know and had no grounds to expect that they were attributable taxpayers and made all reasonable efforts to obtain the required information. Few taxpayers are liable to this regime.

4. The Commissioner’s access to information, evidence and documents

Another information source is the Commissioner’s access to information, evidence and documents embodied in Divisions of schedule 1 of the Taxation Administration Act (TAA).

Division 353 provides that an authorised officer of the Commissioner may require any person to: (1) furnish information; (2) attend and give evidence; and (3) produce

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65 See ITAA36 ss121-35.
66 See ITAA36 s-s102AAT headed “Accruals system of taxation—attributable taxpayer”.
67 See s-s102AAZG(4).
68 Section 353-10(1)(a) notices may require a person “to give the Commissioner any information which the Commissioner requires for the purpose of the administration or operation of a taxation law”. This has been interpreted to exclude any abstract question of law: Perron Investments Pty Ltd v D-FCT (1989) 89 ATC 5038; and cannot require a person to obtain knowledge not previously possessed or confirm information within their custody or control: Geosam Investments Pty Ltd v ANZ Banking Group (1979) 79 ATC 4418; Hart v D-FCT (2005) 2005 ATC 5022, 5048.
69 Section 353-10(1)(b) notices enable an authorized officer to require any person to attend and give evidence “for the purposes of the administration or operation of a taxation law”.

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documents.70 For the purposes of this section, an authorised officer has rights of access to premises and is empowered to examine and take copies of records. The section applies to trusts generally. It includes, but is not restricted to, information kept about trading trusts subject to ITAA36 s-s262A. However, no one is placed under an obligation to make or keep information or documents of any type.

Division 354 extends the Division 353 information-gathering power to trust property. Specifically, the Commissioner is given the right to information about property subject to discretionary trusts based in a "property right or interest" derived from a person’s control of that property.

The Division 354 regime coordinates appropriately with Australian trust usage. Access to discretionary trust property is controlled by the persons who are able to control the discretions of discretionary trustees or of trust appointors. These persons are treated as the effective owners of the trust property as it is assumed that trust controllers will always use their powers to ensure that interests in a trust property are conferred on themselves or on persons whom they direct.71

The rule of law may stand in the way of the cynical assumption behind the contention that trust controllers own the property of the trusts which they control. Discretionary trustees act illegally and “in fraud of a power” when they use trust powers for personal gain or considerations extrinsic to the interests of beneficiaries. This is further discussed below.

There are two situations in which the Commissioner may by notice require a person to give information required for the administration or operation of a taxation law pursuant to s354-5(1). First, where the person has a “legal or beneficial interest” in real or personal property and that person has information about “any other property right or interest in the property”.72 Secondly, where the Commissioner is satisfied that a person may have “information about a

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70 Section 353-10(1)(c) notices empower an authorized officer to “produce to the Commissioner any documents in your custody or under your control for the purpose of the administration or operation of a taxation law.” Only existing documents have to be produced: Fieldhouse v FCT (1989) 25 FCR 187, 194, 209; Perron Investments Pty Ltd v D-FCT (1989) 89 ATC 4310; Hart v D-FCT (2005) 2005 ATC 5022.


72 Paragraph 354-5(1)(a). The notice may be inapt if directed to a member of a class of discretionary objects before exercise of a trustee's dispositive power: see text below at n. 18.
property right or interest in property" and "the information is about the property right or interest".73

A property right or interest is defined by s-s354-5(2) to be "(a) a legal or equitable interest in that property; or (b) a right, power or privilege in connection with that property". Paragraph (a) is unexceptionable and may not be necessary.74 Paragraph (b) is problematic. The "property right or interest" which attracts the Division 354 regime is defined as a "right, power or privilege in connection with that property".

Defining property as a right is uncontroversial. However, defining a property right or interest as a power or capacity is different and repugnant to Anglo-Australian private law.75 "The distinction between power and property is fundamental", states the learned author of *Thomas on Powers*.76 Lord Justice Fry expressed the matter trenchantly in *Re Armstrong ex parte Gilchrist* (1886) 17 QBD 521 at 531:

> No two ideas can be more distinct the one from the other than those of 'property' and 'power'. A power is an individual capacity of the donee of the power to do something. That it may result in property becoming vested in him is immaterial; the general nature of the power does not make it property. The power of a person to appoint an estate to himself is, in my judgement, no more his 'property' than the power to write a book or sing a song.

Anomalies will result when statute law purports to create rights to property subject to discretionary trusts prior to the commencement of general rights to that property. Property is created out of thin air. Intractable problems of entitlement, proportionality and priority arise when people are attributed with ownership of property subject to discretionary trusts prior to discretionary trustees appointing that property to particular beneficiaries.

For example, under s-s354-5(3), the Commissioner is required to specify "the property to which the notice applies" through application of the "property right or interest" definition in s-s354(2). It is possible that property subject to A's trust-controlling power will be attributed to

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73 Paragraph 354-5(1)(b). It is hard to see what is added by the second limb of this paragraph.

74 Normal principles of statutory construction would achieve the same result: see *Statutory Interpretation in Australia* 8th edn, DC Pearce and RC Geddes ((LexisNexis, 2014) at [5.29] citing *Minister for Lands and Forests v McPherson* (1991) 22 NSWLR 687 (CA) and [9.35].


76 2nd edn by Geraint Thomas (Oxford University Press, 2012) at [1.04].
A even where A expressly excludes him or herself from deriving any benefit under the trust. A can therefore obtain an "interest in the property" for the purposes of s-s354(4) which can never vest — a nonsensical conundrum.77

The majority decision in Kennon v Spry (2008) 238 CLR 366; [2008] HCA 56 may have inspired, but does not validate Division 354. The case held that control of a discretionary trust amounted to "property" for the purposes of s79 of the Family Law Act 1975 (Cth) (FLA).78 Two distinct and inconsistent strands in the majority reasoning were evident.

French CJ in Spry's case held at [67] that the husband obtained a property right in the discretionary trust's assets based in the "coupling" of (1) the husband's legal title as trustee; (2) his power to distribute the whole fund to his wife; and (3) the wife's equitable right to be considered.

By contrast, Gummow and Hayne JJ in Spry's case at [130] held that the wife obtained a property right in the discretionary trust's assets based in (1) the wife's equitable right of due administration; (2) the husband's "fiduciary" duty to consider when and how the power should be exercised; and (3) the fact that the power could have been exercised by the husband appointing all assets of the trusts to his wife.79

Whether the husband or the wife was attributed with ownership of the trust's property was not significant in Spry's case because of the words of the FLA definition.80 The ratio of the decision is limited to family law accordingly. Other decisions on "property" in statutory contexts are similarly restricted.81

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77 Occasionally Australian trust controllers disclaim beneficial interests in trust property in order to avoid state and territory land taxes. In Kennon v Spry (2008) 238 CLR 366 (discussed below) Dr Spry was the trustee-controller of a discretionary trust who excluded himself from personal benefit under the thereunder in order to avoid the Land Tax Act 1958. See J Glover in ‘Kennon v Spry: predicting the future of the discretionary trust in Australian tax law’ (2009) 43 Taxation in Australia 581.

78 There is only one definition of "property" in the FLA. Sub-sec4(1) provides that property, in relation to the parties to the marriage or either of them, means property to which those parties are, or that party is, entitled, whether in possession or reversion.

79 Remarkably, French CJ in Spry accepted the reasoning of Gummow and Hayne JJ at [83].

80 See note 20: "property in relation to the parties to the marriage or either of them".

5.2 QUANTIFYING NON-LODGMENT

The issue of non-lodgment is a particularly difficult issue in the context of trusts since there is scant regulation which applies to trusts, trustees and trust deeds. When compared to individual salary and wage earners, or companies where details of these entities are readily available, trusts stand out as a unique form/structure. Data provided by the ATO has been explored in this section with a view to highlighting the consequences of the current regime where trusts can remain entirely hidden from view, particularly in relation to their tax affairs. Trust lodgment patterns and the implications for tax administration are considered in the next section.

5.2.1 DATA AND EMPIRICAL RESULTS

The ATO provided the data in the form of graphs, tables and charts and this data is presented in this section. This data is presented with some narrative around the difficulties in relation to identifying the current trust population size, their changing profiles, which trusts are expected to lodge, non-lodgment risk and the heterogeneous nature of trust lodgment patterns.

5.2.2 DETERMINING THE ACTIVE TRUST POPULATION

In 2015, the total number of trusts “known” to the ATO was 2.6 million. This number was identified based on the information recorded on the ATO system which includes both current trusts (i.e. those with no income tax role end date) and ceased trusts (i.e. those with an income tax role end date). To determine the 2015 trust population sample, there are two identification methods suggested by the ATO, however they yield two completely different results. The first is to use the income tax (IT) role start and the IT role end dates that result in a non-lodging population of at least 550,000 trusts. The second is to use the internal indicators (IT active status) that assign an “active” or “inactive” status to entities which results in 870,453 “active” trusts and 1,734,534 “inactive” trusts. The ATO has noted that the IT active status appears likely to be the more accurate reflection of the current trust population.

5.2.3 IT ACTIVITY STATUS – ACTIVE TRUSTS

In attempting to identify the size of the active trust population for the 2015 financial year, based on Trusts Taskforce sourced data, one of the results was the determination of a ‘potential’ non-lodging population of 108,289 trusts. This determination was made by comparing the trusts lodgments at that point in time against the active trust population as determined through applying a complex calculation methodology. However, this calculation does not capture the various nuances involved in the ATO Enterprise data determination of the anticipated lodging population and therefore the size of the non-lodging population.

When this figure is compared with the 48,302 non-lodging trusts identified through applying the ATO Enterprise Data, (Table 15) a clear discrepancy exists. The disparity is largely due to gaps in trust lodgment data, definitions applied and execution of two distinct calculation methodologies used for two distinct purposes. The Trusts Taskforce data, as a result of gaps in data and different definitions, appears to overestimate the scale of non-lodgers.

The analysis demonstrates that without more complete trust data there is an inherent complexity in better determining the potential size of the active trust population in any one financial year. In turn, this complexity applies to the identification of the size of the non-lodging issue within those trusts. In conclusion, it is apparent from the results obtained using various definitions and methods to ‘estimate’ non-lodgment, that identification is an incomplete process, complicated by gaps in data and the fact that trusts are not regulated to report all data. Therefore, in the context of a self-reporting system, this presents a unique and complex set of challenges for the ATO.
NON-LODGMENT STATISTICS

Table 15 shows that the total anticipated trust lodgment population for 2015, based on ATO Enterprise Data, was 883,423 with a non-lodgment population of 48,302 as at 19/11/16; 22,373 more non-lodging trusts compared with the total amount outstanding for previous years. This difference is expected to decrease as overdue returns are lodged. While the lodgment data seems to suggest that, in general, compliance may be improving as evidenced by the increase in the ‘on-time’ lodgers, there remains the difficulty of knowing the extent of data gaps in the tax authority’s information.

<table>
<thead>
<tr>
<th>Table 15 Number of anticipated lodgment performance 2011-2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lodged: On Time</td>
</tr>
<tr>
<td>Lodged: Late</td>
</tr>
<tr>
<td>Lodged: Data Unknown</td>
</tr>
<tr>
<td>Not Yet Lodged</td>
</tr>
<tr>
<td>Not Yet Due</td>
</tr>
<tr>
<td>Total Lodged</td>
</tr>
<tr>
<td>Total Not Lodged</td>
</tr>
<tr>
<td>Total Anticipated</td>
</tr>
<tr>
<td>Total Not Necessary</td>
</tr>
</tbody>
</table>

Source ATO (2017)

Different ATO sources of data appear to provide different and at times contradictory evidence in relation to the size of the trust population and hence non-lodgment. These results therefore provide support that trusts and trust deeds may need, to some extent and in some form, regulation. If the ATO maintains the status quo this would likely result in continual reporting of incomplete data that will impact the ATO’s administration of taxation laws.\(^\text{82}\)

\(^\text{82}\) Note: (1) At the time Trust taskforce calculations were done for total trust lodgments, the number identified was 812,315. (2) The calculation identified a total of 920,604 trusts that appeared to be active in the 2015 financial year.
In addition to examining the issues surrounding non-lodgment, we also present data on the lodgment patterns of different categories of trusts. This information provides the backdrop within which the broader non-lodgment issues outlined earlier could be considered. The diversity of trust lodgment patterns provides further impetus for increased regulation and/or registration of trusts. Trusts are being used for a variety of purposes and in across various industries. Such heterogeneity means that without some regulatory oversight it would become increasingly difficult for the ATO to monitor and administer the taxation laws in relation to trusts. By comparison, the corporate structure is heavily regulated in Australia and yet trusts are just as prominent across as many industries and sectors.

83 The data used for the analysis in section 5.2.4 represent about 30% of the known trust population. This is the case since trusts which did not have IT end date were excluded from the analysis to provide a better indication of lodgment patterns across various taxpayer groups and industries.
Figure 19 Lodgments by trust types

Figure 19 shows that the lodgment lifecycle of trusts varies considerably, particularly when comparing deceased estate trusts to other trusts. The other notable category is “other” trusts (see label for “trust”) which seem to have a significant proportion of trusts that have lodgment patterns that last 1-5 years and 10 to 20 years. Discretionary trusts in general seem to have a large range with the proportion of trusts in the 1-15 year period being between 10% and 20%. The graphs shown below provide a better view of the various trust types and their lodgment patterns.

Source: ATO (2017)
Figure 20 Deceased estates trusts

Source: ATO (2017)

Figure 21 Fixed/hybrid trusts

Source: ATO (2017)
Figure 22 Discretionary trusts

Source: ATO (2017)

Figure 23 Listed public unit trusts

Source: ATO (2017)
Figures 20 to 25 show the trust lodgment patterns for deceased estates, fixed/hybrid trusts, discretionary trusts, public unit trusts, cash management trusts and other trusts. It can be observed that more than 80% of the deceased estates trusts have a lifecycle of 3 years or less and fixed unit trusts range between 1 year and 15 years. All three sub-types of discretionary trusts spread across a 1 to 15 year period and around 70% of discretionary trusts (investment) are within the 1 to 10 year period. Both public unit trusts and cash management trusts have a range of a 1 to 15 year period with more than 70% in the range of between 1 to 10 years. In

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Figure 25, there are two spikes at the less than 1 to 3 year and 11 to 20 year lifecycle for Other trusts. This is possibly due to a data integrity issue because it is difficult to identify the “Other” trust sub-category.

The trust lodgment patterns of 19 of the 21 industry sectors of ANZSIC Broad Industry Category are presented as follows and a graphical representation of the lifecycles of those trusts in Figure 26.

Figure 26 Trust lodgment patterns for each ANZSIC Broad Industry sector

Source: ATO (2017)

The data used for the preceding graph does not include deceased estates trusts due to their skewing effect on the overall lodgment patterns in certain industry codes. As with the lodgment patterns by trust type, the patterns across the 19 categories are mainly spread across the 1-15 year period with three distinct peaks at the 0 to 3 year patterns, 1 to 5 year patterns, and 8 to 15 year patterns. In general, Figure 9 suggests that there is a distinct peak at the 0 to 3 year patterns for trusts involved in the mining industry and between 38% and 46% of ANZSIC based industry sectors spread across 1 to 5 year lifecycles. Trusts in “Financial and Insurance
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period, a "lives in being" perpetuity period of approximately 120 years, or to change the proper law of the trust to the law of South Australia.87

Once a perpetuity period expires, however, trusts irrevocably terminate and all trust property is transferred to persons entitled by operation of law. A harvest of capital gains tax and (state-based) property transfer duties might be expected if the ATO and state revenue authorities had access to reliable information about when trusts were created in a register of trusts.88

5.4 SUMMARY

This chapter brings to the fore the issues around transparency of trusts and the challenges this poses to effective tax administration. While several direct and indirect sources of information about trusts are available to the Commissioner, these do not contain the fundamental information regarding the operation of trusts, and in particular their constitution, and terms of trust documents. To further complicate matters, it is not clear based on case law whether the Commissioner’s powers under the Taxation Administration Act and ITAA 1936 extend to a trust’s constituent documents, especially in relation to passive or investment-related discretionary trusts.

Quantitative data showed the practical difficulties which arise due to the absence of a mechanism to obtain relevant information. Trusts have diverse lifecycles and come into and go out of existence often without the knowledge of the revenue authority.

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88 From parties who took no avoidance action. Probably the perpetuity period problem will become evident in about 2035-2040 and then continue indefinitely. The ATO may permit a trust-to-company rollover as an alternative to a CGT charge.
6 NEW TRANSPARENCY OBLIGATIONS

“Tax transparency” can be seen from at least three perspectives. First, tax transparency serves the disparate interests of the national tax community. For example, in the public interest, the voluntary “Tax Transparency Code” promoted by the Australian Board of Taxation informs social justice groups, media, analysts, shareholders and “the man in the street” about the tax affairs of business taxpayers.89 Second, the ATO is required to be transparent to promote good tax administration.90 Third, taxpayers are required to be transparent in the interests of fairness and equality. New taxpayer transparency obligations will be the subject of this chapter, with particular reference to trusts.

Offshore revenue-gathering by the United States (US) and OECD-inspired measures to deter cross-border tax evasion have led to new reporting regimes for Australian financial institutions. Private trusts are amongst the taxpayer “entities” required to disclose financial affairs. Australia, at an intergovernmental level, has agreed to enforce these obligations. A new Division of the Tax Administration Act 1953 (TAA) has been inserted for the purpose.

Information about trusts and the beneficial ownership of trust property is needed for Australia to implement the OECD transparency measures as other jurisdictions have done. For example, a registry of trusts and beneficial ownership of trust property was initiated in the United Kingdom in 2017.91 New Zealand introduced a register of foreign trusts in the same year.92

The following sections of this chapter outline the US and OECD trust disclosure regimes and the recommendations of an OECD anti-tax evasion initiative to which Australia is a party. In short, the US and OECD reporting requirements do not apply to Australian trusts unless they are Financial Institutions in the business of holding financial assets or investing on behalf of

89 See Australian Government The Board of Taxation A Tax Transparency Code: Report to the Treasurer (Commonwealth of Australia 2016) (at para 4). Disclosure obligations are limited to “company structures or entities that are treated as companies for Australian tax purposes” (para 5.1) conducting “large” and “medium” businesses with Australian turnovers of $500m and $100m respectively (para 6). “The ATO . . . will not be a key user of the information disclosed under the Tax Transparency Code (TTC), as it has access to far more detailed information about the tax affairs of businesses than is proposed under the TTC”: see TTC Report at para 4 http://taxboard.gov.au/files/2016/05/BoT_TransparencyCode_Final_report

90 For example, the ATO must disclose the dealings of privately owned and wealthy groups which attract its attention: see https://www.ato.gov.au//Business/Large-business/In-detail/Tax-transparency

91 Following the EU Fourth Anti-Money Laundering Directive 2015/849. See [6.3.4.1].

92 Amending the Tax Administration Act 1994 (NZ), after a government inquiry into the 2016 “Panama Papers” disclosures. See [6.4.2].
others. Several of the more significant OECD transparency recommendations cannot apply to most Australian trusts. Beneficial ownership of and vested interests in discretionary trust property are not identifiable before property leaves the trust.

6.1 FOREIGN TAX COMPLIANCE ACT 2010 (US)

The Foreign Account Tax Compliance Act 2010 (US) (FATCA) has been described as a “lever of influence” in the US government’s “ongoing quest to secure tax revenue from its overseas citizens”. On 28 April 2014, the US and Australia signed an intergovernmental agreement for FATCA’s Australian implementation (FATCA agreement). The agreement became part of Australian law in June 2014.

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94 See http://treasury.gov.au/Policy-Topics/Taxation/Tax-Treaties/HTML/Intergovernmental-Agreement (17 July 2017) and generally https://www.ato.gov.au/General/International-tax-agreements/In-detail/International-arrangements/FATCA-detailed-guidance/ (17 July 2017). The FATCA agreement also provides Australia with some exemptions from FATCA requirements, such as a “Financial Institution with a Local Client Base” (sic! with no place of business out of Australia and with at least 98% of Financial Accounts by value held by Australian residents) and “Australian Retirement Funds” including “a pooled superannuation trust as defined in the Income Tax Assessment Act 1997”. Australia entered an inter-governmental agreement of the first kind, under which FATCA reporting obligations were assumed by the ATO as “designated local authority”. Over 100 countries had done likewise by 30 June 2014, when most FATCA agreements came into effect.

95 The Australian parliament passed the Tax Laws Amendment (Implementation of the FATCA Agreement) Act 2014 and inserted “Division 396—Third Party Reporting” into the TAA. Division 396 is originally named “FATCA” and renamed “Third party reporting” in November 2015 to accommodate the OECD “Common Reporting Standard”. Subdivision 396-B appears to go beyond what is necessary to implement Australia’s adoption of FATCA and the CRS. Nine types of government and private entities are required to report tax-related information to the Commissioner of Taxation in the transactions set out in a table headed “Schedule 1—Collection and recovery of income tax and other liabilities”: government grants to business entities, consideration for services supplied to government entities, market integrity data received by ASIC, transfers of land, share or unit transfers in financial markets, otherwise unreported changes of unit holdings in unit trusts, otherwise unreported changes of company share or unit holdings held by other trusts, and payments to business entities made through electronic payment systems.
FATCA contains obligations of due diligence, financial reporting and record-keeping which bind Australian Financial Institutions (AFIs) which have US Reportable Accounts for US citizens and tax residents. Reporting AFIs are required to exercise due diligence procedures in order to identify the US citizens and tax residents who control account holding entities. The US authority announced that it will impose a 30 per cent withholding tax on payments from US sources made to AFIs which fail to observe FATCA requirements.96

6.1.1 FATCA REPORTING REQUIREMENTS — THE OBLIGATION TO REPORT

AFIs subject to FATCA reporting requirements are defined in the FATCA agreement as entities in the investment business which maintain US Reportable Accounts. Specifically, Article 1(1)(g) provides that “[T]he term ‘Financial Institution’ means a Custodial Institution...that holds financial assets for others”. “Custodial Institution” is defined in Article 1(1)(h) to mean “any Entity that holds, as a substantial portion of its business, financial assets for the account of others”. By 1(1)(gg) an “Entity . . . means a legal person (which, for the avoidance of doubt, excludes a natural person) or a legal arrangement such as a trust.” A “US Reportable Account” means a financial account held or controlled by a US citizen, US resident, US corporation or trust controlled by a US citizen (Article 1(1)(cc)).

6.1.2 FATCA REPORTING REQUIREMENTS

A Reporting AFI which maintains a US Reportable Account must supply the ATO with a statement of information listed in the FATCA agreement by 31 July each year together with a statement of payments made to FATCA non-participating financial institutions on behalf of the account-holder. Article 2 of the FATCA agreement describes the “information” to be supplied relative to each “US Reportable Account”. The list includes details of account-holders, the value of the account, interest paid and dividends received each calendar year. Written records of such matters must be kept for five years.

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6.1.2.1 TRUSTS AND AFI REPORTING REQUIREMENTS

FATCA reporting requirements apply to AFIs structured as trusts if they carry on an investment business on behalf of others and are not excepted by the FATCA agreement. The “Investment Entity” species of Financial Institution has the largest application to trusts. As provided by Article 1(1)(j) of the FATCA agreement, “Investment Entities” are in the investment business and trade in money market instruments or portfolio management “for or on behalf of a customer” or otherwise engage in “investing, administering or managing funds or money on behalf of other persons”.

A limited “sponsorship” concession exists for trusts with US Reportable Accounts. An AFI within this description can enter into an agreement with another AFI or a Foreign Financial Institution (FFI) such that the other AFI or FFI will fulfil the sponsored entity’s due diligence, withholding and reporting obligations on its behalf. Family office trusts and trusts used for private investment can thereby avoid the rigour of FATCA obligations.

6.1.2.2 PRIVATE TRUSTS — FIXED

Few private trusts in Australia are "Reporting Australian Financial Institutions" and subject to FATCA requirements. The FATCA agreement defines an "Investment Entity" as an entity which is in the business of investing on behalf of "customers" (Article 1(1)(j)). AFIs are professional trustee companies. Entities of this type in Australia are subject to fairly close prudential regulation under the Australian Securities and Investments Commission Act 2001 and the Corporations Act 2001.

Interests in private trusts not in the business of investing on behalf of others may be either fixed or non-fixed. Fixed trusts engaged in active or passive investment typically invest on behalf of their beneficial owners and not "customers" of an investment business carried on by the trust.

97 Comparable AFI due diligence requirements, Reportable Accounts, controlling individuals and trusts are further examined in the CRS commentary at [6.2].

98 See the FATCA agreement, Annex 2, IV, B.

99 Corresponding requirements exist for "Custodial Institutions" or "Depository Institutions" under FATCA agreement Article 1.

100 The same entities may also be Managed Investment Trusts subject to Division 276 of the Income Tax Assessment Act 1997.
Customers supply value as purchasers in an exchange with the trustee. Only a limited number of interests in private fixed trusts are acquired for value.101

6.1.2.3 PRIVATE TRUSTS — DISCRETIONARY

Non-fixed or discretionary trusts in Australia which conduct investment businesses may do so on behalf of persons chosen from very wide classes of objects (or eligible beneficiaries). Discretionary trusts have been enforced where the class of eligible objects includes the entire world except one person. Or the class of objects in a discretionary trust may be small — perhaps a few specific persons or the present and future members of a single family.

Regardless of this diversity, the objects of a discretionary trust can only be conceived as "customers" of an investment business if they supply value in return for their status as objects in the hope of an acceptable return and the favourable exercise of the trustee's discretion. Such a thing is not impossible. Many large (and FATCA-exempted) 102 superannuation funds in Australia are structured as hybrid fixed and discretionary trusts. Members of such hybrid funds supply a proportion of their salaries over what may be a working lifetime in the expectation that controllers of the fund trustee will exercise the trustee's discretion in acceptable ways.103 But this is a restricted context. Discretionary objects of an investment business who paid value for their status and are prepared to rely on exercises of a trustee's discretion are doubtless very few.104 Australian discretionary trusts are barely within the scheme of FATCA regulation whilst not being FATCA-exempted.

6.1.2.4 WHERE THE TRUSTEE IS A REPORTING AFI INDEPENDENT OF THE TRUST:

101 Tom Lowe in “Cross-border tax investigations and the OECD’s tax information exchange regime” (2015) 21 Trusts & Trustees 1012 at 1016 states that “Family offices can expect to be treated as FFIs” [referred to here as AFIs], after noting that “[T]ypically a professional trustee is within the first category of FFI because it administers financial assets as part of its business”.

102 Note that while Australian superannuation funds are treated as “Non-Reporting Australian Financial Institutions”, investment returns that flow from offshore entities in which Australian superannuation funds hold investments may be subject to the 30% FATCA withholding: see Terry Hayes and Stuart Jones “US FATCA agreement confirms exemption for Australian super funds but obligations remain” 21 May (2014) Superannuation & Financial Services Bulletin 203, at 2013.

103 E.g. Unisuper, one of Australia’s largest superannuation funds, pays death benefits to persons and in proportions determined in the trustee’s discretion.

104 Further on the application of FATCA to discretionary trusts, see Henry Christensen and Jean-Marc Tirard “The amazing development of exchange of information in tax matters: from double tax treaties to FATCA and the CRS” (2016) 22 Trusts & Trustees 898 at 911.
Trusts’ FATCA reporting requirements do not necessarily arise from their own activities. If trusts have trustees or managers which are otherwise AFIs, or their assets are under the control of trustees who are AFIs, they become AFIs themselves.\(^\text{105}\) This has a potentially wide application. The trustees of private trust funds frequently invest in managed funds, index funds, hedge funds or similar investments owned or controlled by AFIs.

Annex II of the FATCA Agreement item IV A exempts this type of private trust from reporting obligations (subject to exceptions). Described as a “Trustee Documented Trust”, a trust will be a “deemed-compliant” entity to the extent that it is a “trust established under the laws of Australia” with a manager or (co-)trustee which is an AFI or a Reporting US financial institution which reports all information required under the FATCA agreement.\(^\text{106}\)

### 6.2 OECD COMMON REPORTING STANDARD\(^\text{107}\)

The purpose of the Common Reporting Standard (CRS) is to identify and deter cross-border tax evasion. On 21 July 2014, the OECD released a *Standard for Automatic Exchange of Financial Account Information in Tax Matters (CRS Standard)*.\(^\text{108}\) Australia undertook to implement the CRS standard from 1 January 2017, pursuant to a CRS *Multilateral Competent Authority Agreement* executed on 3 June 2015. The *Tax Laws Amendment (Implementation of the Common Reporting Standards) Act 2016* amended the TAA and became law on 18 March 2016.\(^\text{109}\)

Sixty-one jurisdictions, including Australia, have agreed to implement the CRS Reporting Standard.\(^\text{110}\) Australia’s first exchange of tax information will occur in 2018.\(^\text{111}\) From that time,

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\(^{105}\) Excluding trustees who are natural persons pursuant to the “Entity” definition extracted above. FATCA applies to corporation, trust and partnership entities.

\(^{106}\) See Christensen and Tirard, note 11, at 914.


\(^{109}\) Amending Div 396 of the Act by inserting “sub-div 396—Common Reporting Standard” and re-titling the Division “Third party reporting”.

\(^{110}\) More participants are expected: see the CRS Implementation Handbook at [48].

\(^{111}\) See ATO *Automatic Exchange of Information—guidance material* (2 September 2016); Australian Treasury Media Release 2 June 2015: “Australia signs up to combat tax evasion”; ATO *Common
the ATO should automatically receive financial account information reported by FFIs in participating off-shore jurisdictions. Reciprocally, AFIs must disclose financial account information and other prescribed details to participating jurisdictions. AFIs’ disclosure obligations are owed to the Federal Commissioner of Taxation.

The CRS draws on the experience of the US and other parties to FATCA agreements, as well as the OECD’s 2005 “Tax Information Exchange Agreement” —based on the global reporting standard for financial institutions proposed in Article 26 of the 2005 Model Tax Convention on Income and Capital. CRS information-sharing and reporting requirements were modelled on, and are quite similar to, FATCA requirements, deleting US specificities in a multilateral information exchange. The CRS is FATCA’s “younger but already bigger sister”, as one US tax official observed.112

6.2.1 CRS REQUIREMENTS—ELIGIBILITY TO REPORT

The CRS Standard defines a “Reporting Financial Institution” (RFI) as an “entity”113 which is a “Financial Institution”114 excluding “Non-Reporting Financial Institutions.”115 The CRS reporting nexus relies on the RFI having an Australian residence. This means an Australian tax residence, or alternatively the RFI’s place of incorporation or where the RFI is subject to financial supervision. Trusts reside where one or more of their trustees reside.116

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113 A corporation, partnership or trust, excluding individuals and sole proprietors: see CRS Standard VIII, A and TAA s396-115.

114 Defined as a “Custodial Institution” (bank or other deposit-taking institution), “Depositary Institution” (broker or other entity that holds the financial assets of others) or “Investment Entity” (entity that either itself or through an intermediary invests the financial assets of others): see CRS Standard VIII, A.

115 A Governmental Entity, International Organisation or Central Bank, a retirement fund, an exempt collective investment vehicle in which no interests are held by Reportable Persons (q.v.), and entities which present a low risk of tax evasion: see CRS Standard VIII, B, 1.

116 See the CRS Standard at VIII, A, 2.
A difference between FATCA and the CRS with particular application to trusts is that a RFI cannot elect to become a sponsored entity whose due diligence and reporting responsibilities are assumed by another RFI. Trusts as investment vehicles for family investment offices or private investment funds may have “Reportable Persons” amongst their beneficiaries. Application of the CRS Standard requirements to this type of entity may be onerous.\textsuperscript{117}

6.2.2 CRS REQUIREMENTS—THE REPORT

An RFI which maintains at least one Reportable Account must provide the ATO with prescribed information.

The CRS Standard defines a Reportable Account as an account held by one or more “Controlling Persons” that is a Reportable Person. “Controlling Persons” exercise control over the entity(ies).\textsuperscript{118} “In the case of a trust”, the CRS Standard adds, such term means the settlor(s), the trustee(s), the protector(s) (if any), the beneficiary(ies) or class of beneficiaries, and any other natural persons(s) exercising ultimate effective control over the trust . . . The term “Controlling persons” must be interpreted in a manner consistent with the Financial Action Task Force Recommendations.\textsuperscript{119}

RFIs are subject to extensive due diligence requirements under the CRS Standard.\textsuperscript{120}

For pre-existing entity accounts, RFIs must conduct “electronic indicia searches” and assess documentary evidence of the residential address of the relevant Controlling Person(s). “Hold mail” and “in-care-of” addresses will not suffice. The RFI must determine whether the account holder is an “Active or Passive Non-Financial Entity” and notify whether the account balance is above $1m.

For new entity accounts, the due diligence procedure for controlling persons is more onerous. An RFI will need to ascertain the account holder’s Taxpayer Identification Number (or TIN) — a

\textsuperscript{117} See CRS Standard at IX, A, 1 and CRS Implementation Handbook Annex 1 “CRS-related frequently asked questions”, [14].

\textsuperscript{118} Relevantly, a “Reportable Person” is an individual or person residing in Australia: see CRS Standard VIII, D, 2.

\textsuperscript{119} See the CRS Standard at VIII, D, 6

\textsuperscript{120} See CRS Standard at VIII,B, re: 3 (“Preexisting Individual Accounts”), 4 (“New Individual Accounts”), (“Preexisting Entity Accounts”) and 6 (“New Entity Accounts”).
This is an independent report commissioned by the Australian Tax Office. Interpretations and opinions expressed should be ascribed to the authors only.
6.3.1 THE RECOMMENDATIONS

In February 2012, FATF published 40 money laundering and counter-terrorist financing recommendations for implementation by its members. Governments, financial institutions and their customers are all within the scope of the FATF Recommendations. FATF Recommendations 10 and, in particular 25, are of relevance to trusts.

6.3.1.1 FATF RECOMMENDATION 10

FATF recommendation 10 is headed "Customer due diligence". It requires financial institutions in member countries to make appropriate inquiries about suspicious customers or customers engaged in "occasional transactions" above a USD/EUR threshold of $15,000/€15,000. The purpose of the recommendation is to identify "the beneficial owner", "taking reasonable measures to verify the identity of the beneficial owner" and "understanding the ownership and control structure of the customer." FATF recommendation 22 at p20 extends the customer due diligence and record-keeping requirements to persons "acting as (or arranging for another person to act as) a trustee of an express trust or performing an equivalent function".

6.3.1.2 FATF RECOMMENDATION 25

FATF recommendation 25 is headed "Transparency and beneficial ownership of legal arrangements". For the purpose of preventing misuse of legal arrangements for money laundering or terrorist financing, member countries must ensure that competent authorities can access adequate information about express trusts and their settlors and beneficiaries. Financial institutions and designated businesses and professions should be able to access trusts' "beneficial ownership and control information".

Interpretive note 33 to FATF recommendation 10 (Customer due diligence) at p62 states that "for beneficiary(ies) of trusts that are designated by characteristics or by class", financial institutions should "establish the identity of the beneficiary at the time of the payout or when the beneficiary intends to exercise vested rights." All trust beneficiaries are assumed to have "vested rights" in the device.

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Recommendations are to be implemented by members in accordance with their different circumstances.

128 Note that FATF Recommendations distinguish "trusts" (referred to in lower case) from "Legal Persons" and generically deal with "trusts" as a species of "other legal arrangements".

129 See Interpretive Note to FATF recommendation 10, note 33 (at p62).
6.3.2 IMPLEMENTING THE RECOMMENDATIONS

The passage of *FATF Guidance: Transparency and Beneficial Ownership* (October 2014) (*FATF Guidance*) which relates to FATF recommendation 25 is headed "Enhancing transparency of legal arrangements". A number of implementation measures are suggested. "Trusts law countries" at [59]-[61] are encouraged to ensure that up-to-date information exists as to "the identity of the settlor, trustee(s), protector (if any), beneficiary or class of beneficiaries, and any other natural person exercising ultimate control over the trust." 130 "Common requirements for all countries" at [62]-[63] include financial institution disclosure and retention of details about trusts when commencing a business relationship with a trust and when transactions are entered above a USD/EUR threshold of $15,000/€15,000. "Other possible measures" at [64]-[68] include the maintenance of registries of trusts, trust assets and professional trustees and tax authorities holding appropriate information about trustees and trust beneficiaries.

6.3.3 NO BENEFICIAL OWNERSHIP AT GENERAL LAW IN MOST AUSTRALIAN TRUSTS

Access to information about beneficial ownership is an overarching theme of the FATF recommendations applicable to trusts. Not all Australian trusts disclose beneficial ownership.

At general law, the objects or "beneficiaries" of discretionary trusts do not own any of the property vested in the trustee until that property is appointed to them as eligible persons. Once created, the property interests are "owned" by beneficiaries.

Beneficial ownership of discretionary trust property is created for the first time when discretionary trustees exercise powers to appoint that property to eligible persons. Discretionary trusts terminate when and to the extent that the discretionary trust property is appointed. 131 On making an appointment, trustees either transfer the trust property outright to discretionary appointees, or hold the property for those persons on new fixed trusts. Property leaves the discretionary trust when it is appointed by the trustee. There is no time when trust beneficiaries can have "vested rights in or "ownership" of the assets of a discretionary trust. 132 Discretionary

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130 At [60], FATF Guidance states that legislation is not necessary so long as "common law or case law" provides sufficient information to comply with the requirements.

131 See discussion in Geraint Thomas and Alistair Hudson *The Law of Trusts* 2nd edn (Oxford University Press, 2010), at [7.47]-[7.50]. Trustees themselves may be within the class of eligible persons.

132 Contrary to the FATF assumption referred to at note 4 above — that there is a person with a vested interest who can “exercise vested rights” to the “ultimate effective control” of a discretionary trust. Discretionary trustees’ powers to deal with the property of others are not “vested” interests and hence do not form part of a trustee’s estate for bankruptcy purposes: see
trustees often have very wide powers to deal with property which they do not own.\textsuperscript{133} Powers of trustees are not a species of property.\textsuperscript{134} The proportion of fixed to non-fixed trusts or discretionary trusts in Australia is not known. Seventy-three per centum of Australian trusts have been estimated to be discretionary in form.\textsuperscript{135} The unwritten law of trusts and powers is inconsistent with the FATF recommendations.\textsuperscript{136} Discretionary trusts are a legal conundrum. Beneficial ownership of discretionary trust assets or vested interests in those assets does not exist at general law. Statutory amendment of state and territory trustee or taxation law is needed to identify beneficial owners of the unappointed assets of discretionary trusts.

\textit{Re Matheson} (1994) 49 FCR 454 at 460, Spender J; \textit{Octavo Investments Pty Ltd v Knight} (1979) 144 CLR 360 at 370-371 curiam.


\textsuperscript{134} See Geraint Thomas \textit{Thomas on Powers} 2nd edn (Oxford University Press, 2012), at [1.01]-[1.05], discussed above at [5.1.2] and \textit{Kennan v Spry} (2008) 238 CLR 366 at [180], Heydon J.

\textsuperscript{135} The ATO \textit{Taxation Statistics 2013-14 Trusts Risk Demographics Excerpt} records that 802,645 trusts lodged tax returns in the 2013-14 year and approximately 73\% of lodging trusts were discretionary in form.

\textsuperscript{136} Cf. \textit{Kennon v Spry} (2008) 238 CLR 366 at [67], per French CJ and 141] per Gummow and Hayne JJ. By a majority, the High Court in \textit{Spry} ’s case held that, for the purposes of the Act, the words of s79 of the \textit{Family Law Act 1975} conferred a property interest on the controller of a discretionary trust.
7 OTHER COMMON LAW JURISDICTIONS

Statutory regimes taxing trusts in Canada, New Zealand, the United Kingdom and the United States of America are contrasted in the tables annexed to this chapter.

Canadian and New Zealand trusts taxation are subjected to a lengthier analysis. The use of trusts in these jurisdictions has greater resemblance to the Australian conditions than the use of trusts in the United States of America or the United Kingdom. Succession duties are not levied in Australia, Canada and New Zealand. The use of trusts in the USA is largely in the context of wills and succession. The use of Australian-style discretionary trusts in the UK is discouraged by stringent legislation.

7.1 CANADIAN TAXATION OF TRUSTS

The Canadian method of integrating trust and beneficiary taxation treats both trustees and beneficiaries as taxable entities. References to “trusts” in the Income Tax Act RSC 1985 (Can) (“the Income Tax Act”) actually pertain to the trustees of trusts.137 Beneficiaries also may have taxable income interests and capital interests in trusts. Realised capital gains in Canada are included in the definition of “income” for the purposes of the Income Tax Act and taxed at a rate equal to three-quarters of the ordinary income rate.

7.1.1 ATTRIBUTION METHOD

Trustees are individually liable to tax on trusts’ income (including capital gains) at the highest marginal rate without the benefit of personal tax credits.138 To the extent that trust income and net capital gains amounts are paid or payable to trust beneficiaries, trustees are entitled to deductions from their trust income liabilities.139

137 Trustees have no separate legal personality under Canadian private law: see Waters Law of Trusts in Canada 3rd edn DWM Waters, MR Gillen and LD Smith (Thomson Carswell, Toronto, 2006) at Chapter 13, Part II A 2 and the Income Tax Act RSC 1985 (5th Supp), c.1, s-ss104(2), 104(6) and 104(13).

138 E.g., no deductions for single or married status or for dependants: see Income Tax Act s-s104(2). Canadian partnerships are also treated as separate persons — but for income reporting purposes only, comparably to partnerships in Australia, per s91 of the Income Tax Assessment Act 1936 (“ITAA36”).

139 See s-ss 104(6) and 104(24) of the Act.
Beneficiaries are liable to tax at their marginal rates on trust income and capital gains paid to them.\(^{140}\) Amounts are regarded as paid or payable to beneficiaries if they are entitled to enforce payment in a given year.\(^{141}\) The character of distributed income as dividends, interest and capital gains generally flows through trusts to beneficiary recipients. Where a capital asset (or “corpus”) of a trust is distributed to a beneficiary, the trust is deemed to have disposed of the relevant property to the beneficiary at its cost price.

Legal disability by reason of minority is treated narrowly in Canada. Minors are defined as “specified individuals” who have not attained the age of 17 years in the year of taxation.\(^{142}\) Only if specified individuals have vested rights to trust income will the income be treated as paid to them and attract the trustee deduction.\(^{143}\) Income shares to which specified individuals are entitled contingently on attaining majority are excluded from the concession.\(^{144}\)

2015 tax law amendments abolished a tax-planning advantage that testamentary trusts had over inter vivos trusts. Formerly, testamentary trust beneficiaries could split their trust incomes from other incomes and benefit from the lower marginal rates applicable to deceased estates. Estate trustees were taxed at the graduated rates rather than the highest marginal rate prior to distributing trust income to beneficiaries. Now trustees of testamentary trusts are taxed at the highest marginal rate in common with other types of Canadian trusts.\(^{145}\)

A limited class of Canadian residents can elect to be the “preferred beneficiaries” of discretionary trusts by asserting that they are prospectively entitled to shares of unappointed and accruing trust income. Preferred beneficiaries making this election will be taxed on the shares of accumulating trust income to which they are prospectively entitled at their marginal rates. The concession originally supplied relief to settlors, their spouses and relatives who were

\(^{140}\) See Income Tax Act s104(13).

\(^{141}\) See Income Tax Act ss104(24); discretionary trusts are accommodated within the scheme comparably to discretionary trusts in Australia, per s101of the ITAA36:

\(^{142}\) See Income Tax Act, s120.4.

\(^{143}\) See Income Tax Act ss104(18).


\(^{145}\) Excepting bare, spousal, alter ego and exempt trusts: see Canada Revenue Agency T3 Trust Guide 2015, at 18-19; MA Buschkens and R Rechtsman “Recent changes in Canada in the areas of trusts and estates law” (2015) 21 Trusts & Trustees 117 at 119 and Natalie Woodbury “Testamentary trusts: the new rules” (2015) 63 Canadian Trusts Journal 269 at 272. At 266, Ms Woodbury suggests that without “the extra set of graduated rates historically afforded to the testamentary trust, it is possible that the use of inter vivos trusts will increase” and she lists a number of advantages which inter vivos trusts have over testamentary trusts.
in lower tax brackets than the trustee.¹⁴⁶ Now preferred beneficiaries must be persons within the same class who are also "dependent because of mental or physical infirmity".¹⁴⁷

### 7.1.2 CAPITAL GAINS TAX

The "essence" of a Canadian capital gain or loss is that it is a "disposition" of "capital property".¹⁴⁸

Capital gains tax charges relative to trusts occur when property is transferred to a trust or a trust is created over the transferor’s property. Dispositions of property held in trust attract capital gains tax. Every 21 years, the Act deems a disposition of all of a trust’s assets to have occurred unless those assets have vested indefeasibly.¹⁴⁹ The death of a taxpayer triggers a deemed disposition of his or her vested trust entitlements.¹⁵⁰ Deemed disposals also occur on a change in the use of capital property and on a trust becoming non-resident.

Exceptions to these capital gains events, not including the deemed disposition on death, are provided for trusts in favour of the spouse or common law partner of a trust creator and alter ego trusts (discussed below). Succession duties and gift taxes at both federal and provincial levels were abolished between 1973 and 1986. Capital gains tax is now the only tax triggered by a taxpayer’s death.

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¹⁴⁶ See Wolfe Goodman, n. 7, at 278. The class of potentially preferred beneficiaries originally included the settlor, the settlor’s spouse or common law partner or former spouse or common law partner, or a child grandchild or great-grandchild of the settlor, or the spouse or common law partner of such descendent.

¹⁴⁷ See Income Tax Act s-ss 108(1) (definition), 104(14) and 104(15).

¹⁴⁸ See Peter W Hogg and Joanne E Magee Principles of Canadian Tax Law (Carswell, Toronto, 1997), 15.9(d), 15.14.

¹⁴⁹ An anti-deferral measure: see Income Tax Act s-s 104(4):

Every trust is at the end of [successive 21 year anniversaries of the trust’s creation] deemed to have disposed of each property of the trust (other than exempt property) that was capital property (other than excluded property or depreciable property) or land included in the inventory of a business of the trust for proceeds equal to its fair market value . . . at the end of that day and to have reacquired the property immediately after that day for an amount equal to the fair market value . . .

¹⁵⁰ E.g., in fixed, alter ego and joint spouse trusts.
7.1.3 RECOGNITION OF BENEFICIAL INTERESTS

Beneficiaries’ beneficial ownership of trust assets is recognised by the trusts’ taxing code in several ways.

First, the final tax liability for trust income is imposed on the beneficiaries who are entitled to be paid that income. Liabilities are computed at the beneficiaries’ marginal rates. Trustees are entitled to deductions from their own incomes measured by the income amounts which they pay or are payable to beneficiaries. Trusts, to that extent, serve as conduits to the tax liabilities of persons beneficially entitled.

Secondly, when trustees distribute trusts’ capital property to capital beneficiaries, there is no charge to capital gains tax. The property’s cost base and other tax characteristics are rolled over from the trustees to the beneficiaries (see below).

Thirdly, “self-help” (or bare) trusts which do not change the beneficial ownership of property are generally not liable to income or capital gains taxation. Bare trusts are treated as agents for their beneficiaries. Blind trusts employed by aspirants for political office are an example. No disposition of capital property occurs when a bare trust is created. Capital gains are rolled over until the death charge occurs. This concession is limited to trusts for individuals who are solely entitled to receive trust income prior to their death.

7.1.4 ALTER EGO AND JOINT SPOUSAL TRUSTS

Concessional categories of alter ego trusts (created by people over 65 years of age) and joint spousal or common law partner trusts are of particular use for retirement and estate planning.

No charge to capital gains tax is raised on the transfer of property to alter ego and joint spousal trusts which satisfy the condition that the trust settlors and/or their spouses are exclusively

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151 Subject to restrictions for real property income paid to non-resident beneficiaries and gains realised by a spouse trust. Beneficiary entitlements to income and capital gains are deed-specific. If no beneficiary is entitled to a capital gain under the terms of the trust deed, the trustee will be liable to tax on that capital gain at the trustee rate.

152 Excluding transfers of property by Canadian residents to non-resident bare trusts, to which ordinary trust rules apply: see *Income Tax Act*, s107.4.


154 As defined in the *Income Tax Act* s-s248(1); see *Waters on Trusts*, n. 1, Chapter 13, Part II A 7 a.
entitled to receive trust income during their lifetimes.\textsuperscript{155} Settled property is rolled over to the trustee with the settlor's cost base. The 21-year deemed disposal of trust assets does not apply to alter ego and joint spousal trusts.\textsuperscript{156} However, the deemed capital gains tax disposal on death is applicable on the demise of the settlors or their surviving spouses. Any property distributed by an alter ego or spousal trust other than to a trust settlor or spouse will be deemed to be a chargeable disposal for fair market value.\textsuperscript{157}

7.1.4.1 Streaming

Trust income amounts comprising capital gains, dividends and foreign source income pass through trusts to beneficiaries with the same character as the amounts had for the trustee in whose name they were derived. Deductions and tax credits corresponding to these income types are allowed to the beneficiaries concerned.\textsuperscript{158}

7.1.4.2 Non-resident beneficiaries of Canadian trusts

The regime for non-resident beneficiaries of Canadian trusts is aimed at deterring the avoidance of Canadian tax on income arising in Canada and on gains arising from the disposition of Canadian capital property.\textsuperscript{159}

Capital gains and other income allocated to non-resident beneficiaries do not flow through trusts to non-resident beneficiaries but are finally taxed at the level of the trust. A capital interest in a

\begin{flushleft}
\begin{footnotesize}


\footnotesize{157} See \textit{Income Tax Act} s-s107(4).

\footnotesize{158} Hence beneficiaries receiving capital gains may claim deductions associated with income from qualified small business corporation shares, qualified farm properties and the offset of allowable capital losses: see s-s 104(21); beneficiaries receiving dividends may claim dividend tax credits or tax-free inter-corporate dividends: see ss and s-ss 104(19), 82(1) 121,112; beneficiaries receiving foreign source income may claim tax credits for foreign tax paid by the trustee: see s-s 104(21).

\footnotesize{159} See Part XII.2 of the \textit{Income Tax Act} (ss210-210.3) and \textit{Waters Law of Trusts in Canada}, n.1, Chapter 13, Part II A 5.
\end{footnotesize}
\end{flushleft}
resident trust is “taxable Canadian property”. Non-resident beneficiaries cannot make preferred beneficiary elections.

Distributions made to non-resident beneficiaries from Canadian resident trusts are liable to a withholding tax of 25 per centum of the income paid or credited (subject to applicable tax treaties). Additional tax is levied on capital gains made from the disposition of taxable Canadian property and on certain income classes to discourage tax savings by non-residents through the use of withholding tax as a final tax on Canadian-source income.

7.1.4.3 NON-RESIDENT TRUSTS

Prima facie, non-resident trusts are subject to Canadian tax only in respect of their Canadian source income. Non-resident trusts are liable for income tax derived from the conduct of Canadian businesses and for capital gains made from the disposition of “taxable Canadian property”. Deductions are available for distributions to resident, but not “designated” or non-resident beneficiaries.

The use of foreign trusts to shelter income derived from contributions made by Canadian taxpayers is discouraged by complicated anti-avoidance rules applicable to “resident contributors” and “resident beneficiaries” of non-resident trusts. Non-resident trusts may be deemed to reside in Canada and be taxable on their world-wide income if those trusts have prescribed links to Canadian contributors. Anti-avoidance legislation deems virtually all trusts that have received a direct or indirect contribution from a Canadian resident to be trusts resident in Canada for tax purposes.

7.1.4.4 DEALINGS WITH TRUST INTERESTS

“Capital interests” of a beneficiary in a trust are a species of capital property. A beneficiary’s dealings with this property may attract capital gains tax. Where a capital beneficiary disposes of their capital interest to another person or to the trustee, a chargeable disposition for capital gains tax purposes will normally occur.

No capital gain is recognized by Canadian trusts taxation law where a trustee transfers a capital asset of a trust to a capital beneficiary in satisfaction of the beneficiary’s beneficial interest in the trust. In such a case, the property is rolled over to the beneficiary together with trustee’s cost

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160 See Waters Law of Trusts in Canada, n.1, Chapter 13, Part II A 4.
161 See Income Tax Act s-s108(1) "capital interest" definition (right to enforce a trust not including enforcement of an income interest); re dispositions to the trustee, see s107.1 "employee life and health trust" and "employee benefit plan".
base and the property's other tax characteristics. The capital asset leaves the trust in a deemed disposition to the beneficiary at the asset's cost amount.

7.2 New Zealand Taxation of Trusts

The New Zealand Law Commission estimates that there is a greater use of trusts in New Zealand than in any comparable country. Taxation statistics indicate that there are considerably more income-earning trusts per capita than in Australia, the United Kingdom or Canada.

Tax planning does not appear to be the main driver of New Zealand trust use. Commentators have suggested that avoidance of means tests applicable to the government's residential care subsidy is the principal reason why many New Zealanders put their homes and other assets in trust.

Income derived by the trustees of New Zealand trusts is taxed either as “beneficiary income” or “trustee income”. Trusts are classified as “complying trusts”, foreign trusts” and “non-complying trusts”. Trust distributions (including ordinary income, foreign income and trust corpus) are attributed to beneficiaries or to trustees or are treated as exempt depending on the type of trust.

162 See Waters Law of Trusts in Canada Chapter 13, Part II A 5.


164 The LC Second Issues paper at [2.1] states that “at least” 237,500 trusts’ tax returns were filed with the Inland Revenue for the 2007-2008 tax year with the consequences that there is one trust for every 18 people in New Zealand. In Australia, 660,324 trusts filed tax returns in the 2007-2008 income year, which “equates to around one trust for every 34 Australians” at [2.3]. In the UK (including trusts used in off-shore jurisdictions such as Guernsey, Jersey and the Isle of Man) “there would be approximately one income-earning trust for every 294 United Kingdom citizens.” Canada’s rate of trust usage “appears to be somewhat greater than the United Kingdom’s but much less than Australia’s or New Zealand’s” at [2.4]. Canada Revenue processed 229,000 resident trust returns in that year and 2,200 non-resident returns. ATO Taxation Statistics for 2013-2014 (latest available) indicate the existence of 802,645 trusts. The Australian population had risen to a little less than 24m. Hence there may now be one trust for about every 30 Australians.

165 A “flawed understanding”: see Nicola Peart “Can your trust be trusted?” (2009) 12 Otago Law Review 59 at 63, describing the common misconception that means testing is inapplicable if subsidy applicants put their homes in trust more than 5 years previously; also the LC Second Issues paper at [3.62]-[3.73]; but cf. Martin Hawkes Family Trusts: A New Zealand Guide 6th edn (Shoal Bay, 2008), at 37-39.
trust. Capital gains tax in New Zealand is not generally applicable and is only payable on some trust distributions made by non-complying and foreign trusts.

7.2.1 Attribution Method

Beneficiaries are liable to tax on beneficiary income if, and to the extent that, the trust income either (a) vests absolutely in interest in the beneficiaries in an income year; or (b) is paid to the beneficiaries in the income year.

Trustees are liable to tax on trustee income at a flat rate of 33 per cent. Trustee income includes all trust income which is not beneficiary income.

7.2.2 Beneficiary Income

Liability for beneficiary income is triggered by a beneficiary being or becoming entitled to trust income, as well as trust income being paid to that beneficiary. Beneficiary income is taxed at the beneficiary’s marginal rate.

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167 See *ITA* s HC 16(2)(c).

168 See *ITA* s HC 6.

169 See *ITA* Schedule 1, Part A, cl. 3, which equals the highest marginal rate of tax applicable to income in excess of $NZ70,001 (from 2011-2012).

170 See *ITA* s HC 7.

171 See *ITA* Schedule 1, Part A, cl. 1.
7.2.2.1 VESTS ABSOLUTELY IN INTEREST

Income “vests absolutely in interest” according to the learning of trusts law and the trust deed. 172

An immediate, fixed right of present or future possession of the trust income comes into existence when the trust income vests absolutely in interest. Either present enjoyment or indefeasible future enjoyment of the income is implied. 173

Unpaid present entitlements are permitted under the New Zealand trusts taxation regime. 174 For example, the trustee of a discretionary trust might create an absolute vested interest in trust income through making an appropriate entry in the books of the trust. There is no need for this to be communicated to the beneficiary concerned. A trustee’s resolution is all that is required to vest the trust property in the beneficiary. After paying the beneficiary’s tax liability, the trustee can retain the amount distributed or transfer it to another beneficiary by means of a loan. 175

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172 See Interpretation Statement IS 12/02: “Income tax – whether income deemed to arise under tax law, but not trust law, can give rise to beneficiary income” at [2]. Tax law/trusts law income mismatches in NZ involve (deemed) tax law income exceeding trusts law income: “[W]here trusts law income exceeds tax law income, there is no problem.” The IRC takes the position that deemed income can only be beneficiary income if it is reflected in an amount actually paid to the beneficiary. Otherwise deemed income will be taxed to the trustee. The leading case defining “an immediate fixed right of present or future possession of the income” is Commissioners of Inland Revenue v Ward [1970] NZLR 1.


174 See discussion of McCarthy J in CIR v Ward (1969) 1 ATR 287 at 310-313 (other JJ concurring), applying the reasoning of Re Vestey’s Settlement [1950] 2 All ER 891 (CA) per Evershed MR at 897 to the interpretation of the proviso to s155(b) of Land and Income Tax Act 1954 (NZ) (income paid or applied for the benefit of a minor). Ward’s case was referred to with approval in Euroasian Holdings Pty Ltd v Ron Diamond Plumbing (in liq) (1996) 64 FCR 147 At 150, Heerey J and Chianti Pty Ltd v Leume Pty Ltd [2007] WASCA 270 at [72]-[73] per Buss JA. Relevant provisions of the 1954 Act have not been re-enacted in the ITA. However, the underlying reasoning in Ward’s case has never been disapproved.

175 Assuming that the trust is a “complying trust” and the distribution is made pursuant to ITA s HC 14. Interest on the loan may be forgiven or not paid.
7.2.2.2 PAID

Liability for beneficiary income also arises to the extent that the beneficiary is paid trust income in a tax year or a date within 6 months of the end of a tax year. Income is “paid” to a beneficiary if the beneficiary receives money or money’s worth, including where the trustee distributes income to the beneficiary or deals with the income on the beneficiary’s behalf.

7.2.2.3 MINOR BENEFICIARY RULE

Beneficiary income derived by a minor (being a natural person under 16 years of age) is taxed to the trustee at the trustee income rate of 33 per cent. Certain trusts are excluded from the minor beneficiary rule, including testamentary trusts and trusts created by persons who are not relatives or guardians of the minor (or associated persons), trusts of damages or compensation and very small settlements. There is no other provision governing income distribution and legal disability.

7.2.3 TRUSTEE INCOME

Trustees are taxed at the 33 per cent rate on an individual basis. Tax is imposed at the same rate regardless of whether the trustees are individuals or corporations and regardless of whether the trusts are complying trusts, non-complying trusts or foreign trusts. Trustees can claim deductions for amounts necessarily incurred in deriving the income of a trust. Expenses incurred by trustees in excess of trust income, leading to trust income losses, cannot be distributed to beneficiaries. However, trust losses can be offset against trust income in subsequent years.

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176 See ITA s HC 6, Sec 34 Tax Administration Act 1994 (NZ) may provide a different date for filing a trust tax return.

177 See definition of “pay” in ITA s YA 1 and (1989) 1 Tax Information Bulletin No 5, Appendix.

178 The rule is intended to prevent “income streaming”: see ITA s HC 35 and NZ Master Tax Guide at ¶25-010.

179 That is, trusts of the deceased’s assets disposed of in his estate. The rule extends to “settlements on qualifying testamentary trusts”, which are made pursuant to a will, codicil, intestacy or court-ordered variation.

180 See IT Ass HC 36 and HC 37.

7.2.3.1 TRUSTEE INCOME AND DIVIDEND IMPUTATION

Dividend income forms part of either trustee income or beneficiary income, depending on whether it is undistributed or the subject of a beneficiary’s entitlement. Imputation credits linked to dividends distributed as part of beneficiary income are allocated to individual beneficiaries.

7.2.4 TRUSTS DISTRIBUTIONS: COMPLYING, NON-COMPLYING AND FOREIGN TRUSTS

"Settlers" are normally the founders of trusts. Complying trusts are established by New Zealand settlers. All income derived by the trustees of complying trusts is subject to New Zealand tax at the rate appropriate for the trustees and/or any beneficiaries entitled. Complying trust distributions other than beneficiary income are received by beneficiaries tax-free.

Foreign trusts are defined by the residence of their settlers when distributions are made. If no settlor was resident in New Zealand on the date of a distribution and on the later of 1987 and when the first settlement was made on the trust, a trust is a foreign trust. Foreign trust distributions of non-beneficiary income, including some capital gains and trust corpus, are taxed at beneficiaries' marginal rates.

Non-complying trusts are any trusts which are neither complying trusts nor foreign trusts. Non-complying trust distributions, other than beneficiary income and trust corpus, are taxed to beneficiaries at the penal rate of 45 per cent.

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182 See n. 187 below.

183 That is, the 33% rate for trustee income or income of minor beneficiaries, the 45% rate for non-complying trusts or the 17.5% rate for the income of Maori authorities.

184 See ITA HC 10, HC 25 and HC 26. Complying trusts do not derive non-resident passive income taxed at a withholding tax rate of between 15 and 30 per cent (and sometimes nil): see ITA ss RF 7, RF 12.

185 Paraphrasing ITA s HC 11. New Zealand residents are taxed on otherwise non-taxable capital gains and corpus distributions made by foreign trusts.

186 Paraphrasing ITA s HC 12.
7.2.5 SETTLOR LIABILITY

New Zealand settlor liability has no counterpart in Australia. There is a trusts law difference between New Zealand and Australia on the point. Many of the responsibilities that the Australian trusts taxation code imposes on trustees are borne by settlors in New Zealand. The residence of the trust settlor (as the trust’s economic agent) is one of the main determinants of liability to New Zealand tax. Complying, non-complying and foreign trusts are largely defined by reference to the residence of their settlors. By contrast, the role of trust settlers in Australia has been de-natured and trivialized.

“Settlors” are defined in the ITA as persons who transfer value or provide financial accommodation to trusts or act or refrain from acting in equivalent ways. When trust settlers cease to be residents of New Zealand, complying trusts of which they are settlors become non-complying trusts.

Trusts are treated as transparent and New Zealand resident settlors will be liable as agents of trustees in respect of income tax payable by trustees where the trustees are not resident for the full income year.


188 See NZ Master Tax Guide at ¶25-175 and John Glover “Nominal or ‘dummy’ settlors: Is it time to reform the law of trusts?” [2012] 1 Journal of Equity 19. The Australian practice is for settlors to provide $10 or equivalent nominal sums and create trusts prior to substantial capitalization of those trusts by other persons. This is regarded as a fraud in several North American jurisdictions.

189 See ITA ss HC 27 and HC 28.

190 Subject to exceptions: see ITA ss HC 25, HC 26 HC 28 and HC 33.

191 See ITA s HC 29 — a complicated provision with several exclusions. Controllers of corporate settlors will be liable as settlors if (a) the company settles an amount on the trust; (b) the company is a controlled foreign company or would have been if it were a foreign company; and (c) the controller has a control interest of 10% or more: see ITA s-ssHC28 (3) and (4).
### SHORT TABLE

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<td><strong>Purpose</strong></td>
<td>Tax planning, asset protection, enterprise vehicle</td>
<td>Asset protection</td>
<td>Means test avoidance, estate planning, asset protection</td>
<td>Estate planning and asset protection</td>
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<tr>
<td><strong>Income Tax</strong></td>
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<tr>
<td>Taxing mechanism-</td>
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<tr>
<td>Attribution- to</td>
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<td>Vests absolutely/ paid</td>
<td>Vested interest</td>
<td>Vested right</td>
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<td>(UPE)</td>
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<tr>
<td>Taxing mechanism-</td>
<td>Trustees are liable in a number of situations</td>
<td>Trustees are liable</td>
<td>Trustee liable</td>
<td>No beneficiary entitled</td>
<td>Trust income that is not distributed/distributable to beneficiaries and not attributable to grantor</td>
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<tr>
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<td>Deduction for income distributed</td>
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<td>trustee</td>
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<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Taxing mechanism-</td>
<td>N/A</td>
<td>N/A</td>
<td>Where trust does not have resident trustee – Settlor deemed as agent of trustee</td>
<td>Income arising under a settlement during the life of the settlor is treated as income of the settlor, and is taxable to the settlor</td>
<td>Liable for tax on income attributed to the portion of trust it is regarded as owning</td>
</tr>
<tr>
<td>Attribution- to</td>
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<td></td>
<td></td>
<td></td>
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<td>Entity</td>
<td>Flow through</td>
<td>“Pass-through” entity</td>
</tr>
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*This is an independent report commissioned by the Australian Tax Office. Interpretations and opinions expressed should be ascribed to the authors only.*
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<th>Minors</th>
<th>Income tax rates</th>
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<td>Beneficiaries - Individual income tax rates</td>
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<td>Trustee income</td>
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<td>Final tax rate of 33%</td>
<td>Trustees - Flat rate of 33%</td>
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<td>Accumulation and discretionary trusts - Flat rates dependent on type and amount of income</td>
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<tr>
<td></td>
<td>Parent’s marginal tax rate</td>
<td>Graduated rates</td>
</tr>
</tbody>
</table>

| Capital Gains Tax            |                                                                                        |
|------------------------------|                                                                                        |
| Capital gains tax            | Streaming                                                                             | Designation to beneficiary                                                      |
|                              | Beneficiaries                                                                        | Not generally applicable                                                         |
|                              | 21 year rule                                                                          | Trustee                                                                          |
|                              |                                                                                        | Taxed to the trust                                                               |

| Inheritance tax              |                                                                                        |
|------------------------------|                                                                                        |
| Inheritance tax              | No                                                                                    | No                                                                                |
|                              | IHT                                                                                  | No                                                                                |
|                              | 10th anniversary                                                                    | Federal estate tax payable by executor                                           |
|                              | Exit charge                                                                          | Exemption                                                                         |

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<table>
<thead>
<tr>
<th>Trust Income Comprising Capital Gains, Dividends and Foreign Source Income Pass Through Trusts to the Beneficiaries Retaining the Same Character That the Amounts Had for the Trustee in Whose Name They Were Derived. Deductions and Tax Credits Corresponding to These Income Types Are Allowed to the Beneficiaries Concerned.</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Streaming” of Capital Gains and Franked Distributions Is Allowed</td>
</tr>
<tr>
<td>No</td>
</tr>
<tr>
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</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Income Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beneficiaries Are “Presently Entitled” to Trust Income If It Is Paid or Applied Towards Their Benefit.</td>
</tr>
<tr>
<td>An Amount Is Currently Distributable to a Beneficiary If It Is Actually Paid to the Beneficiary, or the Beneficiary Is Entitled to Enforce Payment of the Amount.</td>
</tr>
<tr>
<td>Beneficiaries Are Entitled to Trust Income If the Trustee Has a Duty to Pay Them, and the Beneficiaries Have a Vested Interest Exercised in Their Favor.</td>
</tr>
<tr>
<td>Income Is “Currently Distributable” If a Beneficiary Has a Vested Right</td>
</tr>
<tr>
<td>Gross Income of Beneficiaries (Where All Income Is Distributed) Includes the Amount Derived</td>
</tr>
</tbody>
</table>

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192 Asset protection.
193 Means test avoidance, estate planning, asset protection.
194 Estate planning and asset protection.
195 “Streaming” of capital gains and franked distributions is allowed.
196 Beneficiaries are “presently entitled” to trust income if it is paid or applied towards their benefit.
197 Beneficiaries are assessed for tax based on their present entitlement to shares of trust income.
198 Trustees are liable for tax on all trust income.
199 Beneficiaries are entitled to trust income if the trustee has a duty to pay them and the beneficiaries have a vested interest exercised in their favor.
200 Beneficiaries are entitled to trust income if they are entitled to the income.
201 Income is “currently distributable” if a beneficiary has a vested right.
202 Gross income of beneficiaries (where all income is distributed) includes the amount derived.
204 Austalia “Modernising the taxation of trust income – options for reform: Consultation Paper” (Nov 2011) 54.
205 Act 1936, s 97(1).
206 Australia “Modernising the taxation of trust income – options for reform: Consultation Paper” (Nov 2011) 54.
207 (NZ), HC 6.
209 Vatt’s Cases & Materials on Equity and Trusts” (2013) 44.
Generally DNI is the trust's income modified for capital gains or losses, interest and certain amounts added back to capital.206

Gross income of beneficiaries of trusts (this refers to доход исключительно на территории Российской Федерации) includes DNI, and all other income and corpus property required to be distributed to the trust's DNI).207

If the amount of income distributed currently to beneficiaries equals the DNI of the trust, each beneficiary's gross income equivalent to his or her proportionate share of the DNI.208

<table>
<thead>
<tr>
<th>Yes</th>
<th>Yes</th>
<th>Yes</th>
<th>No</th>
<th>No</th>
</tr>
</thead>
</table>

Trustees are liable for tax on trust income.

“Trustee income” is all income the trust earns in an income year that does not vest absolutely in the beneficiary during that year, or is not income to which no beneficiary is entitled.

Trustees are liable for tax on trust income.

Unless trusts are considered to be separate taxpayers, trusts where income is taxed to the grantor, trusts are separate taxpayers.

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206 Income, Gift and Estate Taxation” (2016), 54.05. See also Alex Evans, “The “economic benefits model” for trusts – fool’s gold?” (2014) 34 Australian Tax Review 162, 182.


Some or all of the net income of the trust estate is "income to which no beneficiary is presently entitled." Net income of the trust estate is "income to which no beneficiary is presently entitled" and is derived from a trust administering a will or intestacy, bankruptcy, injury compensation or relief of various sorts. A beneficiary who is presently entitled to a share of the income of a trust estate is a "non-resident" at the end of a year of income. A person has created a revocable trust of income or a trust of income applicable for the benefit of his or her minor children.

Trustees must pay tax on behalf of beneficiaries for income allocated to beneficiaries. In order to avoid double taxation, beneficiaries are entitled to a tax credit for any tax the trustee has already paid on this income. If the trust does not have a resident trustee at some point during the income year when income is derived, a person who makes a settlement on a trust is deemed as a settlor. A person is treated as being a settlor if they have made a settlement. A settlement is widely defined to include a trust. Making a settlement expressly includes providing funds or undertaking to provide funds to the trust. A person is treated as being a settlor if they have made a settlement. A settlement is widely defined to include a trust. Making a settlement expressly includes providing funds or undertaking to provide funds to the trust.

Trusts are entitled to a deduction for income that is required to be currently, and any other amount credited or required to be total amount deductible can be DNI. The grantor is the creator of the trust relationship and is generally treated as being a settlor. The grantor is the creator of the trust relationship and is generally treated as being a settlor.

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210 Trustment Act 1936, s98(2A), 3 and (4).
211 Trustment Act 1936, s99A.
212 Trustment Act 1936, s 99(2) and (3).
213 Trustment Act 1936 s99(4) and (5).
214 Trustment Act 1936 s102. The trustee is taxed at a rate reflecting aggregation with parent's income.
215 (April 2016).
Income which arises under a settlement during the life of the settlor is treated for income tax purposes as the income of the settlor and not as the income of any other person (such as the trustee), unless the income arises from property in which the settlor has no interest. A settlor is treated as having an interest in the settlement if the trust property is or will or may become payable to or applicable for the benefit of the settlor.

If the settlor has put property into a settlement where any child of theirs can benefit, they are taxable on payments of income or capital made to such child under the settlement, amounts applied for the benefit of the child, and amounts to which the child is entitled.

Where the trustees pay a capital sum to the settlor, the settlor is taxable on the lower of the capital sum paid to the settlor and the trustee’s available income in the tax year in which the capital sum is paid to the settlor.

Where trustees have already been taxed on the grantor has a reversionary interest, either corpus or income; the beneficial enjoyment of the income is subject to a power exercisable by the grantor, adverse party, or both; a power to revest in the grantor exercisable by the grantor, adverse party, or both; the income is or may be accumulated for future distribution to the grantor or the grantor’s spouse.

When a grantor is regarded as having a beneficial interest in any portion of a trust, the grantor becomes the owner of the assets to the extent of the beneficial interest and income is taxed to the grantor.

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See also HRMC, “HS270 Trusts and settlements – Income treated as the settlor’s (2016)”. See also HC 29. See also Mark Brabazon, “Trust Residence, Grantor Taxation and the Settlor Regime in New Zealand”, (2016) Sydney Law School Legal Studies Research Paper No. 16/55.
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Minor is regarded as a beneficiary for a legal disability.</strong> Where a beneficiary under a legal disability is entitled, the tax on that portion of trust income is payable on beneficiary’s behalf by the trustee.</td>
<td>Trustees are liable for tax on all trust income.</td>
</tr>
<tr>
<td>Certain types of income received by minors are required to be taxed at the top marginal tax rate.</td>
<td>Trustees are generally liable to tax on trustee income and beneficiary income, subject to deductions for beneficiary entitlements.</td>
</tr>
<tr>
<td>Income derived by a minor from property settled on a trust by a relative or guardian of the minor, or a person associated with a relative or legal guardian of the minor is taxed as trustee’s income, at a final tax rate of 33% when it is derived.</td>
<td>Income can flow through the trust to first and final taxation in the beneficiary’s hands if the beneficiary is entitled to trust income.</td>
</tr>
<tr>
<td>Where a trust is created by the parent of an unmarried, minor beneficiary, any income that arises to the trust and is held or applied for the benefit of the minor, will be assessed on the parent/settlor, where the gross income exceeds £100 in any given tax year (£200 if parents are making a joint gift).</td>
<td>A trust that distributes an amount currently pays no tax and is taxed “through” entity.</td>
</tr>
<tr>
<td>Passive income earned by an individual does not pass into the parent’s marginal tax rate.</td>
<td></td>
</tr>
<tr>
<td>Beneficiaries pay tax at their individual income tax rates.</td>
<td>The top federal marginal tax rate applies to all trusts.</td>
</tr>
<tr>
<td>Trustees pay tax at the top marginal rate.</td>
<td>Trustees pay tax at a flat rate of 33% on trust income and at the beneficiary's marginal tax rate on beneficiary income.</td>
</tr>
<tr>
<td>The first £1,000 of trust income received by accumulation or discretionary trusts is taxed as follows:</td>
<td>Trusts are subject to tax at grant.</td>
</tr>
<tr>
<td>• Dividend type income: 7.5%</td>
<td></td>
</tr>
<tr>
<td>• All other income: 20%</td>
<td></td>
</tr>
<tr>
<td>Trust income over £1,000 is taxed as follows:</td>
<td></td>
</tr>
</tbody>
</table>

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2. Categories of beneficiaries under a legal disability.
3. Littlejohn Act 1936 section 98(1).
4. section 120.4.
<table>
<thead>
<tr>
<th>Capital gains tax</th>
<th>Capital gains tax in New Zealand is not generally applicable and is only payable on some trust distributions made by non-complying and foreign trusts.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital gains are taxed to the extent of the beneficiary's interest in trust.</td>
<td></td>
</tr>
</tbody>
</table>

A capital gain from a trust can be attributed to a beneficiary.\(^{243}\) Capital gains tax may be payable when:

- Assets are put in a trust;
- Assets are withdrawn from a trust; and
- Every 21 years (a disposition of all of a trust's assets are deemed to have occurred, unless those assets have vested indefeasibly\(^ {244}\))

CGT may be payable when:

- Assets are put in a trust; and
- Assets are withdrawn from a trust.\(^ {246}\)

The trustee is liable for tax on gains accruing to the trust.\(^ {247}\) Trustees are generally entitled to an annual exempt amount of £5,500.

Generally, no CGT is payable when a person dies. However, if an asset is disposed of at a later date, and has increased in value since the date of death, no CGT is payable.
| Trusts and Capital Gains Tax | Trustees are liable to pay a charge on every tenth anniversary of the date the trust was set up if the trust contains relevant property with a value above the IHT threshold (£350,000).\(^{250}\) 30\% of the effective rate is applied to the value of the funds on the 10 year anniversary.\(^{251}\) If a person dies within seven years of making a transfer into a trust, his estate will have to pay IHT at 40\%.\(^ {252}\) Inheritance tax (IHT) is charged up to a maximum of 6\% on assets transferred out of a trust. This is known as an exit charge.\(^ {253}\) A federal estate tax will generally include the value of all property to the extent of the descendant’s interest at the time of his or her death: Section 2033 Income Tax Code. | A federal estate tax will generally include the value of all property transferred via a transfer through an inter vivos trust.\(^ {254}\) Estate tax is payable by the estate of the deceased. An exemption of $5 million is permanent in 2013. This amount is indexed.\(^ {256}\) Many states have enacted the federal estate tax. A state death tax is allowed for state death taxes. |
8 UNAUTHORISED LEGAL PRACTICE? TAX AGENTS PREPARING TRUST DEEDS AND/OR ADVISING ABOUT TRUSTS

Whether non-lawyer tax agents can lawfully advise clients about trusts or supply clients with trust deeds is a surprisingly complex question. Trust-related tax agent services appear to be both authorised under federal law and prohibited under the state laws restricting unauthorised legal practice. The reach and possible inconsistency of federal and state laws on tax agents and legal practice are assessed in this chapter.

8.1 FEDERAL LEGISLATION

The *Tax Agents Services Act 2009* (Com) (the *TAS Act*) regulates the providers of defined tax agent services. Service providers must adhere to a code of professional conduct, be registered by the Tax Agents Board and have appropriate qualifications.257 “Tertiary qualifications in accountancy” or related accountancy experience and awards are the main qualifications required for a person’s registration as a tax agent service provider.

Sub-section 90-5(1) of the *Tax Agents Services Act* provides that “a tax agent service is any service”

(a) that relates to:

(i) ascertaining liabilities, obligations or entitlements of an entity that arise, or could arise, under a taxation law; or

(ii) advising an entity about liabilities, obligations or entitlements of the entity or another entity that arise, or could arise, under a taxation law; or

(iii) representing an entity in their dealings with the Commissioner; and

(b) that is provided in circumstances where the entity can reasonably be expected to rely on the service for either or both of the following purposes:

(i) to satisfy liabilities that arise, or could arise, under a taxation law;

(ii) to claim entitlements that arise, or could arise, under a taxation law.258

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257 See *TAS Act* s20-5, regulation 8 of the *Tax Agent Services Regulations* (“TAS Regs”) and *TAS Regs* Schedule 2, Part 2, Division 1—Requirements, item 201: “Tertiary qualifications in accountancy”; item 202 “Tertiary qualifications in another discipline—specialists”; item 203 “Tertiary qualifications in law”; item 205 “Work experience”; and item 206 “Membership of professional association”.

258 Sub-section (2) of ss90-5, 90-10 and 90-15 refers to services specified in regulations to be or not to be services within each definition. “BAS service” and “tax (financial) advice service” are defined similarly in s-ss90-10(1) and 90-15(1) of the Act, with corresponding Code of conduct and qualification provisions. “BAS service” and “tax (financial) advice service” will not be considered in detail here.
Tax agents' provision of trust deeds is not an activity comprehended by any of the "ascertaining", "advising" or "representing" sub-paragraphs of the TAS Act's s-s90-1(5) "tax agent service" definition.

The intersection of law and accountancy disciplines in TAS Act registration requirements is notable. Successful completion of "a course in basic accountancy principles" is required to satisfy the "Tertiary qualifications in law" requirements for registration of a Tax Agent. Correspondingly, "Tertiary qualifications in accountancy" requirements for registration of a Tax Agent, include an applicant's successful completion of courses in commercial law and taxation law. Lawyers' skills are required for accountants who supply tax agent services, just as accountants' skills are required for lawyers who supply tax agent services. TAS Act

259 See TAS Regs, Schedule 2, Part 2, Division 1: Tertiary qualifications in law

204 A requirement is that:

(a) the individual:

(i) has academic qualifications required to be an Australian legal practitioner; and

(ii) has successfully completed a course in basic accountancy principles that is approved by the Board; and

(iii) has successfully completed a course in Australian taxation law that is approved by the Board; and

(b) the individual has been engaged in the equivalent of 12 months of full-time, relevant experience in the preceding 5 years.

260 See TAS Regs, Schedule 2, Part 2, Division 1: Tertiary qualifications in accountancy

201 A requirement is that:

(a) the individual has been awarded:

(i) a degree or post-graduate award from an Australian tertiary institution in the discipline of accountancy; or

(ii) a degree or award that is approved by the Board from an equivalent institution in the discipline of accountancy; and

(b) has successfully completed a course in commercial law that is approved by the Board; and

(c) has successfully completed a course in Australian taxation law that is approved by the Board; and

(d) the individual has been engaged in the equivalent of 12 months of full-time, relevant experience in the preceding 5 years.
requirements for tax agent registration arguably acknowledge that taxation law a hybrid of law and accounting.261

8.1 STATE LEGISLATION

All Australian legislation regulating the legal profession is state-based. The Legal Profession Uniform Law (the Uniform Law) in New South Wales and Victoria prohibits entities from engaging in legal practice unless they are Australian legal practitioners.262 Legal Profession Acts in the other states and territories prohibit unqualified persons from engaging in legal practice in functionally equivalent terms.263

The Legal Profession Acts take one of the following three approaches to designating the practices prohibited for non-lawyers.

The first type of Legal Profession Act makes little attempt to isolate the activities which amount to legal practice and defines prohibited activities in circular terms. For example, the Uniform Law states that the words “engage in legal practice” include “practise law or provide legal services.”264 “[P]ractise law” is not further defined. “Legal services” is defined in the Uniform Law to mean “work done, or business transacted, in the ordinary course of legal practice.” Legal practice is what lawyers do, in other words.265

The second type of Legal Profession Act non-exhaustively sets out a list of activities which constitute the practice of law. The Legal Practitioners Act 1981 (SA) takes this form.266 Sub-

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261 See text below at n.41.
262 By s-s10(1). New South Wales and Victoria were the only states which had adopted the Uniform Law as at 1 January 2017.
263 See Legal Profession Act 2007 (Qld), s-s24(1) (“engaging in legal practice”); Legal Profession Act 2008 (WA), s-s12(2) (“engaging in legal practice”); Legal Practitioners Act 1981 (SA), s21 (“practising the profession of law”); Legal Profession Act 2007 (Tas), s13 (“engaging in legal practice when not entitled”); Legal Profession Act 2006 (ACT), s16 (“engaging in legal practice”); and Legal Profession Act (NT) s18(1) (“engaging in legal practice”). Together, the Legal Profession Acts and the Uniform law will be referred to as “the Legal Profession Acts”.
264 In s-s6(1), adding “but does not include engage in policy work (which, without limitation, includes developing and commenting on legal policy.”
266 Several repealed Legal Profession Acts in other states and territories once took this form. See (the former) Legal Practitioners Act 1998 (NSW) considered in Law Society of New South Wales v Ramalca Pty Ltd (t/a Flat Fee Conveyancing Services) (1988) 12 NSWLR 34; (the former) Legal Practice Act 2003 (WA) considered in Legal Practice Board v Computer Accounting and Tax Pty Ltd [2007] WASCA 184; and (the former) Legal Profession Practice Act 1958 (Vic) considered in Cornall v Nagle [1995] 2 VR 188.
section 21(1) of the South Australian Act provides that "[A] natural person must not practise the profession of law". Sub-section 21(2) adds, "without limiting the generality of subsection (1)",

a person practises the profession of law, if acting for fee or reward on behalf of some other person he or she—

(a) prepares any will or other testamentary instrument; or
(b) prepares an instrument creating, transferring, assigning, modifying or extinguishing any estate or interest in real or personal property; or
(c) prepares any instrument relating to the formation of a body corporate, any amendment to the constitution of a body corporate, any prospectus or take-over scheme relating to a body corporate, or any instrument affecting the rights of shareholders or debenture holders in a body corporate or any scheme of arrangement in respect of a body corporate; or
(d) prepares any other instrument creating, transferring, assigning, modifying or extinguishing any right, power or liability at law or in equity; or
(e) represents any party to proceedings in a court or a tribunal.

The third type of Legal Profession Acts applies in Queensland, Western Australia, Tasmania, the Northern Territory and the ACT. "Legal practice" (or a cognate expression) is defined only for the purposes of defences to or "carve-outs" from legal practice prohibitions.

For example, the Legal Profession Act 2008 (WA) provides in s-s12(2) that "A person must not engage in legal practice in this jurisdiction unless the person is an Australian legal practitioner." Sub-section 12(3) of the Act provides that s-s12(2) does not apply to engaging in legal practice of eight enumerated kinds, including "a public officer doing legal work in the course of his or her duties" and "a person doing legal work under the supervision of an Australian legal practitioner".

Sub-section 12(1) provides that "[I]n this section — "legal work" means:

(a) any work in connection with the administration of law; or
(b) drawing or preparing any deed, instrument or writing relating to or in any manner dealing with or affecting—

(i) real or personal estate or any interest in real or personal estate; or
(ii) any proceedings at law, civil or criminal, or in equity;
8.1.1 POLICY OF THE LEGAL PROFESSIONAL ACTS

Consumer protection is the most commonly cited policy justification of the Legal Profession Practice Acts.²⁶⁷

Three consumer protection rationales for restrictions on legal practice have been suggested.²⁶⁸

*Competence* is the first rationale. The public should be protected from unqualified persons who do not have the knowledge or understanding needed to provide legal advice or representation.²⁶⁹

The second rationale is *remedial*. Lawyers, it is said, "are governed by an elaborate code of ethics and subject to sanction by the court for breaches of ethical duties."²⁷⁰

The third rationale is *motivational*. Lawyers "operate in a fundamentally different fashion than lay persons . . . lawyers, in the minds of some persons, are not motivated to the same extent by profit."²⁷¹

The policy of the *TAS Act* is to ensure that taxation services are provided by tax agents at an appropriate professional standard.²⁷² In the Explanatory Memorandum to the Tax Agents Services Bill 2008, the "[O]bject of the Bill" was described at [1.34] as:

- establishing a national Board to register tax agents and BAS agents;

²⁶⁷ Concerning the *Legal Profession Uniform Law* (2015) see *National Legal Profession Reform Project: Consultation, Regulation, Impact Statement May 2010* at [2.3.2]: "The primary purpose of legal profession regulation is to prevent unqualified persons from providing legal services to Australian consumers"; *National Legal Profession Reform Consultation Group Paper: Guiding Principles* 20 August 2010: "1. To protect consumers from poor quality or unethical legal advice or representation".


²⁶⁹ See *State v Sperry* (1962) Fla, 140 So. 2d 587, 595, O'Connell J (other JJ agreeing); and *Matthew A Melone*, n.12, 51-52.

²⁷⁰ See *Matthew A Melone*, n.12, 98 and terms of the Legal Profession Practice Acts. Australian lawyers are liable to judicial supervision as officers of the courts of admitting jurisdictions.

²⁷¹ This rationale is contentious. See *Matthew A Melone*, n.12, 52, citing Roscoe Pound in *The Lawyer from Antiquity to Modern Times* for the view that "a spirit of public service" characterizes or should characterize the legal profession.

²⁷² At s-s2-1 the *TAS Act* provides:

The objects of this Act is to ensure that tax agent services are provided to the public in accordance with appropriate standards of professional and ethical conduct.
• introducing the Code for tax agents and BAS agents; and
• providing for sanctions to discipline tax agents and BAS agents.

The statutory predecessor of the TAS Act was s251L of the ITAA36. Introduced in 1943, s251L was headed “Unregistered tax agents not to charge fees”. At [1.9], the Explanatory Memorandum notes some of the changes in the tax environment which occurred in the next 65 years. By 2008, approximately 74% of individuals and 95% of businesses use tax agent services to lodge tax returns and comply with tax laws. Neither the Explanatory Memorandum nor relevant second reading speeches evinced any Parliamentary intention to change or limit the ITAA36 s251L exemption for tax agent services provided for barristers and solicitors.273

8.2 MEANING OF "ENGAGE IN LEGAL PRACTICE" — NARROW AND BROAD VIEWS

Authorities and commentators have different views of the scope of the Legal Profession Acts prohibition on unqualified persons “engaging in legal practice”.274 A narrow view would restrict "legal practice" to a person doing what a solicitor alone can do. There is also a broader view that treats “engaging in legal practice” as doing what a solicitor usually does.

The narrow view was adopted by the United Kingdom Court of Appeal in Agassi v Robinson (Inspector of Taxes) (No 2).275 Mr Agassi was a litigant in the Court of Appeal where he was represented by counsel and became entitled to an award of costs. A subsequent hearing was held to determine whether Agassi’s costs included the fees and expenses of the firm of non-solicitor tax advisors who assisted him in the litigation.276 It was common ground between the parties that any costs recovered by Agassi would not include the cost of activities prohibited by the Solicitors Act 1974.277

273 ITAA36 s251L did not include a condition of the exemption that barristers and solicitors complete a course in “accounting principles” or “taxation law”.


276 The costs hearing was premature. On further appeal, House of Lords [2006] 1 WLR 1380; [2006] UKHL 23 ordered that the Revenue’s appeal be allowed "with costs here and below". See Lords Scott at [18] and Mance at [36] (Lords Hope and Nicolls agreeing).

277 Sub-section 20(1) of the Solicitors Act 1974 (UK) then provided that:

(1) No unqualified person shall—(a) act as solicitor, or as such issue any writ or process, or commence, prosecute or defend any action, suit or other proceeding in his own name or in the name of any other person, in any court of civil or criminal jurisdiction; or (b) . . .
The Court of Appeal in *Agassi* took the unlikely view that Agassi was a "litigant in person", despite his being represented by counsel. Next, the words "acting as a solicitor" (equivalent to "engage in legal practice") were said to be limited to the doing of acts which only a solicitor may perform and/or the doing of acts by a person pretending or holding himself out as a solicitor.278

Of course, the firm of tax advisors in *Agassi* never pretended or held themselves out to be solicitors. The issue was what solicitor-like activities were proscribed for non-solicitors.

At [43]-[44] the Court noted the parties' agreement that the *Solicitors Act 1974* did not prohibit unqualified persons performing "purely clerical or mechanical or mechanical activities" and declared that there was no "statute or rule which prohibits an unqualified person from giving legal advice". Tax advisors without practising certificates were entitled to act as solicitors in almost all respects. In particular, they were entitled to be paid for any "administrative support services ancillary to the conduct of litigation" short of the "formal steps required to be performed by a solicitor".279

The broader view is associated with the Supreme Court of Victoria decision in *Cornall v Nagle*,280 where JD Philllips J considered the meaning of the cognate expression "to act or practise as a solicitor".281 His Honour made a lengthy review of authority before stating that an unqualified person would "act or practice as a solicitor":

1. by doing something which, though not required to be done exclusively by a solicitor, is usually done by a solicitor and by doing it in such a way as to justify the reasonable inference that the person doing it is a solicitor. . . .

Section 22 provided that an "unqualified person" was one who had not been admitted as a solicitor and did not have a practising certificate — a description which included the specialist tax advisor.

278 At [36], approving a dictum of Pottter J in *Piper Double Glazing Ltd v DC Contracts* [1994] 1 WLR 777 at 786 (arbitration - representation by a claims consultant - successful party entitled to consultant's expenses) and *R (Factorgame Ltd) v Secretary of State for Transport, Local Government and the Regions (No 8)* [2003] QB 381 (litigation - legally represented party - forensic accountant could provide ancillary services).

279 Sections 20 and 22 of the *Solicitors Act 1974* were repealed by the *Legal Services Act 2007* (UK), with effect from 1 January 2010. Section 20 now provides that "No unqualified person is to act as a solicitor." Section 12 of the *Legal Services Act 2007* describes an area of "reserved legal activities" which is limited to qualified persons. The definition of this term in Schedule 2 includes the preparation of trusts deeds under the sub-heading of "reserved instrument activities".

280 [1995] 2 VR 188.

281 As used in s90 the former *Legal Profession Practice Act 1958* (Vic).
(2) by doing something that is positively proscribed by the Act or by Rules of Court unless done by a duly qualified legal practitioner. . . .
(3) by doing something which, in order that the public may be adequately protected, is required to be done only by those who have the necessary training and experience in law. . . .

Phillips J explicitly relied on the following test contained in the judgment of Cussen J in In re Sanderson: Ex parte the Law Institute of Victoria, [1927] VLR 394 at 397.

What I do decide is that if a person does a thing usually done by a solicitor and does it in such a way as to lead to the reasonable inference that he is a solicitor — if he combines professing to be a solicitor with action usually taken by a solicitor — I think he then does act as a solicitor.

Continuing in Cornall v Nagle, Phillips J said

I have now dealt with the test in Sanderson which applies to conduct which may be done by a solicitor or another person. In such cases there will be no contravention of [the engage in legal practice prohibition] on the part of the person doing the act unless it can be said that the act was done in such circumstances as to lead to the reasonable inference that that person was a solicitor. In contrast, I have said that there is no need for such an inference when the conduct in question involves something which the law requires to be done exclusively by a duly qualified practitioner. [emphasis added]

Cornall v Nagle has been followed in many Australian courts. 282 “Acting as a solicitor” means more than an individual performing tasks which only a solicitor can perform. The prohibition is also attracted when an individual performs acts in circumstances which lead to the reasonable inference that that individual is a solicitor.

Regardless of what an individual pretends to be, according to the Cornall v Nagle test, he or she may attract the prohibition and act as a solicitor by doing what a solicitor usually does. An accountant might “engage in legal practice” whilst at all times purporting to act as an accountant. This is a significant alternative to the austere, ultra vires formulation in Agassi v

282 See, for example, Legal Profession Conduct Commission v Morcom [2016] SASFC 121 at [90]-[91]; Merika v Rathbone [2016] SASFC 95 at [41]; Australian Competition & Consumer Commission v Murray (2002) 121 FCR 428; [2002] FCA 1252 at [92]; Legal Profession Conduct Committee v Nagle [2005] VSC 35 at [63]-[65]; Legal Practice Board v Adams (2001) WASC 78 at [30]. The decision was critically reviewed before being endorsed in Felman v Law Institute of Victoria [1998] 4 VR 324 at 349-352 per Kenny JA, Winneke P and Brooking JA agreeing. In Agassi v Robinson (Inspector of Taxes) (No 2) [2006] 1 WLR 2126, the United Kingdom Court of Appeal considered the Cornall v Nagle decision and said at [49] that “the approach adopted by Phillips J to determining the meaning of ‘acting as a solicitor’ has never been adopted by our courts.”
Robinson (Inspector of Taxes). An individual can be liable for more than performing an act which only a solicitor can do, or pretending to be a solicitor.

Several authorities have attempted to isolate the activities implied by Phillips J's *Cornall v Nagle* formulation of "engage in legal practice" which are additional to the activities exclusively reserved for legal practitioners. It is a difficult exercise. Kenny JA in *Felman v Law Institute of Victoria* [1998] 4 VR 324 at 352 put the matter as follows, when discussing the lawyer-like activities of a registered tax agent:

In my opinion, the expression "engage in legal practice" . . . signifies "to carry on or exercise the profession of law". Reference to the definitions of "engage" and "practice" in the *Oxford English Dictionary* supports the view that this is the ordinary and natural meaning of the expression. The carrying on of the profession of law is done by none other than a "legal practitioner". Accordingly, in my view, the expression "engage in legal practice" means "engage in legal practice as a legal practitioner", the italicized words being implicit in the notion of legal practice.

With respect, the *Cornall v Nagle* formulation is a little circular. A pleonasm may result in the absence of a demonstrated difference between a "legal practitioner" and what it is to "engage in legal practice".

A different approach has been taken by courts in the United States of America when interpreting prohibitions on the practise of law by unqualified persons. In the opinion of the Court in *State v Sperry*, the meaning of the expression "the practise of law" should be directly informed by the prohibition's consumer protection purpose.

*Sperry* was a decision of the Supreme Court of Florida. The Florida Bar sought to prevent Mr Sperry from holding himself out to the public as a "Patent Attorney" whilst not being a member of the Florida Bar. Specifically, Mr Sperry was to be prevented from advertising his ability to give legal advice on the validity and enforcement of patents, together with the preparation of related legal documents. As to "whether the giving of advice and counsel and performance of services in legal matters for compensation constitute the practise of law", O'Connell J stated, "it is safe to follow the rule",

that if the giving of such advice and the performance of such services affect important rights of a person under the law, and if reasonable protection of the rights and property of those advised and served requires the persons giving such advice possess legal skill and knowledge of the law greater than that possessed by the average citizen, then the

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283 Further discussed in text at n.41.

284 (1962) Fla. 140 So. 2d 587.
giving of such advice and the performance of such services by one for another as a course of conduct constitute the practise of law.\textsuperscript{285}

\section*{8.3 LIMITED APPLICATION OF THE NARROW VIEW}

A diminished number of activities is now expressly prohibited to unqualified persons by the Legal Profession Practice Acts. Few species of tax-related legal work are “positively proscribed” for accountants. Notably, the Legal Profession Acts provide that only a party or a duly admitted legal practitioner with a current practising certificate has a “right of audience” before courts in relevant jurisdictions and can commence, carry on or defend a suit or other proceeding.\textsuperscript{286}

The \textit{Legal Profession Act 2007} (SA) additionally includes “preparing an instrument creating or transferring any right or interest in real or personal property” within the sense of “practising the profession of law”. This is the only surviving enactment of a once-common provision in the former Legal Profession Practice Acts which defined the protected exclusivity of legal

\begin{itemize}
\item At [4], Roberts CJ, Thomas, Drew, and Thornal JJ concurring. O'Connell J preceded this statement with a remark in the previous paragraph that

[Many courts have attempted to set forth a broad definition of the practise of law. Being of the view that such is nigh onto impossible and may injuriously affect the rights of others not here involved, we will not attempt to do so here.]

\item See the \textit{Uniform Law} and the Legal Profession Practice Acts cited at n.1. The \textit{Legal Profession Uniform Conduct (Barristers) Rules 2015} of New South Wales provide additional restrictions on “the work of a barrister”, which is defined in rule 11 to consist of “appearing as an advocate”, “preparing to appear as an advocate”, negotiating the compromise of a case, mediating or arbitrating a case, “giving legal advice” and “preparing or advising on documents to be used by a client”. Barristers performing this work must have practising certificates in the jurisdictions in which they practise (rule 6), “not engage in another vocation” (rule 9) and adopt “the cab-rank principle” not to refuse a brief without good reason (rule 17).
\end{itemize}
practitioners’ employment.\textsuperscript{287} Preparation and variation of trust deeds is provided by statute to be solicitors’ work in South Australia.\textsuperscript{288}

Apart from South Australia, the supply of trust deeds by non-lawyers appears to be unregulated in Australia.

\subsection*{8.3.1 APPLICATION OF THE BROADER VIEW

Consistently with the \textit{Cornall v Nagle} taxonomy, a person might trigger the “engage in legal practice” prohibition in either of the following ways.

First, a person might “pretend to be”, or impersonate, a legal practitioner. Accountants performing tax-related work normally do so in their character as accountants and not purporting to be Australian legal practitioners. This possibility is of limited relevance.

Secondly, a person might “engage in legal practice”. This possibility raises the question of how far the courts are prepared to extend law’s consumer protection rationale and protect the public against persons lacking relevant qualifications. Should an accountant’s giving of legal advice or preparing a legal document, without more, amount to a prohibited “engaging in legal practice”? Australian authorities on the point are based in earlier forms of the “engage in legal practice” prohibition enlarged by now-repealed words importing an extended meaning.

Simmons J in the Western Australia Supreme Court in \textit{Legal Practice Board v Computer Accounting and Tax Pty Ltd}\textsuperscript{289} found that an “engage in legal practice” prohibition was triggered when a public accountant (and registered tax agent) sold a trust deed to a client as part of a self-managed superannuation “product”.\textsuperscript{290}

\begin{footnotesize}
\textsuperscript{287} Now repealed prohibitions on engaging in legal practice in a defined sense were discussed in \textit{In re Crowley} (1899) 20 NSWLR 150 (discharge of mortgage); \textit{Law Society of New South Wales v Ramaaca Pty Ltd (t/a Flat Fee Conveyancing Service)} (1988) 12 NSWLR 34 (land titles); \textit{Barristers’ Board of Western Australia v Tranter Corporation Pty Ltd} (contract of sale of land); \textit{Barristers’ Board v Marbellup Nominees Ltd} [1984] WAR 335 (superannuation and other trust deeds) and \textit{Barristers’ Board of Western Australia v Palm Management Pty Ltd} [1984] WAR 101 (incorporation of company).

\textsuperscript{288} Strangely, s13 of the \textit{Legal Profession Act 2007} (Tas), after prohibiting persons from “engaging in legal practice when not entitled”, excludes “preparing an instrument, creating any estate or interest in real or personal property if not done for fee or reward”.

\textsuperscript{289} (2007) 213 FLR 212; (2007) 35 WAR 59; [2007] WASC 184

\textsuperscript{290} The Legal Practice Board was ultimately unsuccessful as the prohibition was held not to apply to a corporate defendant.
\end{footnotesize}
The prohibition in Computer Accounting was contained in s-s123(1) of the now-repealed Legal Practice Act 2003 (WA). Paragraph 4(b) of that Act provided that “[A] person engages in legal practice if the person directly or indirectly— . . . (b) performs or carries out or is engaged in any work in connection with the administration of law.” Paragraph 4(b) of the 2003 Act has no counterpart in the now-applicable Legal Profession Act 2008 (WA). Under s-s123(3) of the Legal Practice Act 2003 (WA) it was a defence to a charge under s-s123(1) that the person who did the work was not directly or indirectly paid or remunerated or expected pay or remuneration.

Justice Simmons followed earlier the Western Australian decisions in Barristers’ Board v Palm Management Pty Ltd291 and Barristers’ Board v Marbellup Nominees Pty Ltd292 and found that the “use of a structure using a trust” was “work involved in the practice of law” within the scope of an “engage in legal practice” prohibition. Each of the authorities applied the Legal Practitioners Act 1893 (WA). The no-payment defence in s-s123(3) of the Legal Practice Act 2003 (WA) was found to be inapplicable in view of the plaintiff’s tax invoice and other elements of the defendant’s case.293

Palm Management was concerned with a company which oversaw the preparation of a trust deed to give effect to tax minimisation advice. Marbellup involved a business consultant who prepared a unit trust deed with individual family trusts for the shareholders and staff members of a former incorporated business.294 There was “sufficient similarity in the relevant language of the two Acts”, his Honour found in Legal Practice Board v Computer Accounting and Tax, for the decisions to be persuasive.295 Simmons J did not examine the then-repealed, additional references to legal practice in the 1893 legislation. General “practise of law” reasoning in Palm Management and Marbellup was quoted to fortify the conclusion that preparation of the trust deeds in Computer Accounting and Tax was prohibited lawyer’s work.

293 See [201]-[204].
294 Both Barristers’ Board v Palm Management Pty Ltd [1984] WAR 101 and Barristers’ Board v Marbellup Nominees Pty Ltd [1984] WAR 335 applied the following expanded prohibition in the now-repealed Legal Practitioners Act 1893 (WA) s77:

(1) No person other than a certified practitioner shall directly or indirectly perform or carry out or be engaged in any work in connection with the administration of law, or draw or prepare any deed, instrument, or writing relating to or in any manner dealing with or affecting real or personal estate or any interest therein or any proceedings at law, civil or criminal, or in equity. [emphasis added]

295 i.e., the 1893 and the 2003 Acts: see [144].
8.3.2 IS THE TAS ACT INCONSISTENT WITH THE LEGAL PROFESSION PRACTICE ACTS?

By application of s109 of the Australian constitution, the Legal Profession Practice Acts may be invalid to the extent that they purport to prohibit unqualified persons from engaging in acts which they have liberty to perform under Commonwealth legislation.

The TAS Act is a Commonwealth Act which permits non-lawyers acting as tax agents to provide "any service . . . that relates to:

(i) ascertaining liabilities, obligations and entitlements of an entity . . . that arise . . . under a taxation law;

(ii) advising an entity about liabilities, obligations and entitlements of the entity . . . that arise . . . under a taxation law; or;

(iii) representing an entity in their dealings with the Commissioner.296

Trusts are not legal persons. The general law of Australia does not accord "entity" status to trusts.297 Taxation law is different. The word "entity" is defined in ITAA97 s960-100 to include both legal persons (like "a body corporate") and relations that are not legal persons (like "a partnership", "a trust" and "any other body of persons").298

In the definition of "tax agent service" in TAS Act paragraph 90-5(1)(a) trusts are not susceptible of and cannot possess the "liabilities, obligations or entitlements" to which the paragraph refers. Only legal persons can be subject to or enjoy those "liabilities, obligations or entitlements". This has a serious consequence. By reason of what the TAS Act definition of "tax agent service" excludes, arguably the Act does not authorize tax agent services which relate to trusts.

Limiting the "liabilities, obligations or entitlements" in paragraph 90-5(1)(a)TAS Act to the liabilities of legal persons accords with the scheme of how the Income Tax Assessment Acts apply to trusts and trust estates. No obligations are imposed on or entitlements are allowed to

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296  See TAS Act s-s90-5(1), 90-10(1) and 90-15(1). See comparable provisions relating to "customs agents" in Pt X1 of the Customs Act 1901 (Com) and "migration agents" in Pt 3 of the Migration Act 1958 (Com), discussed by Kenny JA in Felman v Law Institute of Victoria [1998] 4 VR 324 at 342-348.

297  See The Law of Trusts 5th edn WA Lee, M Bryan, J Glover, M Fullerton (Thomson Reuters, looseleaf and online), (Ford & Lee), [1.6110].

298  The "Note" following ITAA97 s-s960-100 states that the "entity" definition "covers groups of legal persons and other things, that in practice are treated as having a separate identity in the same way as a legal person does." The ITAA36 s-s95(1) definition of "net income", in relation to a trust estate" exemplifies how the words "trust estate" are used to refer to an entity with a separate identity "in practise" rather than at law.

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"trusts" or "trust estates". Liabilities, obligations or entitlements are imposed on or allowed only to trustees, beneficiaries, trust settlors and contributors to trusts. To the extent that trusts are ever referred to independently of the legal persons who comprise them, trusts are reporting entities for the purposes of ITAA36 s-95(1) and related provisions.299

Many accountants are registered tax agents. Advising clients on their liabilities, obligations and entitlements arising under taxation laws and representing clients before government bodies are activities ordinarily conducted by persons engaged in legal practice.300 But there is an important difference. The advice and representation of tax agents is limited to taxation law and is not "legal advice" in a broader sense.

As Kenny JA put the matter in Felman v Law Institute of Victoria,301 "nothing in [the former s251L of the Income Tax Assessment Act 1936] manifests an intention to regulate the legal profession or legal practice in Victoria." Solicitors and counsel were expressly exempted from tax agent requirements. 302 Accordingly, her Honour continued, "[T]he Commonwealth Parliament would appear to have acted upon the assumption that"

a tax agent who gives advice as to income tax matters in his or her capacity as a tax agent does not give what is ordinarily understood as legal advice, i.e., advice of the kind properly given by a legal practitioner in his or her capacity as a legal practitioner. When tax agents give advice on income tax matters in their capacity as tax agents they give advice on the basis of their familiarity and experience with income tax matters, including familiarity with the approach adopted by the Commissioner of Taxation and other Commonwealth officers as to the administration of the income tax legislation, rulings and guidelines. Tax agents do not ordinarily hold out their advice as being legal advice of the kind sought from and given by legal practitioners. [emphasis added]

The US authority of State v Sperry decided that the "engage in legal practice" prohibition in that case co-ordinated with legal policy imperatives on restricting the expertise which unqualified persons should be permitted to "hold out" to the public.303 Tax liabilities, obligations and

299 Such as Division 266 or 267 in Schedule 2F to the ITAA36 or Division 275 of the ITAA97.
300 See text at notes 16-21.
301 [1998] 4 VR 324 at 345
302 (The former) s-s251L of the ITAA36 provided that

(4) Subsection (1) shall not apply to any solicitor or counsel acting in the course of his profession in the preparation of any objection or proceedings before a board, the Tribunal or a court, or so acting in an advisory capacity either in connection with the preparation of any income tax return or with any income tax matter.

303 (1962) Fla. 140 So. 2d 587, at 593-594.
entitlements are legal matters. Accountants can permissibly charge their clients for related legal advice and dealings with the Commissioner. However, this is as far as the TAS Act goes.

Referring to Federal legislation empowering "patent attorneys" to prepare patent applications and represent persons applying for patents, and to rules enabling non-lawyers to practice before Federal courts and agencies, the Court in Sperry said at 594:

It may well be that this state may not prohibit any person from appearing and practising law before a federal court or agency in this state, if he is licensed by the federal court or agency, even though such person not be a member of the Bar in this state. But appearing before such bodies is an entirely different thing from a person holding himself out in this state as a person qualified to practise law before such federal bodies, maintaining an office in this state for that practice, and doing in this state the many things that are necessary to be done preparatory to the actual appearance before such bodies.

The Court illustrated this analysis at 594 by reference to a restriction once common in the jurisdictions of both the United States of America and Australia:

if a United States Court of Appeals conducts sessions in a state, attorneys from other states, not licensed to practice in this state, could not be prohibited from arguing before the court in this state, but they would not be permitted to establish an office and hold themselves out as qualified to practice before the federal court unless they were first admitted to the Bar of this state.

The sense of a patent attorney “holding-out” to the public in Sperry is wider than the sense of an individual “pretending” to be a legal practitioner in either the Agassi or Cornall v Nagle formulations. The patent attorney never pretended to be other than a patent attorney in the place where he practised. What was held to be objectionable was that person’s represented ability to deal with legal issues without being admitted to practice in that state. There is a distinct correspondence with an Australian tax agent’s holding out an ability to supply legal structures as part of tax representation and advice.

At the time that Computer Accounting was decided, provisions similar to those in the TAS Act were contained in (the now-repealed) s251L of the Income Tax Assessment Act 1936 (Com). One of the defendant’s arguments was that the sale of the superannuation product was legitimate because s251L permitted registered tax agents to conduct and be paid for relevant activities. Simmons J dismissed the contention. At [31]-[32], his Honour remarked in relation

304 Corresponding to the “tax agent service” activities referred to in the above extracted TAS s90-5 definition. The defendant said at [205]-[221] that she also relied on advice from an officer of the ATO superannuation section, ATO Fact Sheet No 2059, an ATO booklet entitled “Role and responsibilities of trustees” and a book entitled Self Managed Super Funds DIY Super. Simmons J treated her reliance as immaterial. An ATO Decision Impact Statement dated 22 October 2007

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to s251L that “the direct relevance of this provision was not pressed by the respondents in argument, in my view rightly so.”

This provision, in my view, simply includes allowance for relief for registered tax agents from the prohibition in the provision. It does not purport to provide relief for registered tax agents or anyone else, from any other prohibition, whether under federal or state law, including other prohibitions of the same conduct as that prohibited by s251L.

Still less does that provision authorise registered tax agents or any other person to engage in any conduct, such that it might be contended Legal Practice Act, s13(3)(c) applies.

The Administrative Appeals Tribunal decision in Sinclair and Commissioner of Taxation305 was broadly consistent with the Western Australian Supreme Court decision in Computer Accounting. Sinclair involved the disallowance of a tax deduction in a conveyancing transaction. At [91]-[92], Deputy President Forgie considered the appropriate amount of an administrative penalty. The taxpayer had not taken “reasonable care” concerning the availability of the deduction, the Deputy President said, in not seeking advice from a lawyer and relying on an accountant’s advice. Though the accountant “is a Fellow of the Tax Institute of Australia . . . he could not give legal advice regarding the legal implications of the arrangements.”

8.4 CAN SUPPLY OF AN “OFF-THE-SHELF” TRUST DEED AMOUNT TO UNAUTHOURISED LEGAL PRACTICE?

A legal or accounting stationery shop’s sale of a commercially available trust deed does not amount to legal practice on the part of the shopkeeper, as Simmons J said in Computer Accounting at [175]. There may be little difference when a tax agent on-supplies a trust deed, whether from a shop or an on-line supplier.

Attendance to the execution of a commercially available trust deed will not normally amount to legal practice on the part of a tax agent. Attending to execution was only a “clerical function” in his Honour’s view. An unauthorised “transaction” must involve providing a “product” which is “adapted to and suitable for the purpose for which the document had been sought from [the service-provider].”

Unauthorized legal practice requires something more than supply of or ministerial dealing with a previously prepared trust deed. Possibly “engage in legal practice” prohibitions are attracted

when pre-prepared trust deeds are the subject of accountants’ combined business and taxation law advices, or are customized to clients’ uses.

In *Samuels v American Legal Clinic*, the owner of a typing service trading under the name of the “American Legal Clinic” was alleged to have engaged in an unauthorized practice of law. The defendant Ms Longley advertised her legal skill, advised clients on bankruptcy matters and prepared bankruptcy forms through the use of proprietary software. Jerry A Funk, Bankruptcy Judge, found that the unauthorized practice of law offence was established. His Honour noted that the defendant used the Matthew Bender computer software to prepare her bankruptcy forms. The Court is familiar with this software, and knows that this software was designed for use by attorneys, not laypersons. The software is designed to expedite the process of filling out bankruptcy forms and schedules. For example, there are many places on these forms that require the debtor's name and address. The attorney need only type in the debtor's name and address once, and the computer will place it in every place required. However, there are legal decisions that have to be made to use this software. For example, the software cannot distinguish between exempt and non-exempt property. The attorney must make this decision. As the expert witness on this subject testified at the trial, the program has its limitations. It doesn't ask questions that it doesn't think are relevant, but sometimes it's wrong. The attorney, when inputting the information into the system, must tell it whether it is a secured or unsecured debt. It would require more information than the average layperson would possess to complete the forms using the software. Ms Longley is not an attorney and is in no way qualified to make these decisions. By using the Matthew Bender software that was designed for use by attorneys, the Court feels that Ms Longley is engaging in the unauthorised practice of law.  

Two related issues are whether the supply of a trust deeds by accountants is (1) incidental to accountants’ taxation services; and/or is (2) too difficult a legal matter to entrust to accountants.

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307 See also *In re Bachmann* (1990) 113 Bkrtcy SD Fla 113 BR 799; and *In the matter of Bradford Arthur* (1981) Bkrtcy Pennsylvania 15 BR 541 (supply of unauthorised legal services to the public by advertising legal skill, advising debtors on bankruptcy law and "preparing legal documents").
8.5 IS THE PROVISION OF TRUST DEEDS INCIDENTAL TO THE SUPPLY OF TAX AGENT SERVICES?

There is a view that taxation law practice is "mainly a matter of accounting". Core accountancy skills of classification and measurement are said to be the skills required for the computation of tax liabilities. Tax agents' provision of trust deeds may be legitimated by the TAS Act and immune from challenge under the Legal Profession Practice Acts if provision of trust deeds is incidental to the supply of tax agent services.

Another view of taxation law practice regards it as a hybrid of law and accounting. Both law and accountancy skills are required in tax practice. In addition to tax agents’ abilities to classify and measure, interpretive skills of lawyers are needed to correlate transactions with the tax base and identify what is assessable and what is not. Non-tax law issues commonly arise. These are often definitional. Relationships with workers are an example. Are workers employees or independent contractors, for the purposes of entitlements and tax? Issues may relate to obligations and concern whether contracts with suppliers or customers are enforceable. Trusts law questions may arise. Is a discretionary trustee empowered to enter a business arrangement which has tax consequences? Is a trust which operates a shop entitled to reduce its assessable income by making provision for the return of defective goods? Who in trusts law terms is entitled to the fund? If tax law practice is a hybrid of law and accounting regulated by the Legal Profession Practice Acts it is not legitimated by the TAS Act.

Advising on trusts law and providing trust deeds is an activity within the broader view of an individual “engaging in legal practice” judicially applied and considered at State Supreme Court and Court of Appeal level. The narrower view of “engaging in legal practice” which obtains in South Australia arguably also extends to advising on trusts law and providing trust deeds.  

308 See Matthew A Melone, n.12, at 62, 79.

309 See Matthew A Melone, n.12, at 62, citing Re New York County Lawyers Association (1948 NY App Div) 78 NYS 2d 209 at 218-219, where the New York Court of Appeals rejected the view that tax law is "mainly a matter of accounting" and held that "regardless of specific tax knowledge an accountant, does not have the orientation even in tax law to qualify as a tax lawyer."


311 See Legal Practitioners Act 1981 (SA), s-s21(2): "... a person practises the profession of law, if acting for fee or reward on behalf of some other person he or she—

(a) . . .
At least 829,588 Australian trusts were known to the Commissioner of Taxation on 1 October 2015. Of that number, 647,440 trusts, or approximately 75 per cent, were discretionary in form. A further 109,277 trusts (or approximately 10 per cent) were fixed unit or other fixed trusts. The main source of income for 268,007 discretionary trusts was business activities and trading, as distinct from investment or service-management activities.

Provision of a trust deed by a tax agent is more likely to be incidental to the provision of business services than to any of the three “tax agent services” defined in of the TAS Act. The supply of business structures is not a “tax agent service”. Only in a speculative sense could providing a trust deed prior to its use amount to ascertaining liabilities, obligations or entitlements of an entity that arise, or could arise, under a taxation law.

Whether the TAS Act validates tax agent provision of trust deeds (and the supply of related advice) as incidental to the supply of tax agent services may depend on the scope of the activity to be validated. The TAS Act only authorizes persons not legally qualified to hold themselves out to the public as entitled to engage in legal practice to the extent that the tax agent activity relates to "liabilities, obligations or entitlements of [an] entity that arise, or could arise, under a taxation law". Advice concerning trusts and the supply of trust deeds arguably goes beyond being

(b) prepares an instrument creating, transferring, assigning, modifying or extinguishing any estate or interest in real or personal property; or

(c) . . .

(d) prepares any other instrument creating, transferring, assigning, modifying or extinguishing any right, power or liability at law or in equity; or

(e) . . .

312 The latest data available, 1 October 2015 was the cut-off day for Trust Records in the ATO Taxation Statistics 2014-15. Late-lodging trusts were excluded.

313 ATO Taxation Statistics 2014-15 indicate that the trust population comprised:

<table>
<thead>
<tr>
<th>Trust Type</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discretionary trust (all income sources)</td>
<td>647,440</td>
</tr>
<tr>
<td>Deceased estate</td>
<td>50,274</td>
</tr>
<tr>
<td>Cash management unit trusts -</td>
<td>538</td>
</tr>
<tr>
<td>Fixed unit trusts and other fixed trusts</td>
<td>109,277</td>
</tr>
<tr>
<td>Hybrid trusts</td>
<td>9,050</td>
</tr>
<tr>
<td>Special disability trusts</td>
<td>533</td>
</tr>
<tr>
<td>Refund of franking credits claimant</td>
<td>2,617</td>
</tr>
<tr>
<td>Other</td>
<td>4,332</td>
</tr>
</tbody>
</table>

829,588


315 Or advising an entity thereon, or representing an entity in dealings with the Commissioner. See the definition in TAS Act paragraph 90-5(1)(a), extracted above at n.2.
merely incidental to advice on taxation laws. Advice on trusts and trust deeds equally relates to business structure and liability limitation — “commercial or business” advice — for the giving of which tax agents have no particular qualification or immunity.

8.6 ARE TAX AGENTS COMPETENT TO PERFORM TRUSTS WORK WITHOUT LEGAL EXPERTISE?

Mandating university-certified, legal competence is the first, and possibly the main rationale of the Legal Profession Acts. The public is protected against persons charging fees for advice on matters about which they do not have demonstrated competence. Significant legal documents like trust deeds should only be supplied by persons who have a verified understanding of the documents’ working and effect.

“Trust law” is not one of the courses comprising “Tertiary qualifications in accountancy” requirements which most tax agents must successfully complete in order to be eligible for registration as a tax agent. Obligatory courses in “commercial law” or “taxation law” do not extend to trusts.

Australian Lawyers, by contrast, must demonstrate an understanding of “trust law” as a condition of their eligibility to enter the legal profession. Significant uniformity on legal admission requirements exists amongst the Australian jurisdictions. Most states and territories have adopted the words of the trust-law knowledge requirement proposed by the Consultative Committee of State and Territory Admitting Authorities chaired by Mr Justice Priestly in its Report on Practical Legal Training Requirements (February 1994). Trust law is one of the

316 Discussed above at n.

317 See TAS Act s20-5, referring to TAS Regs, reg 8 and Schedule 2, Part 2, Division 1 extracted above at n. 1. Other tax agents qualify through being Australian lawyers.

318 See GE Dal Pont, Lawyers’ Professional Responsibility (Thomson Reuters, 2015) at [2.10]. There is no Australia-wide admission standard for certification of law-specific knowledge areas. Speaking of the admission requirements, Linda Haller and Francesca Bartlett in “Views from inside: a comparison of admission process in New South Wales and Victoria before and after the Uniform Law” (2016) 42 Monash University Law Review 109 at 111 comment:

The national approach did not attract sufficient state support and so a “Uniform Law” approach was substituted, to which only Victoria and New South Wales signed up.

319 Adopted in the NSW and Vic Legal Profession Uniform Admission Rules 2015, reg. 5, Schedule 1, item 8:

Trusts with particular reference to the types of trusts and the manner and form of their creation and variation. The duties rights and powers of trustees should be included, as should the consequences of breach of trust and the remedies available to, and respective

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“Priestly 11” legal subject areas about which candidates must demonstrate knowledge to qualify for admission as a lawyer.

Little is intuitive about trusts. Accountants and lawyers from civil law jurisdictions are often mystified by a device. Trusts do not function according to ordinary business principles and are largely not amenable to accounting standards. Instead, trusts are “institutions developed by equity and cognisable by a court of equity”—relationships—not persons, not entities and not collections of rights and obligations. Property is held by “trustees” for the benefit of “beneficiaries” pursuant to a medieval code with individuated moral overtones.

Flexible rules govern both the attributes of trusts and the times when trusts may come into existence. Trusts can hold “property” which did not exist when the trust was created.

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rights of, beneficiaries . . . OR . . . [topics including] the elements of trust law . . . various kinds of trusts; the rights, duties and powers of trustees; the consequences of breach of trust . . . equitable doctrines . . . (it is expected that about half the course will be devoted to trusts).

Qld: Supreme Court (Admission) Rules 2004 regs 6, 9AA. (Undisclosed) subject guidelines for legal training courses are approved by the Law Admissions Consultative Committee;

SA: Legal Practitioners Education and Admission Council Rules 2004 reg.2.1 and Appendix A - [same as Uniform Admission Rules];

WA: Legal Profession Admission Rules 2009, reg 6, referring to subject guidelines in the Model Admission Rules 2015 [same as Uniform Admission Rules];

ACT: Court Procedure Rules 2006 reg. 3695 - “equity (including trusts)”; and

NT: Legal Profession Admission Rules reg.4, Sched.3 - [same as Uniform Admission Rules].

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320 In Statement of Accounting Concepts SAC 1 “Definition of the Reporting Entity published by the Australian Accounting Research Foundation and the Accounting Standards Review Board”, para [6] defines an “entity” as “any legal, administrative or fiduciary arrangement, organized structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives.” SAC 1 para [18] qualifies this. A “trustee” is not a para [6] economic entity if the trustee’s “relationship with the trust does not extend beyond the normal responsibilities of a trustee.” See www.aasb.gov.au/admin/file/content102/c3/SAC1_8-90_2001V.pdf (11 August 2017). SAC 1 is inconsistent with the general law. Trustees have the legal capacity to dispose of trust assets. Trusts have no legal personality.

321 See Jacobs Law of Trusts in Australia 8th edn JD Heydon and MJ Leeming (LexisNexis, Sydney, 2016) at [1-01].

322 Hence “unconscionability” — a “quaint, paternal apostrophe” which measures fairness and trust: see J Glover Equity, Restitution & Fraud (LexisNexis, 2004) at [1.4].

“Beneficiaries” may include after-born people.324 An enforceable class of beneficiaries may comprise all persons in the world except at least one.325 “Trustees” may possess a wide power (or discretion) to determine who should benefit from trust property, in what measure persons should benefit and whether anyone should benefit at all.326 This last characteristic identifies the “discretionary trust”. It is of particular relevance to Australia, given that some 75 per cent of trusts known to the Commissioner are discretionary in form.327

Discretionary trusts are something of a misnomer. Powers of appointment are conferred on “discretionary” trustees, annexed to vestigial trusts.328 How much of the trust property to distribute, to whom to distribute, or whether the trustee must distribute at all are matters pertaining to the laws of powers rather than the law of trusts. The law takes a “hands off” attitude to powers and discretions. Discretionary trustees’ powers to dispose of trust property are lightly regulated.329 The subject is confusing. Extensive litigation and legal learning exist on the point.330 Where discretionary trustees refuse to exercise their powers, there are few things that courts can do.331

Property subject to discretionary trusts may indeed be “ownerless” prior to exercise of trustees’ powers to dispose of the property. For at no time does the trustee beneficially own the property. Nor does anyone else own the property prior to exercise of the trustee’s discretion. Discretionary trusts are a challenge to the revenue as well as to persons with expectations of benefit from the device. No one is appropriately taxed on or entitled to the undistributed assets of a discretionary trust — a situation which may go on for years. There is a limitation period or “perpetuity period” applicable to discretionary trusts, based in the “rule against remoteness of vesting”. Different states stipulate different periods. Trusts in Australia, discretionary trusts in particular, are a conundrum and a jurisprudential anomaly.

324 See Ford & Lee, [5.3050] on unborn beneficiaries and corporations not yet in existence.
325 See Ford & Lee, [5.6570] on hybrid or intermediate powers.
326 See Ford & Lee, [1.270], [7.6910] – no one has a beneficial interest until the trustee so determines.
327 See ATO Taxation Statistics 2013-14 referred to at n.46.
330 See legal literature and authorities cited in Ford & Lee and Moffat at nn.61-62.
331 See Thomas and Hudson, Chapter 20.
No other country in the world has as many trusts as Australia.\textsuperscript{332} Most comparable countries and jurisdictions use simpler pass-through devices as small-business and investment vehicles. But the number of Australian trusts has risen substantially in recent years and exceeds the number of Australian companies.

8.7 CONCLUSION

There is no necessary inconsistency between the \textit{TAS Act} and the Legal Profession Practice Acts. The \textit{TAS Act} does not authorize tax agents to act as lawyers and supply legal advice or legal documents.

At the same time, the balance of Australian authority suggests that an unqualified person “engages in legal practice” by offering advice on and/or supplying trust deeds. The provision of trusts advice and trust deeds to business clients is usually more than incidental to advising businesses on taxation law liabilities. Trusts advice and the provision of trust deeds have wider implications. Tax agents are not authorized by the \textit{TAS Act} to re-organize the structures of business enterprises and change the nature of liabilities owed to business creditors.

Tax agents who give paid advice to clients concerning trusts and/or who supply clients with trust deeds potentially commit the state or territory offence of engaging in legal practice when not entitled to engage in legal practice.\textsuperscript{333} The consumer protection rationale of the Legal Profession Practice Acts requires a finding to this effect. Unqualified persons should possibly be denied the right to hold themselves out as fit to advise the public about trusts or to provide trust deeds.

\footnotesize{\textsuperscript{332} New Zealand is almost an exception to this statement. Whilst having a smaller number of trusts in total, New Zealand has a greater number of trusts per head of population. See

\textsuperscript{333} Unless otherwise exempted. See offences under state or territory Legal Profession Acts listed at note 6.}
9 PRACTITIONER PERSPECTIVES

Using depth interviews with ten industry practitioners (tax/accounting and legal experts) in Melbourne, Sydney, Brisbane and Canberra, the purpose of this phase of the project was to explore the behaviours and attitudes surrounding the use of trusts with a particular focus on any taxpayer/industry practices which may facilitate tax avoidance strategies.

The key findings from the data are as follows:

- **Motivation for using trusts**
  a. Trusts provide flexibility in terms of structuring businesses and tax affairs when compared to establishing companies or partnerships.
  b. Trusts are viewed as useful vehicles for asset protection and estate planning since legal ownership and beneficial ownership are separated.

- **Complexity of the current system**
  a. There was consensus amongst participants about the complexity of the current system, but they did not advocate for substantial reform.
  b. The participants identified several legal complexities, with the major one pertaining to the separation of distributable income (income according to trust law principles) and net income of the trust (income according to taxation laws).

- **Tax avoidance**
  a. Most participants argued that extreme cases of tax avoidance were rare, typically suggesting that practitioners who dealt with explicit avoidance schemes were at the “smaller end of town”.
  b. Participants generally held the view that the ATO currently has sufficient powers under Part IVA of the ITAA 1936 to prosecute ‘egregious cases’ of tax avoidance through the use of trusts.
  c. Most if not all high net worth and wealthy groups utilise multiple trusts and companies within their structures. In many cases it was suggested that one of the aims is to reduce the effective tax rate to the corporate rate of 30%.

- **Participants’ suggestions for reform**
  a. A withholding tax regime similar to that in place for salary and wage earners.
  b. Taxing the trust/trustee as an entity, and maintaining the current flowthrough features of trusts.
The key observations from these findings are:

- Without some form of regulatory oversight of trusts and/or trust deeds, further complications are likely to arise in terms of their administration.
- It was suggested that one of the motivations for using trusts is to reduce the effective tax rate to the corporate rate of 30%.
- In the context of a self-declaration taxation system, trusts appear to provide taxpayers with enormous flexibility with limited statutory oversight and accountability.

9.1 PRACTITIONER INTERVIEWS

The purpose of undertaking qualitative research in this project was to delve more deeply into the behaviours and attitudes surrounding the use of trusts with a particular focus on any industry practices which may facilitate tax avoidance strategies. We also explored perceptions of the current legal issues in relation to the taxation of trusts, motivations for using trusts, whether attitudes toward the use of trusts have changed and any compliance or administrative issues associated with the use of trusts.

Using depth interviews, primarily with industry practitioners (tax/accounting and legal experts), this phase of the project aimed to uncover elements of taxpayer and tax advisor behaviours to provide more nuanced insight into the issues relating to the taxation of trusts as well as to potentially explain some of the results from our quantitative analysis. That is, these interviews provide a practical and finer grained insight with which to interpret the overall findings in this project.

9.2 METHOD

Depth interviews of between one and one and a half hours were conducted with ten participants, primarily accounting or legal practitioners that specialised in the area of trusts, from Melbourne, Sydney, Brisbane and Canberra. At least two members of the research team, and sometimes three, were present at each interview. Interviews were conducted either face-to-face, by phone or via Skype. Prior to undertaking these interviews, ethics approval was received from RMIT’s Business College Human Ethics Advisory Committee. To enhance the trustworthiness of the data, participants were assured of confidentiality in the participant information and consent form. A copy of the interview guide is in Appendix E.

In relation to the key topic areas, the interviews sought to elicit information and insight into tax avoidance behaviours on the part of taxpayers as well as the role of tax advisors in facilitating this behaviour. In addition to the areas of interest outlined in the introduction, the questions focused on the three key areas for this project: trust income mismatch, complex distributions and lodgment/compliance issues. It should be noted that in these interviews, the focus was on...
discretionary trusts, especially those that involve high net wealth individuals. We did not canvass issues pertaining to fixed trusts and managed investment trusts.

A semi-structured interview guide consisting of open ended questions was used; however we also pursued related topics and issues that arose during the course of the interview as well as modifying our guide as the interviews progressed, based on responses received. Data collection was concluded once it was deemed that no new information was emerging. The interviews were audio recorded, with the participants’ permission, and transcribed verbatim. The transcription of these interviews was undertaken by a professional services firm, subject to a confidentiality agreement. All interview data has been de-identified and stored securely. In total the interviews generated approximately nine hours of audio recordings resulting in 153 pages of single spaced transcripts.

Analysis of the data was an iterative process. Each interview was reviewed and discussed by the researchers prior to undertaking the following interview. This allowed us to reflect on the responses, review the appropriateness of our questions and identify additional questions or issues to address with the next participant. The final data set was analysed by two members of the research team using thematic analysis aided by the use of NVivo, a qualitative analysis software package. Thematic analysis is generally defined as the method through which patterns can be identified and analysed in qualitative data334. This process involved initial coding of each interview, undertaking comparisons across interviews and then identifying the emerging themes to get a deep and rich understanding of the use of trusts, the complexity of the current system, tax avoidance behaviours and associated issues in relation to the taxation of trusts.

9.3 FINDINGS

The key findings from the data are organised under the following areas:

- Motivation for using trusts
- Complexity of the current system
- Tax avoidance
- Participants’ observations about reform

The findings are based on the views of our participants with analysis added by the research team where relevant. To illustrate key points, we have included verbatim comments from a range of participants. However, to preserve confidentiality, participants are only identified by number. Our analysis of these findings and associated implications are outlined in section 8.4.

9.3.1 MOTIVATION FOR USING TRUSTS

Our participants conveyed that trusts were viewed favourably by their clients, however a couple of advisors suggested that this structure was more popular in Victoria and South Australia compared to Queensland and New South Wales. There was agreement among our participants that, in most cases, it is the advisor who recommends the use of trusts in group structures. Given the complexity of the law in this area, individuals are more likely to seek advice on the appropriate vehicle for their needs as opposed to approaching advisors with a specific request to set up structures that include trusts.

Several reasons were provided as to why trusts are widely used in Australia but the general consensus was that the primary drivers related to flexibility and asset protection, as will be outlined in the following sections. Two participants articulated the key benefits of a discretionary trust to clients as follows:

“They're absolutely regarded favourably, because of a couple of advantages that they have. One is that they do allow, to some extent, for flowthrough of taxation consequences to beneficiaries. So they have an advantage over a company in that way. They are eligible for the capital gains tax discount. That is an advantage where capital appreciating assets are being held. They allow for the separation of legal and beneficial ownership and indeed, in a sense, they allow for one entity to have the legal ownership, but for there to be no definite beneficial ownership in the case of a discretionary trust. That is incredibly powerful from what's broadly referred to as asset protection. I don't necessarily agree that that's the right term to use, but from an asset protection point of view, to use that term, that is an incredibly powerful benefit.” (Participant 3)

“Yeah, you might have good commercial reasons to allocate income particular ways and companies don’t quite allow you the flexibility to do that but trusts do and there’s not really another vehicle around that allows you that flexibility. And obviously, from an investment management perspective, almost the whole industry is underpinned by the use of trusts for that flexibility.” (Participant 1)

9.3.1.1 FLEXIBILITY

Trusts are viewed as providing more flexibility as a legal structure than any other entity (e.g., a company or partnership). This perception stems from the ability to create and, if permitted by the deed, modify the trust deed as circumstances change. For example, in other structures such as companies or partnerships the shareholders and partners are pre-defined and a formal record of these entities is maintained. In the context of a trust however, there is no requirement that the trust deed be registered or formalised in any way. Hence from a tax administration perspective...
viewpoint, tracing trust beneficiaries can be difficult. The trust deed for instance can even define what constitutes the income of the trust estate (commonly referred to as distributable income by the ATO, and hereafter in this section). As one participant stated:

“The rules of equity are a little more forgiving and a little more malleable, so I can have a deed for some things that I may not be able to do in a company.” (Participant 3)

This unique feature of trusts, as facilitated by the trust deed, poses a number of legal and compliance challenges which are discussed later in the findings. A related advantage is perceived to be the lack of regulation, as expressed in the following comment:

“They don’t have to be audited, they’re not regulated, you don’t have to disclose anything, so they’re quite useful.” (Participant 10)

Trusts also are seen to provide flexibility in structuring financial affairs since certain types of income can flow through a trust, such as dividends and capital gains, and can be specifically directed to beneficiaries. This allows the beneficiaries to access tax concessions that would not be available to them had the transaction transpired through other entities, such as a company. This flowthrough feature is particularly attractive to those who establish trading trusts (where an active business is carried on by the trustee) as capital gains can flow through to beneficiaries who can access the 50% discount, whereas a corporate beneficiary would be taxed on the whole amount of the capital gains.

9.3.1.2 ASSET PROTECTION

Trusts are viewed as useful vehicles for succession and estate planning since legal ownership and beneficial ownership are separated. The characteristics of trusts where neither the trustee nor the beneficiary/s owns the property means that high net wealth individuals can control how their wealth is managed over long periods of time, even after death. Several participants commented on the desire of some of their clients to ‘rule from the grave’.

Similarly, trusts are useful asset protection vehicles in the unfortunate circumstance of fractured family relationships or marriage breakdowns where assets can be preserved for future generations. In addition, this separation between legal and beneficial ownership is attractive to international investors since it is more difficult for creditors to foreclose on assets that are held in trust. This particular feature of trust law however may pose problems for Australia’s compliance with international agreements such as FATF and FATCA. Compliance with these agreements and implications for trusts are discussed in Chapter 6.

Finally, the majority of participants conceded that the disparity between the top marginal tax rate (47%) and the company tax rate is a significant motivator for the use of trusts. For those taxpayers who have sufficient wealth and/or income that may be subject to the top marginal tax rate, there is an incentive to set up structures that involve companies and trusts so as to be able
to accumulate (and in some circumstances distribute income) wealth at a lower tax rate of 30 cents on the dollar. This benefit could become a more powerful motivation if the corporate tax rate is lowered, as proposed by the current Federal Government in the 2016 budget.

9.3.2 Complexity of the current regime of taxation of trusts

There was a high level of consensus regarding the complexity of the current system of taxing trusts in Australia, with some participants describing the system as ‘horribly’ or ‘insanely’ complex. Part of this complexity was attributed to the need for a sophisticated understanding of the interaction between trust laws (Law of Equity) and taxation laws. Some of our participants expressed the opinion that ‘the small end of town’, that is smaller legal or accounting practices, simply did not have a full grasp of the complexities involved and that this resulted in advice that would at times be potentially non-compliant. In terms of applying the principles of the current system, one participant commented:

“I’m not sure anyone would have any hope of applying them properly unless you look at them day in, day out, like we might.” (Participant 1)

The complexity of the current system has led to a lack of understanding around trusts and particularly trust deeds by many clients and advisors, as discussed in the next section.

9.3.2.1 The trust deed and legal issues

The following comment illustrates some of the common difficulties that stem directly from the trust deed:

“…we sometimes get put in a situation where either because the client assumes that all trust deeds are the same, which they’re not, or my colleagues in the profession, whether within or without [company name], assume that all trust deeds are the same. What happens is we get put in a position where somebody has been operating a trust sometimes and we come along and we look and go, ‘Hang on. You can’t do that. You say you’ve been distributing to Mr X. Mr X isn’t actually eligible to be a beneficiary’ or, ‘You’ve been using this approach to the calculation of income of the trust estate but that’s not actually what the deed says. And yes the trustee can vary that by written declaration but where’s your written declaration?’ Because of the variability, it requires an understanding that they vary and that those variations are important.” (Participant 3)

In general, our participants indicated the following areas, in relation to the trust deed, as being problematic:
They vary from trust to trust and are not a standard document (as some practitioners seem to treat them).

Deeds are by default self-executing and require certain actions to be taken by the trustee, such as for instance, creating a sub-trust after the year-end resolutions to make payments to beneficiaries that have been made presently entitled.

In many cases trust deeds are set up by accountants rather than lawyers. This poses a significant risk to clients and also raises questions about whether accountants should be providing legal advice (this issue is discussed in more detail in section 8).

Trust deeds are often are not stored by clients and hence cannot be retrieved, which makes it impossible to appropriately administer a trust.

Regarding the last point, one of our participants (9) described a practice undertaken in their organisation which involves submitting the trust deed with the trust tax return. This participant explained this practice as way of proactively providing evidence to the ATO that the trust deed has been appropriately administered.

The preceding discussion highlights only some of the challenges that taxpayers and their advisors face in complying with the taxation of trusts due to the complexity of the current system. In addition, there are specific legal and process issues that arise from this complexity as well as the nature of the trust deed. The centrality of the trust deed as an instrument which dictates the operation of a trust was apparent from the data. The trust deed is central to:

- Defining income, such that it may be "anything" that the deed declares it to be. Giving the trustee the power to determine amongst other things what constitutes income of the trust estate. The discretion to decide which beneficiaries will receive entitlements from the trust.

- As previously alluded to, the trust deed varies considerably from trust to trust and yet it is not regulated in any way.

It is important to note that despite the centrality of the trust deed to the taxation of trusts there is no requirement in Australia that the deed be registered or recorded/formalised in any way. The trust deed in its current state therefore adds a layer of complexity to the taxation of trusts by being a flexible instrument which is opaque and provides little accountability to any of the stakeholders involved, including the beneficiaries of the trust and the ATO.
9.3.2.2 Complexities arising from Division 6 of the Income Tax Assessment Act 1936

The flexibility afforded by the trust deed in defining and redefining income gives rise to both natural and contrived/artificial income mismatches. When coupled with the proportionate approach (see s97 of ITAA36) confirmed in FCT v Bamford (2010) 240 CLR 481, this can lead to outcomes where the economic benefits do not follow the tax outcomes. This results in situations where the entity that bears the tax liability is not the same as the entity that receives the benefit of the income.

A number of participants suggested that natural differences between the income and distributable income can occur because of timing issues including accounting differences such as Division 40 capital allowances and Division 43 capital works deductions, franking credits and capital gains discount. However, artificial differences also can be created, for instance, by recognising internally generated goodwill, including such amounts as distributable income and then distributing such amounts to beneficiaries who are tax preferred entities or companies that have prior year losses which can be used to absorb the trust distributions. A recent Australian Tax Office taxpayer alert, TA 2016/12– Trust income reduction arrangements, sets out other examples where distributable income is manipulated such that the tax outcome is attributed to the tax preferred entity, whereas the economic benefit flows to another beneficiary of the trust as a non-assessable amount.

While our participants made it clear that they did not advise their clients to take up such practices, they claimed that some practitioners did engage in these deliberate income mismatch schemes. However, the participants were of the opinion that egregious cases where distributable income was artificially manipulated for the purpose of tax avoidance were rare in their experience.

9.3.2.3 Present entitlements and unpaid present entitlements

Most participants did not see the notion of present entitlement as a fundamental problem, but did identify some associated issues, as the following comment demonstrates:

“I think we just need a more certain way of creating that deflection to a taxpayer. The idea about present entitlement - and the reason why we had all this uncertainty and complexity, and people sort of go ‘oh, what's going on?’ - about whether it's streaming, whether it's how we deal with capital gains and how we deal with the intersection with division (7) - so I mean I think it comes down to there just needs to be a way. I think we can do it, of properly deciding who's going to be taxed on it. The sort of proxy of using present entitlement to economic gains in a trust sense I think probably has to go. It just doesn't seem to work all that well.” (Participant 5).

Further, it was acknowledged that the current system does allow for the practice of entitlements that remain unpaid, raising issues in relation to reimbursement arrangements (s 100A ITAA
1936), untaxed amounts distributed to beneficiaries (section 99 A, B and C), as well as Division 7A loans where the unpaid present entitlements are made to companies. In the context of trading trusts, this is particularly problematic since such entities prefer to retain amounts (i.e. have unpaid present entitlements) to grow or sustain the business. As one participant commented:

“But the issue with the reinvestment of profits of the business back into the business, and the tax rate that applies. In essence you’ve got two choices. You can distribute eventually to ultimate beneficiaries that are individuals, in which case they pay tax at up to 49% and you reinvest down to 51 cents in the dollar back in the business. Or they distribute to a corporate beneficiary, the ultimate beneficiary of the company, and you pay tax at 30% and you reinvest in the business 70 cents in the dollar but then you start running into Division 7A and then dividends and all sorts of stuff.” (Participant 3)

Some participants did discuss whether the concept of present entitlement should be revamped. Alternatives to the current notion of present entitlement would need to consider the taxation trigger which would result in more reasonable outcomes. For example, if the amount paid, as opposed to the entitlement, was taxed, would this lead to more reasonable outcomes? Given a) the complexities and the centrality as well as flexibility of the trust deed, and b) the proportional approach and the opportunities to create income mismatches, looking at the concept of present entitlement in isolation may be a futile exercise. In Chapter 7 we provide a detailed comparison of the taxing trigger and the present entitlement equivalent across other comparable jurisdictions.

In relation to unpaid present entitlements, it was noted that there is a general lack of understanding amongst taxpayers about the consequences of this. Further, the participants were of the view that many trusts wished to retain the funds to reinvest in business being operated through the trust, and this was somewhat problematic, as indicated by the following comments:

“A trust is not a holding vehicle so you’ve got surplus profits at the end of the year, you’ve got to do something with them, you’ve got to dump them somewhere. The problem is if the trust still wants them. What that suggests to me is the trust is not an appropriate structure.” (Participant 9)

“It’s difficult for trusts that are running an active business and want to retain cash to grow the business and you’ll hear a lot of people argue about that. My view’s a bit different; if you want to use a trust, you know you’ve got to pass out your income. There’s no point in whinging about it afterwards when you don’t like the outcome because you’ve chosen a particular structure; use a company. You know what I mean? Like, you can’t have your cake and eat as well.” (Participant 1)
Such entitlements might also constitute a Division 7A loan where the unpaid present entitlements are made to corporate beneficiaries. Several participants noted that the practice of giving unpaid present entitlements to corporations has reduced following the release of PS LA 2010/4 which made it clear that the tax office views unpaid present entitlements to corporations as a breach of Division 7A under certain circumstances.

9.3.2.4 STREAMING RULES

Participants argued that the current streaming rules were exceptionally complex and that it was difficult to interpret and apply these laws in practice as highlighted in the following comment:

“I was involved in some of the consultations, so I can’t say that they’re too horrible. But there’s some difficulties where they’re obviously very hard to apply in practice. And I think you do have the spot, I might call the smaller end of town, trying to apply some of these principles to the trusts they deal with and it’s just so horribly complicated.” (Participant 1)

There was also mention of the fact that these rules allow preferential treatment for certain classes of income, namely capital gains and dividends, but do not allow beneficiaries to be specifically entitled to other classes of income.

“I think what I see as predominantly a bit of an issue is probably post Bamford when the High Court said, well what you end up here is this blended cocktail of income and it effectively doesn’t retain its character. So I’ve got this mismatch where a trust deed might permit me to stream a certain class of income to you and the tax implications don’t follow that unless I happen to be in the two relevant classes of income dividends or capital gains.” (Participant 4)

9.3.2.5 PROCESS ISSUES

Most participants identified complexities that exist in the process of administering and complying with trust taxation laws. The two most frequently mentioned issues were:

- The requirement to pass trustee resolutions by 30th of June: Almost all participants argued that the need to have resolutions passed for distributions to beneficiaries by this date was not in line with reporting requirement for other entities. There are practical difficulties such as having a complete set of accounts by 30th of June in order to make decisions about distributions. One participant overcame this issue by asking their clients to pass resolutions which described the proportional allocation to beneficiaries rather than the amounts of the distributions. The consequence of not making resolutions by the due date is that the trustee may be deemed not to have made any distributions in the relevant income year and hence be forced to pay the penalty rate of tax on all trust income.
• Unpaid present entitlements to corporate beneficiaries which are now covered by TR 2010/3 and PS LA 2010/4 and the seven-year grace period: The primary concern of participants was that the amounts of unpaid present entitlements (which may have been subsequently invested or otherwise expended by the trust) may or may not exist within the trust for these amounts to be paid to the corporate beneficiaries following the end of the seven-year grace period allowed for in PS LA 2010/4. This however highlights a primary problem with the concept of unpaid present entitlements and the complications that it creates when trading trusts choose to retain funds instead of paying out the amounts to beneficiaries.

9.3.3 TAX AVOIDANCE – ATTITUDES AND BEHAVIOURS

While the participants did not articulate specific examples of tax avoidance that they had encountered in their professional work, they did point to several pertinent issues affecting attitudes and behaviours in relation to tax avoidance. Given that the key concern of the ATO is the separation of economic benefits from tax outcomes in relation to discretionary trusts in general and closely held trusts in particular, the discussion with participants in relation to tax avoidance focused on this issue.

9.3.3.1 ATTITUDES TOWARDS THE USE OF TRUSTS FOR TAX AVOIDANCE

Participants generally commented that egregious tax behaviour will always exist, or as one participant (5) put it ‘mischief at the margins’, but they did not subscribe to the notion that trusts are a vehicle that is particularly conducive to tax avoidance behaviours/schemes. Some participants argued that tax avoidance schemes were entirely a function of the risk appetites of the individual or groups, and their advisors, which engage in such schemes. There was in general an attempt on the part of the participants to stress that the use of trusts was part of legitimate tax planning and that tax avoidance was not the primary intent. There also appeared to be one explicit attempt to deflect attention away from trusts being a specific problem area in relation to tax avoidance by pointing to other, broader tax avoidance issues. This view is illustrated by the following comment:

“I think if people want to avoid tax, I don't think they necessarily need a trust to do so. I think you'll find the tax gap will — if we ever see that the, I guess, the analysis,

335 The ATO subsequently has released PCG 2017/13 Division 7A – “Unpaid present entitlements under sub-trust arrangements maturing in the 2017 or 2018 income years” which provides practical guidance on how the sub-trust arrangement should be dealt with, particularly in relation to the interest only loans to the main trust.
most of the tax gap, if you like, is going to come from the cash economy and the sharing economy, maybe now these days et cetera, and illegal activities and a whole raft of things. I think not much has been made to do about trusts." (Participant 4)

In relation to the role of the client-advisor relationship and tax avoidance, several participants indicated that advisors, particularly at the 'smaller end of town' were under pressure from their clients. In essence these practitioners, it was argued, had to come up with strategies for tax minimisation to maintain client satisfaction and business. Conversely, and potentially controversially, one participant suggested that the 'Big 4' accounting firms have a greater risk appetite and were more likely to test the boundaries of Part IVA since they have both the legal and monetary resources to develop and defend tax avoidance schemes. The following comment demonstrates how one advisor differentiates their role from that of a counterpart in a 'Big 4' firm:

“My view is that our role as tax advisors is to basically help clients with their commercial ventures and to manage tax around the periphery, you know? So if a client wants to run a business then we should be making sure that they're focusing on generating profits and getting employment and the tax is managed efficiently, it's not driving the transaction. Whereas the big four sort of sit down and have long sessions about what smarter tax ideas can we go and tell the clients. We don't do that, we sort of say well how can we help clients manage their business and how can we make sure that tax is not a frustration." (Participant 10)

According to our participants, however, in general, the driving force for tax avoidance schemes was attributed to a relatively small number of advisors as illustrated in the following comment:

“So look I actually think that a lot of this stuff still is at the edges. It's at the edges where you have - and it's driven by advisors, there's no question about it. People always try to save money on tax. There's just less opportunities now to do it. Because there's less opportunities, the sort of things you see tend to be a lot more extreme…” (Participant 5)

Participants were forthcoming in mentioning that most, if not all private groups and/or high net wealth individuals' groups would have structures that contain multiple trusts and companies. They were however also of the opinion that most of these structures were driven by business/financial considerations, particularly in relation to the flexibility and asset protection benefits mentioned earlier, not primarily by tax planning considerations. This presents particular challenges for the ATO since they would have to prove ‘dominant purpose’ in any investigation that might be undertaken under Part IVA of ITAA 1936.

Interestingly the divergent definitions of income, i.e. distributable income and net income, were not seen as a factor contributing to tax avoidance but rather as a fundamental feature of the
taxation of trusts. That is, participants did not see the divergent income definitions as a problem in itself. They attributed tax avoidance to the risk appetite of individuals who engaged in artificially contriving income mismatches in order to gain a tax advantage. It is however worth noting that, despite this view expressed by our participants, the fact remains that artificially contrived or otherwise, income mismatches are only possible in the context of trusts and, but for the law which allows two parallel definitions of income, such arbitrage opportunities would not exist.

9.3.3.2 Attitudes towards tax rates achieved through the use of trusts
Some participants expressed the view that tax authorities should not be too concerned as long as someone was held responsible for paying tax on trust income. This was associated with the perspective that as long as at least the corporate tax rate was being applied to income, there should be no concerns on the part of the tax authorities. Essentially this was seen as playing by the rules. Similarly, some participants held the view that the top marginal rate for individuals (47%) was too high and that parity between the corporate tax rate and the top marginal rate should be achieved. Conversely, some participants argued that fulfilling one’s tax obligation is what they viewed as the cost of living in a civilised society:

“Like, there’s lots of taxpayers that come up to me and say I don’t want to pay any tax, so I sort of say, well neither do I. But, you know, you want to live in this beautiful country, you want your kids to go to nice schools, you want roads that don’t have holes in them, then someone’s got to pay the bills. So either just put up or shut up, or go somewhere else,” (Participant 10)

While the use of trusts may or may not expressly result in tax avoidance, our participants did suggest that the use of multiple trusts and corporate beneficiaries in private group structures did result in tax being capped at 30%. In relation to effective tax rates, one participant commented:

“So yeah it’s hard to say what your average taxes are but you tend to bring everyone to 30% and then you’ve got to look at their disposable income, if they need more, they’ve got to pay more. But I do hear of arrangements where people are still trying to place private cash into company’s tax, corporate tax rate and still use those cash for personal living. Whereas my approach is well if you’re using it for personal living you should be paying income tax at a personal level and anything that’s surplus can go into a corporate because you’re not going to draw upon it.” (Participant 6)

Essentially, this results in the effective top marginal tax rate for high net wealth individuals (or any other group that uses discretionary trusts) being 30% rather than the 47% rate which would be applied in the absence of the trust within the structure.
9.3.3.3 PERCEPTIONS OF CURRENT ANTI-AVOIDANCE PROVISIONS

All practitioner participants argued that the current laws and provisions were strong enough to both dissuade potential tax avoidance as well as allowing for the successful investigation of cases of artificial manipulation of distributable income to create income mismatches. Specifically, it was suggested that the ATO has sufficient powers under Part IVA of ITAA 1936 to challenge artificially contrived trust arrangements designed to avoid tax. The participants argued that the ATO simply needed to better target certain avoidance behaviours and not tarnish all trusts as vehicles of tax avoidance.

Practitioners also pointed out that recent (2012) changes to the trust tax returns make it easier for the ATO to identify differences in distributable income (label 53A) versus net income (label 26). Some participants indicated that they were cautious of the overarching nature of the provisions in Part IVA and did not wish to provide advice which could result in lengthy court cases.

9.3.4 PARTICIPANTS’ OBSERVATIONS ABOUT REFORM

While recommendations for reform are outside the scope of this report, several options for reform in both a macro and micro sense were discussed by the participants. In general however, there was little appetite for broad based changes to the taxation of trusts. Despite their comments and criticism regarding the complexity of the current system, the majority of participants were hesitant about change. Some even joked that the complexity was advantageous to them from a business perspective. However, the most frequently mentioned suggestions made by participants were as follows:

- Move towards an entity taxation system where tax is paid by the trustee. The flowthrough feature of trusts would be maintained such that beneficiaries would receive credits for tax paid at the trustee level. This suggestion would essentially align the taxation of trusts more closely with the taxation of companies.

- Implement a withholding tax regime for trusts. The suggestion was to again tax the trustee on all income of the trust and have the trustee remit this to the ATO. The beneficiaries would receive the after tax distributions from the trust and be given a tax offset for the tax paid at the trustee level. This is essentially similar to the current treatment of salary and wage earners.

- The ATO could provide a ‘safe harbour’ definition of distributable income. This suggestion would result in reducing the flexibility in what constitutes income of the trust estate. By providing a clearer boundary around this definition, the ATO could potentially better divert/direct resources to investigate cases where the schemes ignore the ‘safe harbour’ definition of income.
• Allow trading trusts to reinvest profits at 30 cents in the dollar. This option would allow
trusts that were carrying on a business to pay tax at the company tax rate and distribute
the surplus to beneficiaries. This suggestion however is perhaps not as simple since it
would further complicate an already difficult system by creating different classes of trusts
that are taxed at different rates.

Some participants argued against reform altogether on the basis of the following:

• Most taxpayers were compliant and that the trend is towards greater compliance. As
such, the system should not be changed on the basis of a minority of egregious cases.

• The ATO already has sufficient powers under Part IVA to pursue the cases at the
margins.

• The proportionate approach established in the Bamford case is the correct approach
and reflects what beneficiaries should receive and hence should remain unchanged.

• If there was broad based change, there would be a need for complicated transition
arrangements. This would result in greater complexity and confusion.

In general, there was little interest in bringing about significant reform. Despite its complexity,
there were no obvious solutions to the issues identified by participants that wouldn’t create other
issues. Further, the nature of the current system creates a secure role for practitioners due to its
complexity and the necessary expertise required to successfully navigate the system.

9.4 SUMMARY OF FINDINGS AND IMPLICATIONS FOR THE TAXATION OF TRUSTS

• Trusts are an incredibly flexible legal relationship/instrument and create a unique set of
challenges in relation to taxation. The participants agreed that the current system is too
complex, yet were hesitant about the prospect of reform.

• The legal complexities were seen to arise due to several reasons. However the source
of most tax avoidance issues is the separation between distributable income and net
income of the trust, coupled with the proportionate approach confirmed in the FCT v
Bamford (2010) case. The Bamford case itself was not seen by practitioners as having a
significant impact on the use (misuse) of trusts in Australia. Most practitioners argued
that the Bamford case resulted in the correct decision being made particularly in relation
to the proportional approach.

• The trust deed, while being a flexible instrument, provides many challenges from an
administration point of view as discussed in section 3.1. Without some form of regulatory
oversight of trusts and/or trust deeds further complications are likely to arise in terms of the administration.

- The notion of unpaid present entitlements continues to pose challenges for practitioners and the ATO alike. Also problematic are the streaming rules in relation to capital gains and dividend income. These aspects of the current regime result in legal as well as administrative complications.

- In relation to tax avoidance, most of our participants argued that extreme cases were rare. However as we have demonstrated in the quantitative analysis (see Chapter 3), the potential remains for widespread misuse of trusts to artificially contrive differences between distributable income and net income, and engage in tax avoidance behaviour. Additionally, the ability to create income mismatches does not apply to other legal forms/entities such as companies or partnerships.

- Participants generally held the view that the ATO has at present sufficient powers under Part IVA of the ITAA 1936 to investigate what they referred to as ‘egregious cases’ of tax avoidance through the use of trusts. In practice however, as one participant pointed out, actions taken by the ATO using Part IVA are often a last resort, potentially suggesting that such cases are unlikely to succeed due to the difficulties in proving that the schemes used by the taxpayer are primarily for tax avoidance rather than business/financially geared which is the fundamental requirement for invoking Part IVA of the ITAA 1936.

- Most of the participants argued that the disparity between the corporate tax rate and the top marginal tax rate was the driver behind the use of trusts. While this may be the case, the merits of lowering the top marginal rate or increasing the corporate tax rate must be carefully deliberated.

- Most if not all high net wealth and wealthy groups utilise multiple trusts and companies within their structures. In many cases it was suggested that one of the aims is to reduce the effective tax rate to the corporate rate of 30%.

- Participants suggested a number of potential changes to the trust tax law including:
  - A withholding tax regime similar to that in place for salary and wage earners.
  - Taxing the trust/trustee as an entity and maintaining the current flowthrough features of trusts.

- The current regime in Division 6 is complex and the nature of trusts as they are used in practice presents challenges for the ATO to successfully audit the large numbers of cases of tax avoidance involving trusts. In the context of a self-assessment taxation
system, trusts appear to provide taxpayers with enormous flexibility with limited statutory oversight and accountability.

- The current tax treatment of trusts creates a disparity between the tax treatment of salary and wage earning taxpayers and high net wealth individuals and those who derive business income through trusts. In section 7 of this report we compare and contrast Australia with four other common law jurisdictions.
10 CONCLUSION

This report presents the findings of an investigation commissioned by the Australian Taxation Office (ATO). The findings contribute to the objectives of the Tax Avoidance Taskforce – Trusts in three main ways:

1. This is the first report which analyses ATO de-identified data, relating to various discreet groups of taxpayers and reveals the extent of the inherent risks in the current taxation of trust regime.
2. Critically reviewing how other common law jurisdictions (a) tax trusts (with a particular focus on jurisdictions with similar legal systems to Australia), (b) deal with similar tax use of trusts (c) deal with similar issues that arise from the interaction of tax and trust law and (d) regulate trusts.
3. Assessing known commercial and legal matters that are relevant to the use of trusts and have an impact on tax administration.

Given the large and complex nature of the law in this area, the investigation focused on five key areas:

1. Taxation issues arising from Division 6 of ITAA 1936, focusing on mismatches between trusts’ distributable income and net income of the trust estate – referred to in our report as the income tax shuffle.
2. Complex trust distributions, including distributions between trusts.
3. Non-lodgment of trust tax returns and the difficulties that arise for tax administrators.
4. Australia’s international obligations under CRS, FATF and FATCA and implications for the taxation of trusts regime.
5. A comparison of the taxation regime for trusts in comparable jurisdictions. The countries included in the analysis are the United States, United Kingdom, New Zealand, and Canada.

Complementing this focus was consideration of unauthorised legal practice by tax agents. Three modes of investigation underlie this investigation: a doctrinal evaluation of relevant taxation laws, a quantitative analysis of ATO data and depth interviews with industry practitioners.

The main findings include:

The Income tax shuffle exploits the differences in definitions of income under trusts law and tax law. Beneficiaries are made liable for tax on the amounts which they do not receive. This results in a separation of economic and tax outcomes.

The major indicator of an income tax shuffle, present in every case, is that a trust has a smaller amount of distributable income than net (taxable) income, however it should be noted that there
may be other explanations for this indicator. Five income tax shuffle case studies provided by the ATO were analysed as part of the investigation. The estimated tax leakage, featuring 18 arrangements and an income amount of $729 million, was $195m.

More generally, analysis of de-identified trusts’ tax return information revealed:

- There is strong evidence of income mismatches.
- Distributions to company beneficiaries accompanied by franking credits to permanently limit the tax liability and cap the tax rate at 30%.
- On average, ‘loss-making’ company beneficiaries received 22% of trust total distributions while ‘non-loss-making’ company beneficiaries received only 14%.

Several case-based scenarios were conducted to estimate the potential size of total tax revenue being sheltered. Conservative estimates indicate between $672 million to $1.2 billion of tax revenue could be being sheltered annually. Less conservative estimates suggest the amount of tax sheltered could be several billion dollars which will be further inflated as the corporate tax rate decreases.

In summary, the findings demonstrate that orchestrating income tax shuffles can be particularly advantageous for high wealth individuals. Further, in some cases there appears to be intent to construct complex trust arrangements.

Complex distributions between trusts were also examined. It was observed that taxpayers can derive income from trusts in convoluted ways in order to defer, reduce or extinguish tax liabilities.

Four key traits, based on ATO case studies were evident:

1. **Multiple trust structures:** Chains of trusts make it difficult for the ATO to identify the ultimate beneficiaries to assess. “Circular entitlements” are an extreme example whereby at least two trusts make each other presently entitled. Analysis of ATO data indicated that one in every five trusts distributed beyond two levels. Further that the distributions are growing and five tier deep trust chains were not uncommon.

2. **False present entitlements:** Low-taxed and tax-preferred entities – charities, tax exempts, loss companies and ‘bucket companies’ - agree with existing trust beneficiaries that they will become trust beneficiaries and transfer the (low-taxed) distributions they receive in that capacity, less a service fee.

3. **Association with income tax shuffles:** Income tax shuffles seem to be a common feature of complex distributions, in particular added complexity aids individuals in having arrangements whereby a trust’s trusts law income happens to be less than its tax law income, or a distribution that is made to an unlikely tax exempt or corporate beneficiary.
5. **Income re-characterisation arrangements:** Provisions of the Tax Act may be manipulated through the use of trusts in complicated transactions. For example, substitution of income character to achieve a lower rate of withholding tax for non-resident beneficiaries.

These types of arrangements make it difficult to levy the correct tax burden on the appropriate ultimate beneficiary or entity. As well as increasing the level of tax sheltered, it puts a heavy burden on ATO administrative resources tasked with unravelling money flows so that appropriate tax liabilities are realised.

A complicating administrative challenge is the *non-lodgment* of trust tax returns. The Commissioner has limited sources of information on trusts and these are insufficient given the increasing complexity surrounding their (mis)use.

The findings demonstrate that the lack of information, in relation to trusts, their composition and trust deeds, presents administrative as well as compliance monitoring challenges and is a major problem.

Analysis of ATO data revealed that different types of trusts have different lodgment patterns. However, there was no way of corroborating this given the lack of information available. The limited information is not just a domestic concern as Australia is party to a number of global initiatives including the OECD’s CRS standard, the Financial Action Task Force as well as FATCA.

A review of *Other Common Law Jurisdictions* revealed that in the United States and Canada, tax on trust income (including capital gains) is attributed to trustees at a high marginal rate subject to the trustees being entitled to a deduction for income distributed or distributable to beneficiaries. New Zealand trustees are taxed on trust income at a 33% rate amounting to a tax credit for beneficiaries to whom the income is distributed. Difficulties associated with the Australian ITAA36 s97 present entitlement formula are avoided in those jurisdictions.

Canadian capital gains tax charges occur when property is transferred to a trust, when trust property is disposed of and, as an anti-deferral measure, every 21 years all the property of a trust is deemed to be disposed of unless it has “vested indefeasibly”. In Australian terms, this means that the subsisting assets of discretionary trusts (before appointment) will be taxed once every 21 years — limiting some of the remarkable immunities of the Australian discretionary trust.

*Non-lawyer tax agents* (and accountants) are known to regularly advise their clients about trusts and supply trust deeds. It is questionable whether they are able to perform this work without appropriate legal expertise. Analysis of the *Tax Agents Services Act 2009* and state-law *Legal Profession Acts* indicates that tax agents may not be authorised by federal law to engage in legal practice as unqualified persons, contrary to state-law prohibitions.
Depth interviews of 10 industry practitioners exploring the behaviours and attitudes surrounding the use of trusts complemented the investigation. Key insights from these interviews include:

- Trusts provide flexibility in terms of structuring businesses and tax affairs when compared to establishing companies or partnerships.
- Trusts are viewed as useful vehicles for asset protection and estate planning since legal ownership and beneficial ownership are separated.
- Most if not all high net worth and wealthy groups utilise multiple trusts and companies within their structures. In many cases it was suggested that one of the aims is to reduce the effective tax rate to the corporate rate of 30%.
- Most participants claimed that extreme cases of tax avoidance were rare.
- Participants' suggested reform could include a withholding tax regime similar to that in place for salary and wage earners or taxing the trust/trustee as an entity and maintaining the current flow through features of trusts.

In conclusion, this report has identified a number of focus areas for future consideration. However, suggestions of how these areas could be addressed is beyond the scope of the report.
Appendix A: A Detailed Background of Taxation of Trusts in Australia

Trusts

1. Anglo-Australian trusts are fiduciary relationships concerning property. Trustees hold property for the benefit of beneficiaries or for purposes enforceable by law. Trusts are not legal entities. Rights and liabilities attributable to trusts are incurred by trustees and not beneficiaries.

2. Trusts can be fixed or non-fixed. Beneficial interests in fixed trusts are held in specific shares for identifiable persons or purposes. Unit trusts normally (but not always) contain fixed beneficial interest shares proportionate to unit-holdings. Non-fixed (or discretionary) trusts empower the trustee or some other person with a discretion to determine (1) beneficial interest shares in particular trust distributions; and (2) whether and when distributions should be made. Some unit trusts are a hybrid of these fixed and discretionary trust characteristics.

3. Express trustees in Australia are often empowered to carry on business with some or all of the trust property. The trust is primarily a commercial phenomenon.

4. Australian commercial trusts in Australia are often used as an alternative to incorporated business vehicles. There are a number of reasons for this. First, enterprise profits “flow through” trusts and are taxed to beneficiaries in a way sometimes considered to be more tax-efficient than taxation of corporate profits at corporate entity level. Secondly, amounts distributed by trustees to beneficiaries generally retain the character which those amounts had in the hands of the trustees. Thirdly, limited liability advantages associated with incorporation can mostly be obtained through the use of corporations as trading trustees.

5. The great majority of trusts in Australia are discretionary in form. Beneficiaries of discretionary trusts are not entitled to any knowable share of a trust’s income or capital gains prior to the occurrence of trustee determinations to make a particular distribution. Trustees of discretionary trusts (or persons with the authority to determine beneficial interests) are subject to minimal trusts-law control in the exercise of their powers to distribute the assets or income of discretionary trusts.

336 Source ATO Statistics, 2013-14 accessed 3 March 2017. Trusts, Table 4. See Figure 1 above at [1.1].
The purpose of trusts

6. Australian trusts are used primarily for asset protection, tax planning and succession purposes. Trusts became a common vehicle for investment and small business enterprises in the 1960s. There was, at this time, a perceived double taxation of companies and shareholders.

7. Discretionary trusts facilitate conduit taxation and income-splitting within closely-held, family groups. Persons eligible to benefit from trusts’ discretionary distributions are usually described in classes of persons who share a family relation to the trust founder or to “Special Beneficiaries”.

8. Asset protection is a subordinate purpose of the trust. Many of the benefits of limited liability associated with corporations are available to trusts which have corporate trustees. Personal liability for engagements entered by trusts is assumed by corporate trustees, not trust creators or beneficiaries — subject to a limited equitable jurisdiction which attributes trustee liabilities to beneficiaries who receive trust distributions and to statutory provisions which impose trustee liabilities on trustee corporation directors.

9. Estate planning is another subordinate purpose. Unlike Britain or the United States of America, Australia does not have the estate or inheritance taxes which replicate the founding conditions of trusts in early modern Britain. Death in Australia does not trigger a capital gains tax liability in the way that it does in Canada. However, Australian testamentary trusts may be planned to derive and distribute the income of a deceased estate. Ownership of a deceased’s assets may be re-structured tax-free through use of the CGT roll-over on death.

10. Business arrangements may be conducted with a high degree of flexibility through the trust device. There is no public register of trusts, nor annual fee to maintain the entities. Insolvent trusts may be free to trade on whilst corporate trustees are unable to pay their debts. A complication has arisen with the introduction of “discretionary trust surcharges” for land tax in some Australian state and territory jurisdictions.

The taxation of trusts

11. The trust-taxing scheme of Division 6 of the Income Tax Assessment Act 1936 ("the ITAA36") is based in ideas of entitlement and proportion.

12. The default position is that tax liabilities flow-through trusts to “presently entitled” beneficiaries who bear the first and final liability to pay tax on trust income. Trustees pay tax at individual rates on the income of certain tax-preferred trusts and trusts for beneficiaries who are presently entitled subject to a legal disability. Tax at the highest marginal rate is paid by trustees on income to which no beneficiary is presently entitled.
13. The formula is expressed in ITAA36 ss97-99A. Pursuant to s97, beneficiaries pay tax on shares of a trust’s tax-law “net income” which correspond to their trust-law entitlement to the “income of the trust estate”. Entitlements are expressed as proportions. Beneficiaries’ are liable to pay tax on the proportion of a trust’s taxable net income which equals the proportion of their trusts-law entitlement to income of that trust (see Federal Commissioner of Taxation v Bamford (2010) 240 CLR 481). The scheme is elegant. Tax liabilities are measured by trusts-law concepts.

14. Trustees of trusts are taxed in a residual way. Where presently entitled beneficiaries are under a legal disability (i.e., when beneficiaries are disabled), s98 provides that trustees pay tax for such persons at their appropriate individual rates. Where a trust results from a will or intestacy, from bankruptcy or in certain other tax-preferred circumstances, s99 provides that trustees are liable for tax on trust income at the rates applicable to individuals. Where there is no presently entitled beneficiary and the income is accumulated, s99A provides that trustees pay tax on a trust’s net income at the highest marginal rate.

15. ITAA36 s101 deems discretionary trust beneficiaries to be presently entitled to the extent that they are paid in exercise of a dispositive discretion. If the discretion is not exercised in a particular tax year, or trust income or gains are accumulated, s99A taxes trustees at the highest marginal rate (in the absence of prior year losses carried forward).

Character retention and the source of trust income:

16. Trust income assessed to tax in the hands of a presently entitled beneficiary may retain the character that the income had when it was derived by the trustee: Charles v FCT (1954) 90 CLR 598. This followed from the High Court’s conclusion in that case that certain trust beneficiaries had “a proprietary interest in all of the property which for the time being is subject to the trusts of the deed”. The same proprietary conclusion was not drawn in CPT Custodian Pty Ltd v Commissioner of State Revenue (Vic) (2005) 224 CLR 98. In CPD Custodian, where the High Court concluded that the unit holders had no rights to any trust property and were entitled to trust income distributions only after the exercise of trustees’ powers to withhold trust income for various purposes. Consequently, unit holders may not enjoy beneficial ownership of unit trust property “at least in some statutory contexts”: Jacobs at [3.12].

17. Where a beneficiary’s proprietary interest in trust property is found to exist, the character retention conclusion in Charles v FCT will apply. On one view of what Charles’s case case decided, income distributed by the trustee to beneficiaries of a simple fixed trust retains the character which the income had when derived by the trustee in the absence of a contrary indication.
18. Statutory streaming rules applicable to the treatment of capital gains accruing to trusts in ITAA97 Subdiv 115-C have confirmed that capital gains accruing to trusts are assessable as capital gains in the hands of “specifically entitled” beneficiaries. ITAA97 Subdiv 207-B provides that franked distributions and franking credits flow through trusts to beneficiaries who are specifically entitled to franked distributions. Pursuant to Divisions 275 and 276, Managed Investment Trusts and Attribution Managed Investment Trusts in may elect that statutory streaming rules qualify income distributed to relevant beneficiaries.

19. Provisions assigning a geographical source to income flowing through trusts are contained in ITAA36 s-s6B. Sub-sec 6B(1) provides that income derived by a beneficiary has the character of dividend income if the beneficiary was the beneficial owner of the share in respect of which the dividend was paid or the income is otherwise attributable to the dividend. Income derived by a beneficiary will have the character of passive income or interest income if the income “represents” the passive or interest income or is otherwise attributable to it: s-s6(1A) and s-s6(2). Distributed trust income will be deemed to be income from a particular source if the beneficiary derived the income by reason of being beneficially entitled to an amount derived from that source or the income is otherwise attributable to income derived from that source: s-s6B(2A).

Following trust distributions and associated tax liabilities:

20. “Ability to monitor the tax equation” is dealt with under this heading. Trusts law supplies an interesting analogue. Misappropriated trust property can be traced into substituted forms through equity’s remedy system. Persons who have handled, received or converted that property can be identified. Allegations of fraud activate the right to trace. Misappropriated trust funds can be traced, for example, into the reduction of mortgage liabilities or the purchase of other property in the name of a corporation or a wrongdoer’s spouse. Value can be followed through digital transactions in and between multiple jurisdictions and tax havens.

21. Tax fraud even amounting to dishonesty will not activate the trusts law right to trace under existing law. Distributions made to eligible beneficiaries and between trustee-beneficiaries not contrary to civil or criminal law are currently outside the tracing procedure. Nevertheless, the law of tracing is developing. Claims to trace are now upheld even though persons can show no beneficial interest in the subject property.

22. Australian taxation law provides several means of following complex trust distributions and attaching tax liabilities to taxpayers associated with trusts.
Closely held trusts, TBs and TB non-disclosure tax:

23. Division 6D of the ITAA36 is part of an anti-avoidance regime applicable to the trustees of closely held trusts which distribute shares of untaxed or tax-preferred income to beneficiaries which are trustees of other trusts. Distributing trustees are required to provide the ATO with a “correct TB statement” which identifies final recipients. In default of compliance, the Taxation (Trustee Beneficiary Non-disclosure Tax) Act 2007 imposes tax on the distribution at the highest marginal rate.

Diverted trust income — “tax avoidance agreements”

24. Division 9C of Part III of the ITAA36 may be applicable where taxpayers exploit the status of tax-exempt entities by transferring property to those entities in return for the receipt of agreed tax-exempt consideration. Income taxable at the highest or a high marginal rate may be thereby diverted from taxpayers to tax-exempt entities. The Division empowers the Commissioner to impose tax at the highest marginal rate on the tax-exempt entity to the extent that the consideration the entity pays exceeds the consideration that could be expected to be paid by a person who was not exempt from tax.

Trust stripping – “reimbursement agreements”

25. ITAA36 s100A may be applicable where trustees divert (or “wash”) trust income through distributions to third party beneficiaries who have trust losses, low tax rates or exempt status. Original trust beneficiaries benefit from the diversion of income when they receive equivalent payments, property or services from the third party beneficiaries (less transaction fees). A common form of trust-stripping reimbursement involves the presently entitled third party beneficiaries (or their associates) settling capital sums in other trust estates for the benefit of original beneficiaries. ITAA36 s100A empowers the Commissioner to deem a third party beneficiary not to be presently entitled if the present entitlement arose out of a “reimbursement agreement” (defined to include a formal or informal arrangement or understanding, whether or not enforceable) whereby the third party beneficiary pays money or transfers property to other persons. The result is that no beneficiary is presently entitled and the diverted income is assessed pursuant to ITAA36 s99A.
Trusts and diversion of income to superannuation funds

26. Self-managed superannuation funds (SMSFs) may derive concessional-taxed income which represents a disproportionately large return on the SMSF's investment in the trust and/or the exclusion of other trust beneficiaries (TA 2008/4). The SMSF's income will then be taxed under ITAA97 Subdiv 292—C as "non-arm's length income" under s-ss295-550(4) and 295-550(5) on the basis that the SMSF and the trust were not dealing with one another at arm's length and, in case of a fixed trust, the SMSF did not acquire the interest in an arm's length transaction and the amount of the relevant income was more than might be expected had the parties dealt with each other at arm's length.

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Appendix B: Data sources and methodology

This section outlines the data and methodology employed to answer the research questions in Chapter 3. Specifically, details about the data sources, sample units, sample composition and coverage are provided in this appendix. The model specification and estimation methods for research questions are also documented.

Data

This section describes data sources, the initial sample, sample units and coverage used to address the research questions.

The two datasets were provided by the ATO. Dataset 1 contains information on trusts (henceforth trust dataset) and trust beneficiaries (henceforth Beneficiaries dataset) based on the ATO’s Division 6 risk classification rules. Dataset 2 contained only the top 20% of all income mismatches. The second dataset has been used only for the purposes of estimating the tax sheltered. The first dataset was used to answer the key research questions in Chapter 3.

Dataset 1 contains 76 variables in relation to trusts and is in wide format (the value for each variable in each year is presented in its own column). The dataset was first converted to a long format which each column contains a distinct variable across time such that each trust appears in several rows representing values over 6 years. This dataset covers an initial sample of 346,572 numbers of group-related entity observations during the period of 2010-2015.

The entire sample was divided into six small sup-groups based on their client types (listed in Table 1) below.

<table>
<thead>
<tr>
<th>Table 1 Initial sample observations per client type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client type</td>
</tr>
<tr>
<td>Company</td>
</tr>
<tr>
<td>Individual</td>
</tr>
<tr>
<td>Partnership</td>
</tr>
<tr>
<td>Self-Managed Super Fund</td>
</tr>
<tr>
<td>Trust</td>
</tr>
<tr>
<td>Other</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

Source: Prepared by RMIT University using ATO data

The initial sample consisted of 209,435 group-related entity observations during the period of 2010-2015. Duplicate IDs for all client types were identified. In the trust dataset, for example, 12,945 IDs did not have duplicates while 50,730 trusts contained more than one duplicate ID.
and these duplicates contained the same information across their variables. Similarly, 20,514 companies did not have duplicate values while 61,887 companies did. After removing those duplicate values, the final number of observations and its sample coverage are listed in Table 2. The final sample covered 23.51% of the initial sample's observations.

<table>
<thead>
<tr>
<th>Client type</th>
<th>Initial Numbers of Observations</th>
<th>Numbers of Observations after Removing Duplicates</th>
<th>Sample Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company</td>
<td>82,401</td>
<td>20,515</td>
<td>24.89%</td>
</tr>
<tr>
<td>Individual</td>
<td>7,846</td>
<td>5,853</td>
<td>11.88%</td>
</tr>
<tr>
<td>Partnership</td>
<td>10,066</td>
<td>2,638</td>
<td>26.21%</td>
</tr>
<tr>
<td>Self-Managed Super Fund</td>
<td>2,399</td>
<td>2,149</td>
<td>4.36%</td>
</tr>
<tr>
<td>Trust</td>
<td>63,675</td>
<td>17,529</td>
<td>27.52%</td>
</tr>
<tr>
<td>Other</td>
<td>43,048</td>
<td>566</td>
<td>1.31%</td>
</tr>
<tr>
<td>Total</td>
<td>209,435</td>
<td>49,250</td>
<td>23.51%</td>
</tr>
</tbody>
</table>

Source: Prepared by RMIT University using ATO data

Methodology

This section specifies the econometric and estimation issues, models and testing procedures utilised to answer the research questions specified in Section 3.

Income of the trust estate (53A) vs Taxable income (26) and the presence of (substantial) capital gains (21A)

The first comparison that indicates the possible existence of the Bamford shuffle is between distributable income (i.e. trusts law income) which is found at Label 53A in the trust tax return and Label 26 which refers to net income of the trust (i.e. tax law income). The difference can be quantified in terms of the extent of the difference between the trusts law income and tax law income for each trust each year.

\[
D_{\text{Income}}_{t,i} = NI_{26,t,i} - DI_{53A,t,i}
\]  

Where subscripts i, t indicate individual trust and year, D_{\text{Income}} is the difference in the level of income, NI_{26} is the net income of the trust (Label 26) and DI_{53A} is the trust distributable income in Label 53A.
If there is a difference between the distributable income and net income of the trust each year, Label 21A of reported capital gains will then be divided by the difference to investigate whether the large proportion of the income mismatch is contributed by capital gains for each trust each year. In theory, the difference between Labels 26 and 53A would be large when there are capital gains.

\[ P_{CapGain_{i,t}} = \frac{CapGain_{21A_{i,t}}}{Dif_{Income_{i,t}}} (2) \]

We then investigated the magnitude of the difference between distributable income and net income of trust and the role of capital gains in such income mismatch for each client type. Using label Group_Type in the trust dataset, four individual sub-groups are categorised based on their total assets range as listed in Table 3 below:

<table>
<thead>
<tr>
<th>Group Types</th>
<th>Total Assets Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>High wealth individuals (HWI)</td>
<td>$260 m - $270 m</td>
</tr>
<tr>
<td>Potential high wealth individuals (PHWI)</td>
<td>$50m - $60m</td>
</tr>
<tr>
<td>Wealthy Australian</td>
<td>$20m - $25m</td>
</tr>
<tr>
<td>Others</td>
<td>$1m - $2m</td>
</tr>
</tbody>
</table>

Source: Prepared by RMIT University using ATO data

The income mismatch and its associated capital gains will then be quantified and compared across all client types also using Equation 1 and Equation 2 above.

**Using franking credits to reduce tax payable by company beneficiaries**

The second indicator is the distribution of a large share of distributable income to companies that are also distributed franking credits. If the franking credits are approximately 30% (i.e. the company tax rate) of the amount distributed the company, it indicates that the amounts being distributed to the company will result in zero tax being paid on the distribution since the franking credits will cover the tax liability in full.

To examine the third research, the franked distributions (COY_FD_54U in Label 54U) are added to franking credits (COY_FC_54D in Label 54D) for each company in each year to calculate total income declared by the company (Total Income Declared).

\[ Total\ Income_{j,t} = COY\_FD\_54U_{j,t} + COY\_FC\_54D_{j,t} \quad (4) \]
Where subscripts \( j, t \) indicate each company (as a beneficiary) and each year.

The Proportion Franked Income (\( P_{FrankCredit} \)) is then calculated by dividing franking credit (COY_FC_54D) by the total income declared by the company (Total Income).

\[
P_{FrankCredit_{jt}} = \frac{COY_{FC_{54D}}_{jt}}{Total\ Income_{jt}}
\]  
(5)

If the franking credit received from the company is to cover all the tax liability associated with the share of the income from its trust resulting in zero tax paid, then the whole distribution is franked at a rate equal to the corporation tax or \( P_{FrankCredit} \) equals to 30%.

**Trust distributions to loss company beneficiaries**

A third comparison is whether or not trust income is being diverted to loss-making companies who can either offset the income against their losses (current or prior years’ losses); or are about to go out of business that they have no capacity to pay their tax liability. We note that it is not possible for us to detect whether a loss-making company beneficiary was subsequently wound up. However, case studies provided by the ATO to the research team indicate that such practices do exist.

To investigate whether trust income is being distributed to loss-making companies, we will need to identify whether any given beneficiaries are companies and whether they are reporting a loss in their company tax return in the prior and relevant year. This is done through four essential steps:

**Step 1: To calculate total trust income, The Trust Distributable Income (Label 53A: Income Trust Estate) provided to each individual beneficiary in the Beneficiary dataset is used.** For each income year and each available entity identifier (i.e. Rltd_Eny_scrambled_id), the Label 53A information is summed to provide the ‘Total Trust Distributable Income’ and this value is reported for all beneficiaries (i.e. Beneficiary_scrambled_id) associated with the relevant entity.
Step 2: A data linkage procedure is performed to merge the ‘Total Trust Distributable Income’ into the Trust dataset. This is done by matching 'Beneficiary_scrambled_id' and 'Income_Year' in the beneficiaries’ dataset with the relevant 'rltd_enty_scrambled_id' and 'year' in the Trust dataset. Through this linkage, each entity that is identified as a beneficiary in the Trust dataset is provided with the ‘Total Trust Distributable Income’ associated with their relevant trust entity.

Step 3: The dataset is then filtered to include only companies and the proportion of total distributions to a given company is calculated as:

\[ P_{COY\text{-}Distribution}_t = \frac{\text{COY\text{-}DISTRIBUTION}_{6E_t}}{\sum \text{INCOMETRUST}_{53A}} \]

Step 4: We classify and filter companies to separate those that made current or prior year losses and those that either broke even or made a profit. To identify a company beneficiary that made a current year income loss, Company total income or loss (Label 7T) variable is used. The above calculations are completed for 674 companies identified as making a loss and 19,186 companies identified as either breaking even or making a profit (total 20,460 companies).

To investigate whether trusts distribute trust income tax liabilities to company beneficiaries who have carry forward income losses, Label 13U: Company Tax Losses Carried Forward, is used instead to determine whether a company is a loss-making company, and the proportional distributions to loss-making and non-loss-making companies is compared. To this end, 2210 incidences of carry forwards losses are identified in the data and compared to 1059 incidences where no carry forward loss was recorded.

Trust distributions to bucket company beneficiaries

A fourth comparison is whether trusts distribute income to company beneficiaries with no economic activity aside from receipt of trust distribution. In such a case, companies where information from Label 6E: Company distributions received from trusts equals information from Label 7T: Company Tax Return are identified as “Bucket Companies”. The analysis is conducted utilising the same procedure as in Section 1.3.3.3 above except for Step 4, bucket companies are filtered by comparing Label 6E and Label 7T. Only 59 “Bucket Companies” are identified and are compared against 3,210 other companies that do not meet the criteria.
Appendix C: Income Mismatch Analysis

Figure 1 investigates the association between capital gains made in the relevant year and the differences between distributable income and net income of the trust for each of the group types while Figure 2 presents the same data split by year. Figure 3 presents the tax revenue loss simulations across Bamford Shuffle prevalence scenarios. In these graphs, cases where either an income mismatch did not exist or when there was no net capital gain are removed.

It was noted in Chapter 3 (section 3.5.4) that when an increase in the positive difference between net income of the trust and distributable income (i.e. net income > distributable income) is associated with increasing capital gains providing strong evidence to support the assertion that the income mismatch is closely associated with capital gains made by the trust. This relationship appears to hold for a visual inspection of the beneficiary sub-groups with the one-to-one relation being less clear but still evident for the ‘PHWI’ category. As noted before, when net income of the trust and distributable income becomes negative (i.e. net income < distributable income), this is still associated with increasing capital gains for all beneficiary subgroups.
Figure 1: Scatterplot of the Difference in Trusts Law and Tax Law Income Reported against Trust Net Capital Gains by Beneficiary Type

Source: Prepared by RMIT University using ATO data

This is an independent report commissioned by the Australian Tax Office. Interpretations and opinions expressed should be ascribed to the authors only.
Figure 2: Scatterplot of the Difference in Trusts Law and Tax Law Income Reported against Trust Net Capital Gains by Beneficiary Type and Year

Source: Prepared by RMIT University using ATO data
FIGURE 3 TAX REVENUE LOSS SIMULATIONS ACROSS BAMFORD SHUFFLE PREVALENCE SCENARIOS

Simulation of Tax Revenue Loss for Difference Scenarios of Bamford Shuffle (BS) Prevalence

Source: Prepared by RMIT University using ATO data
Appendix D - Beneficial ownership of trust property and the shape of an Australian trusts’ registry

A trusts registry which complies with FATF requirements in FATF Guidance: Transparency and Beneficial Ownership (October 2014) must in the first place identify the beneficial owners of trust property. The Report at [6.3.3] has highlighted difficulties with identifying the beneficial owners of property held by many Australian trusts.

The following definition in the Money Laundering, Terrorist Financing and Transfer of Funds (Information on Payer) Regulations 2017 (UK) (Money Laundering Regulations) provides a recent example of a UK provision which identifies the beneficial owners of trust property. The Money Laundering Regulations broadly adopt the “beneficial ownership” definition in the Fourth EU Money Laundering Directive, which in turn adopts the FATF Revised Recommendations of 2012.

Meaning of beneficial owner and similar arrangements

6.—(1) In these Regulations, "beneficial owner", in relation to a trust, means each of the following—

(a) the settlor;
(b) the trustees;

337 The regulations were made pursuant to the Financial Services and Marketing Act 2000 (UK) and came into force on 26 June 2017. Their context is “money service businesses” carried on in the UK by credit institutions, financial institutions, auditors insolvency practitioners, external accountants, tax advisors, legal professionals, trust or company service providers, estate agents, high value dealers and casinos: see s-s3(1) and 8(1).

338 Art 3(6)(b) of the EU Fourth Directive defines the “beneficial owner” of a trust to mean: i. the settlor; ii. the trustee; iii. the protector (if any); iv. beneficiaries or where these have yet to be determined, the class of persons in whose main interest the trust is set up or operates; v. any other individual exercising control over the trust.

Information is accessible to any taxation or law enforcement authority in an EU state. The proposed Fifth Anti-money Laundering Directive will provide wider access to registered information, including by access by creditors and former spouses. See Martyn Nouwen “The European Code of Conduct Group becomes increasingly important in the fight against tax avoidance: more openness and transparency is necessary” (2017) 45 Intertax 138 at 146-147; Dr S Wong “The implications of the 4AMLD for trusts in the UK” (unpublished paper delivered at “The use and abuse of trusts and other wealth management devices” conference, Singapore, 27-28 July 2017).
(c) the beneficiaries, or where individuals benefiting from the trust have not been determined, the class of persons in whose main interest the trust is set up, or operates;

(d) any individual who has control over the trust.

(2) . . .

(3) In paragraph 1(d), "control" means a power (whether exercisable alone, jointly with another person or with the consent of another person) under the trust instrument or by law to—

(a) dispose of, advance, lend, invest, pay or apply trust property;

(b) approve proposed trust distributions;

(c) vary or terminate the trust;

(d) add or remove a person as beneficiary or to or from a class of beneficiaries;

(e) approve the appointment of an agent or advisor;

(f) appoint or remove trustees or give another individual control over the trust;

(g) resolve disputes amongst the trustees;

(h) direct, withhold consent to or veto the exercise of a power mentioned in sub-paragraphs (a) to (g).

(4) For the purposes of paragraph (1)—

(a) where an individual is the beneficial owner of a body corporate which is entitled to a specified interest in the capital of the trust property or which has control over the trust, the individual is to be regarded as entitled to the interest or having control over the trust; and

(b) . . .

(5) . . .

The provision is an instance of UK statutory overreach which is unlikely to be enforceable in the context of Australian trusts.

First, settlors may be nominal persons or persons of limited solvency. The role of trust settlors has been de-natured and trivialised in Australia.339 Settlors usually have a ministerial function in trust creation and they are not the parties who capitalise Australian trusts. Contributors to Australian trusts perform the role that settlors perform in other trusts-law jurisdictions. Paragraph 6(1)(a) is inappropriate for Australian conditions.

Secondly, trustees may be nominal persons or persons of limited solvency. Companies capitalised with $2 and which have no financial capacity are in many cases the trustees of Australian trusts. Nor is there a reliable pathway to trustee liability. Access to trust assets

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339 The pantomime whereby trusts come into existence through a $10 settlement made by a clerk has been endorsed by High Court of Australia: see J Glover "Nominal or 'dummy' settlors: is it time to reform the law of trusts?" (2012) 6 Journal of Equity, 19, 27-28.
may be blocked for defaulting trustees and for creditors subrogated to both defaulting and non-defaulting trustees’ rights.  

Thirdly, beneficiaries may be too numerous to assess and, in most cases, will be persons who have no access to a given trust’s assets prior to a trustee’s appointment in their favour. This refers to the design feature of the discretionary trust both in the UK and Australia that eligible beneficiaries have no ownership interests in or access to trust assets until they become the appointees of trust assets. After appointments are made, beneficiaries still do not beneficially own any of the assets of discretionary trusts. Instead, beneficiaries to whom appointments are made beneficially own the property distributed to them and property retained for them by the trustees under new fixed trusts dating from the time of the appointment. Neither the appointees nor eligible beneficiaries enjoy ownership interests in the unappointed property of a discretionary trust.

Attribution of "beneficial ownership" to eligible beneficiaries of discretionary trusts and eligible beneficiary classes may create an unworkable category of beneficial ownership. There is a serious problem of over-inclusion. The result resembles a tontine — that is, a fund subscribed by many persons which inures to the benefit of the last surviving subscriber. Eligible classes of relatives grow exponentially over time. Ownership interests will be multiplied on a logarithmic scale if each member of an eligible class is ascribed with beneficial ownership of the totality of trust assets.

Taxpayers who are discretionary trust beneficiaries may assert that it is unjust to tax them on attributed ownership of discretionary trust property simply because they are eligible to receive appointments of that property before appointments are made. Eligible beneficiaries have no more than the hope of appointments. Directing a trustee to appoint to one beneficiary rather than another is a “fraud upon a power” and an illegal act.

See Ford & Lee: The Law of Trusts 4th edn (looseleaf and online), at [14.3030]: no trustee indemnity for liabilities improperly incurred; and [14.3930]: creditor subrogation to trustees’ rights against beneficiaries can be barred in Vic, SA, Tas and possibly NSW.

“Unpaid present entitlements” is a term used for Australian federal income tax purposes to describe the fixed interests of appointees in property retained by trustees.

Given that the eligible class of a discretionary trust in Australia typically is not closed and comprises the relatives of one or more “Primary Beneficiaries”; generally, see above at [1.1].

Cheekily, some Australian discretionary trusts nominate the “Commissioner of Taxation” as an eligible beneficiary.

eligible beneficiaries "in whose main interest the trust was set up" may be very large and include persons numbered in hundreds of thousands, or billions.³⁴⁵

Fourthly, trust controllers are perhaps the likeliest persons to whom the "beneficial ownership" of trust property could be attributed. Sub-regulation 6(3) of the Money Laundering Regulations defines "control" in terms of the powers reserved to the appointors, governors or guardians of many discretionary trusts who direct, withholds consent to or veto another's exercise of the powers enumerated in sub-reg 6(3). Identifying that controlling person will sometimes be problematic. Where "control" over a trust is exercised by a body corporate, sub-reg 6(4) provides that the "individual" who is "the beneficial owner of the body corporate" will be the trust controller.³⁴⁶ Such an individual might become practically impossible to find in an on-shore chain of companies, trusts and nominees. Ultimately, control might be exercised by an unnamed foreign resident who is not amenable to the laws of the taxing jurisdiction.

The Money Laundering Regulations (UK)

Taxation obligations imply trustee registration liabilities under the UK Money Laundering Regulations. A "relevant trust" in sub-reg 44(13) is one where the trustee is liable to pay taxes in the UK including income tax, capital gains tax, inheritance tax, stamp duty and land tax.

Pursuant to sub-reg 44(1): "Register of beneficial ownership" of the Money Laundering Regulations, HMRC Commissioners "must maintain a register of beneficial owners of taxable trusts".³⁴⁷ Trustees of "relevant trusts" must also provide the following categories of "specified information" described in sub-reg 44(4):

(a) the name of the trust;
(b) the date on which the trusts was established;
(c) a statement of accounts of the trust, describing the trust assets and identifying the value of each category of the trust assets (including the address of any property held by the trust);
(d) the country where the trust is considered to be resident for tax purposes;
(e) the place where the trust is administered;
(f) a contact address for the trust; and,}

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³⁴⁵ E.g., see Re Manisty's Settlement [1974] Ch 17, where Sydney Templeman J (later Lord Templeman) upheld the validity of a discretionary trust embodying a mere power where the class of eligible appointees included the whole world except the trustee and persons contributing to the settlement (thus excluding UK CGT and CTT liabilities).

³⁴⁶ Regulation 5 provides a formula for establishing a formula for establishing the beneficial owner of a body corporate which is specific to the terms of the Companies Act 2006 (UK) and UK stock listing rules.

³⁴⁷ Considered at [6.3.4.1].
(g) the name of any advisors who are being paid to provide legal, financial, tax or other advice to the trustees.

Sub-regulation 44(8) places a continuing obligation on the trustee of a “taxable relevant trust”, who must:

(a) if the trustee becomes aware that any of the information provided to the Commissioners under paragraph (2) [referring to the above] has changed, notify the Commissioners of the change and the date on which it occurred before the end of the tax year in which the change occurred; or

(b) if the information provided under paragraph (2) has not changed, notify the Commissioners of that fact before the end of any tax year in which the trustees are liable to pay UK taxes.

Registration and disclosure of foreign trust particulars (NZ)

From 21 February 2017, the NZ Commissioner of Taxation is required to maintain a register of foreign trusts and of New Zealand-resident trustees of foreign trusts. The register was recommended in a review of foreign trust practices which followed the 2016 disclosures in what became known as the “Panama Papers”.348 The fact that New Zealand’s foreign trust rules functioned so that New Zealand “could be used as a tax haven was well known amongst the court’s tax professionals,” according to one commentator, “but until recently it attracted little interest.”349

New Zealand’s trusts register does not apply to the large number of domestic trusts employed within that jurisdiction.

Resident foreign trustees are now required to register under s59B of the Tax Administration Act 1994 (NZ) and to disclose:

(a) the name of the trust;
(b) the date, amount and nature of each settlement on the trust . . . ;
(c) the name, email address, physical residential or business address, jurisdiction of tax residence, taxpayer identification number and connection with the trust of—

(i) each settlor,
(ii) each person with power to dismiss a trustee;
(iii) each person who controls a power in (ii);

(iv) each person with power to control a trustee in the administration of the trust;
(v) each trustee;
(vi) for a fixed trust, each beneficiary that is not a minor and each nominee for a beneficiary;
(vii) for a fixed trust and a beneficiary who is a minor, the parents or guardian of the beneficiary;
(d) for a fixed trust and a beneficiary who is a minor, the name, age and taxpayer identification number of the beneficiary;
(e) for a discretionary trust, details of each beneficiary or class of beneficiaries sufficient for the Commissioner to determine, when a distribution is made under the trust, whether a person is a beneficiary; and,
(f) a copy of the trust deed and each document that amends or supplements the trust deed, and a copy of each document that is the functional equivalent of a trust deed or amending or supplementing document.

A New Zealand-resident trustee of an unregistered foreign trust is now liable for New Zealand tax on the trust’s worldwide income. Michael Littlewood, in his paper delivered to the Singapore conference in July 2017, noted this fact and made some observations about foreign trust registration. The Sherwan Report proposed a registration fee of NZ$500 per trust and NZ$500 per year thereafter. The legislation provided for a registration fee of only NZ$70 and an annual fee of NZ$50.\(^{350}\) Probably the fee imposed did not cover the IRD’s costs of maintaining the register.

At the end of 2016, Littlewood continued, there were “about 11,750 foreign trusts in New Zealand”.\(^{351}\) By 1 July 2017, fewer than 3,000 of those trusts had registered. Another 3,000 trusts “had indicated to the Internal Revenue that they did not intend to register. Presumably they had either been wound up or moved to some friendlier jurisdiction, such as Hong Kong.” This left 6,000 foreign trusts unaccounted for, which “had either been wound up or shifted to some other country . . . without informing the IRD”.

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\(^{350}\) Tax Administration Act 1994 (NZ), s 59E.

\(^{351}\) M Littlewood Singapore conference op cit.
Appendix E- Interview Guide – Taxation of Trusts in Australia

Introduction:

We are interested in exploring the use of trusts by your clients. In particular, we would like to understand what motivates them to set up a trust(s), the advice that they seek from you when doing so and the taxation issues that are of most concern to them.

1. Tell us a little bit about your current role.
2. Current issues in relation to operation of taxation laws for trusts in Australia.
   a. What do you identify as the key issues in relation to taxation of trusts?
   b. Have attitudes/behaviours towards the use of trusts changed in recent times (probe: especially since the Bamford case)?

   Other probes: are private companies being used to cap tax at 30%; what about the use of non-resident beneficiaries?; do large capital gains create a greater incentive to engage in a Bamford shuffle?; are trusts increasingly being used in groups?

3. Clients and their needs (for practitioner interviewees only)
   a. What are your clients’ needs/why do they come to you?
      Probe: are there tax related reasons for setting up a trust? (there might be other reasons here as well)
   b. Why are people using trusts? Do you recommend the use of trusts? If so why (or in what circumstances)?

4. Difficulties you experience in relation to administrative and compliance matters.
   a. What are the difficulties you face in compliance related matters?
   b. How could compliance be improved or made more effective or efficient?

5. What trends have you observed in relation to the use of trusts by various groups or entities?
   a. What type of clients do you see (HWI, etc)?
   b. Has the profile of these clients changed over the last 5 years or so? If yes, then how?
   c. How do you see the use of trusts changing in the next 3-5 years?

6. Is there anything else that we haven’t asked in relation to the taxation of trusts that you think is relevant?

7. Additional issues
   a. Are there any other participants that you can refer us to?
   b. Would we be able to contact you again if we need further clarification?
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