TA 2022/1 - Parents benefitting from the trust entitlements of their children over 18 years of age

Taxpayer Alert

Parents benefitting from the trust entitlements of their children over 18 years of age

About Taxpayer Alerts

Alerts provide a summary of our concerns about new or emerging higher risk tax or superannuation arrangements or issues that we have under risk assessment.

While an Alert describes a type of arrangement, it is not possible to cover every potential variation of the arrangement. The absence of an Alert on an arrangement or a variation of an arrangement does not mean that we accept or endorse the arrangement or variation, or the underlying tax consequences.

Refer to PS LA 2008/15 for more information about Alerts. See Alerts issued to date.

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Overview

1. We are currently reviewing trust arrangements where parents enjoy the economic benefit of trust income appointed to their children who are over 18 years of age (Children). The common feature of the arrangements is that trust income is appointed between members of the family group but in substance it is the parents who exercise control over and enjoy the economic benefit of the income.

2. In some arrangements, there is an understanding that trust income appointed to the Children will be paid to their parents or otherwise dealt with at their parents' discretion. In others, the trust income appointed to the Children is recorded as applied (with or without their knowledge) to repay amounts owed by them to their parents, being amounts owed in respect of expenses that benefit the children but are properly understood as parental expenses. Examples of these expenses are the costs of their upbringing as a minor or for the kinds of ongoing financial support parents would ordinarily provide their children.

3. The arrangements we are concerned about are those which are more properly explained by the tax outcomes obtained, including the accessing of tax-free thresholds and

lower marginal tax rates of family members, rather than ordinary familial considerations. These arrangements, if effective, may have unintended tax consequences or may attract the application of specific or general anti-avoidance provisions.

Description

4. The arrangements may display all or most of the following features:

- The trustees of a discretionary trust (Trust), or the directors of a corporate trustee, are either one or two individuals who are the parents in a particular family (Parents).
- Income derived by the Trust is used during the year of derivation to meet the expenses of the Parents. These may be recorded as beneficiary loans made from the trustee to the Parents throughout the year.
- Resolutions of the trustee for the year show one or more of the Children presently entitled to a share of the income of the Trust.
- The entitlements are for substantial amounts but do not generally result in the Children's taxable income exceeding the threshold for the top marginal tax rate ($180,000).
- Amounts are not paid to the Children. Rather, at the actual or purported direction of the Children, the entitlements are satisfied by the amounts being either
  - paid to their Parents, or
  - applied against any beneficiary loans owed by the Parents.
- The parties contend that the entitlements are paid or applied in this manner because
  - the Children are required to repay their Parents for expenses incurred in relation to their upbringing or while they were minors (for example, school fees, school uniform costs or their share of the family holidays)
  - the Children are required to pay or repay their Parents amounts to meet their share of family costs for the current year in excess of amounts it would reasonably be expected an adult child would meet for their personal living expenses while they remain living at home or otherwise supported to some extent by their Parents (those amounts being, for example, a reasonable rate for their board, lodgings or rent if living away from home, or car expenses), or
  - there is an agreement that the Parents will manage the pooled family members' entitlements from the Trust for the benefit of the family members.
- There is no expectation or understanding that the Children's income they derive from sources other than the Trust distributions will be used to either repay their Parents for expenses incurred when they were a minor or pay more than their reasonable share of the household expenditures, or be placed in a pool to be managed by the Parents for the benefit of the family members.

5. For some of the expense repayment arrangements, there will be no contemporaneous evidence of the claimed obligation of the Children to repay their Parents. In cases involving the Parents' management of the entitlements from the Trust for the benefit of the family members, there may be no documentary evidence to demonstrate how that objective will be achieved.

6. The Children may or may not be aware of their purported entitlements, or obligations, or the application of their entitlements against relevant expenses incurred on their behalf by their Parents.

Example 1

7. *The ABC Trust's beneficiaries include the members of the ABC Family. David is the sole trustee of the ABC Trust. David and his wife Rani have two children, Jenny (aged 22) and Paul (aged 19), who live with them in the family home. David and Rani have an existing mortgage on the home. Jenny and Paul are both full-time students and during the 2020–21 income year, they each earned approximately $12,000 from casual employment.*

8. *During the 2020–21 income year, the ABC Trust derives income of $720,000 (the trust's net income is also $720,000).*

9. *A resolution of the trustee of the ABC Trust dated 30 June 2021 shows both Jenny and Paul are each presently entitled to $160,000 of the income of the ABC Trust, with David and Rani each presently entitled to $200,000.*

10. *Jenny and Paul are not paid any amounts. Instead, David transfers an amount equal to their entitlements to the mortgage offset account that he and Rani maintain. Jenny and Paul's entitlements are recorded as having been fully paid in the accounts of the ABC Trust. David pays Jenny and Paul's tax liabilities in relation to their entitlements from his personal funds.*

11. *David has taken these actions as Jenny and Paul have agreed that their entitlements from the ABC Trust will be managed by David for the benefit of all family members. David has determined that those entitlements should be applied to reduce the debt on the family home.*

12. *This arrangement raises the concerns mentioned in this Alert. By entering into this arrangement, the purported $160,000 entitlements of both Jenny and Paul are not subject to the top marginal tax rate. David has not managed the entitlements for the benefit of all members of the family. The arrangement has the result that the post-tax amounts of Jenny and Paul's entitlements have been diverted to meet their parent's individual liabilities in circumstances where their parents would have been able to meet them. David and Rani receive the same economic benefit from that income as if it had been appointed to them directly, but without the amounts being included in their assessable income and subject to tax at a higher marginal tax rate. The arrangement involving the making of the trust distributions and use of those amounts appears to be motivated by the tax outcome achieved rather than ordinary familial objectives.*

Example 2

13. *The trustee of the Blue Family Trust is Azure Pty Ltd. Trevor is the sole shareholder and controller of Azure Pty Ltd. The Blue Family Trust derives assessable income in excess of $400,000 a year. Trevor's daughter, Simone, is a beneficiary of the trust. Simone has recently turned 18 years of age and works part-time. Simone expects to derive assessable income from her work of approximately $20,000 a year.*

14. *Before the end of the 2020–21 income year, Simone meets with her father and agrees that any distribution resolved to be made by the Trustee will, after the payment of tax, be paid to Trevor to reimburse him for part of the fees for secondary schooling and costs of other extracurricular activities since Simone was five years old. Records maintained by the family show that these expenses amounted to $315,000.*

15. *The Trustee resolves to distribute $160,000 to Simone and pays this amount into an account held in Trevor's name. Trevor pays income tax on Simone's behalf.*

16. *This arrangement raises the concerns that are mentioned in this Alert. Simone is purportedly made entitled to a trust distribution and this amount is used to reimburse her parents for expenses that they would ordinarily meet. The arrangement, which results in Trevor obtaining the economic benefit of the trust income without that income being subject to tax at the top marginal tax rate he would otherwise have paid, appears to be more readily explained by the tax outcomes achieved, rather than any familial objectives.*

Example 3

17. *The Green Trust's beneficiaries include the members of the Green Family. Mary Green is the sole trustee of the Green Trust. Mary has an adult child, Genevieve (aged 19), who lives with her grandmother in order to be close to the university she attends.*

18. *It is agreed between Mary and Genevieve that Genevieve's tuition fees of $20,000 will not have to be met by Genevieve but that they will be paid out of her trust entitlement. It is agreed between Genevieve and her grandmother that the grandmother will be paid board of $10,000 a year.*

19. *During the 2020–21 income year, the Green Trust derives income of $300,000 (the trust's net income is also $300,000).*

20. *On 30 June 2021, Mary as the trustee of the Green Trust resolves to make Genevieve presently entitled to $40,000 of the trust income and make Mary entitled to the remaining $260,000.*

21. *$20,000 of the $40,000 that Genevieve is presently entitled to is paid to Mary, who has previously met the tuition fees of $20,000 as they fell due. $10,000 of that $40,000 is paid directly to the grandmother. The remaining $10,000 is paid to Genevieve, some of which is used to meet her tax obligations on the $40,000.*

22. *Although $30,000 of the $40,000 is not received directly by Genevieve, and might appear to be within the scope of this Alert, it is important that the $30,000 is applied to repay loans for legitimate expenses that might ordinarily be borne by an adult child and were temporarily met on Genevieve's behalf (being tuition fees and arm's length board). The remaining $10,000 was actually received by Genevieve. Accordingly, the concerns raised in this Alert do not arise in arrangements of this type.*

What are our concerns?

23. We are concerned that taxpayers are entering into these arrangements to avoid tax on the net income of the trust by utilising the lower marginal tax rate applying to the Children in circumstances where the benefit from these arrangements is, in substance, enjoyed by the Parents as:

- the Children are paying amounts for expenses that would ordinarily be met by their Parents, or
- the Children's entitlements are otherwise being applied for the benefit of the Parents either directly, or by the charging of excessive amounts, and/or
- there are elements of contrivance.

24. From our review of these arrangements, we consider that the following consequences may arise:

- the purported entitlement of the Children to trust income may be a sham or otherwise ineffective for trust law purposes

- the arrangement may constitute a reimbursement agreement under section 100A of the *Income Tax Assessment Act 1936* (ITAA 1936)
- subsections 95A(1) and 97(1) of the ITAA 1936 may apply to treat the Parents as presently entitled where the means by which the trustee permits the use of the funds evidences the exercise of a discretion to pay or apply those amounts to the Parents (notwithstanding that the appointments are recorded as 'beneficiary loans'), or
- the general anti-avoidance provisions in Part IVA of the ITAA 1936 could apply.

25. While this Alert specifically considers arrangements involving the children of controlling individuals, we are also concerned about similar arrangements involving other family members of controlling individuals that would have lower marginal tax rates than those of the controlling individuals.

What are we doing?

26. We are currently reviewing these arrangements and are engaging with taxpayers who have entered into, or are considering entering into, these and similar arrangements.

27. Taxpayers and advisers who enter into these types of arrangements will be subject to increased scrutiny.

What should you do?

28. If you have entered, or are contemplating entering, into an arrangement of this type, we encourage you to:

- phone or email us using the contact details provided at the end of this Alert
- ask us for our view through a private ruling
- seek independent professional advice, and/or
- make a voluntary disclosure to reduce penalties that may apply.

29. Penalties may apply to participants in, and promoters of, this type of arrangement. This includes serious penalties under Subdivision 290-B of Schedule 1 to the *Taxation Administration Act 1953* for promoters. Registered tax agents involved in the promotion of this type of arrangement may be referred to the Tax Practitioners Board to consider whether there has been a breach of the *Tax Agent Services Act 2009*.

Do you have information?

30. To provide information regarding this type of arrangement or about a promoter of this or another arrangement:

- contact the officer named in this Alert with the relevant information or to arrange a meeting with us
- phone us on 1800 060 062
- complete the ATO Tip-Off Form.

Contact officer: Christopher Ryan
Email address: christopher.ryan@ato.gov.au
Phone: (02) 9374 2646

Commissioner of Taxation
23 February 2022

Amendment history

Date	Comment
19 January 2024	Updated ATO tip-off hotline number

References

Related Practice Statements:
PS LA 2008/15

Legislative references:
- ITAA 1936 95A(1)
- ITAA 1936 97(1)
- ITAA 1936 100A
- ITAA 1936 Pt IVA
- TAA 1953 Sch 1 Subdiv 290-B
- Tax Agent Services Act 2009

ATO references
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