EXPOSURE DRAFT

TREASURY LAWS AMENDMENT (MEASURES FOR A LATER SITTING) BILL 2018

EXPLANATORY MATERIALS

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

Abbreviation	***Definition***
Bill	Treasury Laws Amendment (Measures for a later sitting) Bill 2018
ITAA 1936	*Income Tax Assessment Act 1936*

Chapter 1
Extending anti-avoidance rules for circular trust distributions

Outline of chapter

1.1 Schedule # amends the ITAA 1936 to extend to family trusts the anti-avoidance rule that applies to other closely held trusts that undertake circular trust distributions. This enables income tax to be imposed on the circular trust distribution at a rate of tax equal to the top marginal tax rate plus the rate of Medicare levy.

1.2 All references in this chapter to legislation are to the ITAA 1936 unless otherwise stated.

Context of amendments

1.3 The income tax law imposes trustee beneficiary non-disclosure tax on circular trust distributions. Circular trust distributions occur when a trustee of a closely held trust becomes entitled to an amount that is attributable to an amount of trust income that the trustee had distributed to a beneficiary that was a trustee of another trust (a trustee beneficiary).

1.4 Trustee beneficiary non-disclosure tax can apply to closely held trusts. Closely held trusts are:

- trusts in which up to 20 individuals have a fixed entitlement to 75 per cent or more of the income or capital of the trust; or
- a discretionary trust;

other than an ‘excluded trust’.

1.5 Tax imposed under the *Taxation (Trustee Beneficiary Non-Disclosure) (No. 1) Act 2007* applies on the untaxed amount of a share of the net income of a closely held trust that is included in the assessable income of a trustee beneficiary, if the trustee does not give the Commissioner of Taxation a correct trustee beneficiary statement. Alternatively, if a trustee gives a correct statement then the trustee is subject to tax imposed under the *Taxation (Trustee Beneficiary Non-Disclosure) (No. 2) Act 2007* on the untaxed amount of a distribution made to a trustee beneficiary, if that distribution returns to the trust as a circular distribution.

1.6 Prior to the amendments an 'excluded trust' included a family trust and as a result trustee beneficiary non-disclosure tax did not apply to circular trust arrangements involving family trusts.

1.7 Accordingly, as trustee beneficiary non-disclosure tax did not apply to family trusts prior to the amendments, it created the potential for circular trust distributions to occur involving family trusts that could result in the original trustee avoiding liability for tax on such distributions.

1.8 On 8 May 2018 in the 2018-19 Budget, the Government announced that it would extend to family trusts a specific anti-avoidance rule that applies to other closely held trusts that engage in circular trust distributions. This will better enable the Australian Taxation Office to pursue family trusts that engage in these arrangements by extending the specific anti-avoidance rule, imposing tax on such distributions at a rate equal to the top personal tax rate plus the Medicare levy.

Summary of new law

1.9 The amendments ensure that trustee beneficiary non-disclosure tax applies at the top marginal tax rate plus the rate of Medicare levy to the untaxed part of a circular trust distribution to which a trustee of a family trust becomes presently entitled.

Comparison of key features of new law and current law

New law	*Current law*
Trustee beneficiary non-disclosure tax applies to the untaxed part of a circular trust distribution to which the trustee of the closely held trust, including a family trust, becomes presently entitled.	Trustee beneficiary non-disclosure tax applies to the untaxed part of a circular trust distribution to which the trustee of the closely held trust (other than a family trust) becomes presently entitled.

Detailed explanation of new law

Trustee beneficiary non-disclosure tax to apply to circular distributions involving family trusts

1.10 The definition of an excluded trust is amended to remove:

- family trusts;

- a trust in relation to which an interposed entity election has been made and is in force in accordance with section 272-85 in Schedule 2F of the ITAA 1936; and
- a trust that is covered by subsection 272-90(5) in Schedule 2F of the ITAA 1936.

[Schedule #, items 1 and 2 paragraphs 102UC(4)(b) to (e)]

1.11 References to family trust in this chapter are to the trusts referred to in paragraph 1.10 above.

1.12 The effect of removing these trusts from the definition of excluded trust is to apply trustee beneficiary non-disclosure tax to any circular distributions that are made by those trusts.

No trustee beneficiary statements for family trusts

1.13 Ordinarily, the trustee would be required to lodge a correct trustee beneficiary statement with the Commissioner of Taxation within a certain period after a year of income. If a trustee does not make such a statement, then they are liable to pay trustee beneficiary non-disclosure tax on the untaxed amount of any trustee beneficiary's share of the net income of the trust.

1.14 The amendments, however, do not require a trustee of a family trust to lodge a trustee beneficiary statement because it is considered that such reporting would impose unnecessary compliance costs on family trusts. ***[Schedule #, item 4, paragraph 102UT(1)(c)]***

1.15 Because a trustee of a family trust is not required to lodge a trustee beneficiary statement, a corresponding amendment is also made to ensure that a trustee of a family trust is not liable to pay tax imposed under the *Taxation (Trustee Beneficiary Non-Disclosure) (No. 1) Act 2007* merely because they have not submitted a statement. However, they will be liable to tax imposed under the *Taxation (Trustee Beneficiary Non-Disclosure) (No. 2) Act 2007* on the untaxed amount of a share of the net income of a trustee beneficiary associated with a circular distribution. ***[Schedule #, item 3, paragraph 102UK(1)(ca)]***

1.16 These amendments also ensure that a trustee of a family trust will not be guilty of an offence against section 8C of the *Taxation Administration Act 1953* because it fails to submit a correct trustee beneficiary statement. ***[Schedule #, item 4, paragraph 102UT(1)(c)]***

Example 1.1—Discretionary family trust

Mr Johnson is the trustee of the Johnson Family Trust, which is a discretionary trust. Mr Johnson makes an election that the trust is a 'family trust' for the 2019-20 income year. Under the amended rules the Johnson Family Trust is a closely held trust.

The trust has $1,000 income for the 2019-20 income year. Its net income is equal to the income of the trust. Mr Johnson resolves to distribute 50% of its net income for the 2019-20 income year to his daughter, Ms Johnson, in her capacity as trustee of the Johnson Jr Family Trust.

Ms Johnson resolves to distribute all $500 she receives to her father, Mr Johnson, in his capacity as trustee. He is now presently entitled to a share of the income of the Johnson Family Trust. Mr Johnson will be liable to pay tax as imposed by the *Taxation (Trustee Beneficiary Non-Disclosure Tax) (No. 2) Act 2007* on $500 of income.

Consequential amendments

1.17 As a result of removing family trusts from the definition of an 'excluded trust' a consequential amendment has been made to clarify that trustees of family trusts continue to face a withholding obligation where the beneficiary does not quote a tax file number to the trustee before the time of the distribution. ***[Schedule #, item 5, subparagraph 12-175(1)(c)(ii) of Schedule 1 to the Taxation Administration Act 1953]***

Application and transitional provisions

1.18 Schedule # to this Bill applies to income years starting on or after 1 July 2019. ***[Schedule #, item 6]***