

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

EXPOSURE DRAFT EXPLANATORY MATERIALS

---

TREASURY LAWS AMENDMENT (MEASURES FOR CONSULTATION)  
BILL 2019: TESTAMENTARY TRUSTS

---

EXPLANATORY MEMORANDUM

(Circulated by authority of the Minister for Housing and  
Assistant Treasurer, the Hon Michael Sukkar MP)

---

## ***Table of contents***

---

Glossary.....	1
Chapter 1      Improving the taxation of testamentary trusts .....	3



---

# **Glossary**

---

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

<i>Abbreviation</i>	<i>Definition</i>
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
The Bill	Treasury Laws Amendment (Measures for Consultation) Bill 2019: testamentary trusts



---

# **Chapter 1**

## ***Improving the taxation of testamentary trusts***

---

### **Outline of chapter**

1.1 The Bill amends Division 6AA of the ITAA 1936 to ensure the tax concessions available to minors in relation to income from a testamentary trust only apply in respect of income generated from assets of the deceased estate that are transferred to the testamentary trust (or the proceeds of the disposal or investment of those assets).

1.2 All legislative references are to the ITAA 1936 unless otherwise indicated.

### **Context of amendments**

1.3 Division 6AA and section 13 of the *Income Tax Rates Act 1986* impose higher tax rates on minors<sup>1</sup> as a specific tax integrity measure to deny most minors a tax advantage from receiving income that might flow from income-splitting arrangements. In broad terms, the rules discourage the diversion of income from adults to minors.

1.4 One exception to Division 6AA and section 13 imposing higher tax rates on minors is assessable income resulting from an entitlement to income from a testamentary trust. This income is a type of ‘excepted trust income’ that is generally taxed at ordinary rates.

1.5 The existing law does not specify that the assessable income of the testamentary trust be derived from assets of the deceased estate (or assets representing assets of the deceased estate). As a result, assets unrelated to a deceased estate that are injected into a testamentary trust may, subject to anti-avoidance rules, generate excepted trust income that is not subject to the higher tax rates on minors. This is an unintended consequence, which allows some taxpayers to inappropriately obtain the benefit of concessional tax treatment.

1.6 The Bill clarifies that excepted trust income of the testamentary trust must be derived from assets transferred to the testamentary trust from the deceased estate or from the accumulation of such income.

---

<sup>1</sup> Minors are people under 18 years of age on the last day of the income year.

## Summary of new law

1.7 The Bill amends Division 6AA to limit the tax concessions available to minors in relation to income from a testamentary trust to income derived from assets in the testamentary trust that were transferred from the deceased estate or subsequently accumulated. The amendments apply to assets transferred to the trust on or after 1 July 2019.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
In a testamentary trust, income from assets transferred to the trust on or after 1 July 2019 will not be excepted trust income for the purposes of Division 6AA unless the assets were transferred to the trustee from the deceased estate or from the accumulation of such income.	In a testamentary trust, income from assets that did not form part of the deceased estate can be excepted trust income for the purposes of Division 6AA.

## Detailed explanation of new law

1.8 The Bill amends Division 6AA of the ITAA 1936 to limit the tax concessions available to minors in relation to income from a testamentary trust. In particular, the amendments limit concessional tax treatment to income derived from assets transferred from the deceased estate to the testamentary trust or subsequently accumulated.

1.9 Currently, income from a testamentary trust that is unrelated to assets of the deceased estate can be excepted trust income for the purposes of Division 6AA. In particular, paragraph 102AG(2)(a) provides that an amount included in the assessable income of a trust estate is excepted trust income in relation to a beneficiary of the trust estate to the extent to which the amount is assessable income of the trust estate that resulted from:

- a will, codicil, or an order of a court that varied or modified the provisions of a will or codicil; or
- an intestacy or an order of a court that varied or modified the application, in relation to the estate of the deceased person, of the provisions of the law relating to the distribution of the estates of persons who die intestate.<sup>2</sup>

---

<sup>2</sup> A trust estate that results from these circumstances is referred to as a ‘testamentary trust’ in this Explanatory Memorandum.



1.10 This Bill limits the extent to which income is excepted under paragraph 102AG(2)(a). It does this by making amendments to impose additional conditions that must be met in order for income of the testamentary trust to be excepted trust income. In particular, the amendments require that in order for income to be excepted under paragraph 102AG(2)(a):

- the assessable income must be derived by the trustee of the testamentary trust estate from property; and
- the property must satisfy any of three specific requirements, directed at ensuring there is a connection between the property and the deceased estate.

*[Schedule 1, items 1 and 2, paragraph 102AG(2)(a) and subsection 102AG(2AA) of the ITAA 1936]*

***Income must be derived from property***

1.11 First, the assessable income must be derived by the trustee of the trust estate from property. Property is defined in the existing law by subsection 102AA(1) as property, whether real or personal, and includes money. *[Schedule 1, item 2, paragraph 102AG(2AA)(a) of the ITAA 1936]*

1.12 Due to the operation of existing subsection 102AA(4), the reference to income derived from property includes income derived from property that, in the opinion of the Commissioner, represents that property. This allows property that satisfies any of the three requirements below to be converted from one asset type to another, without losing the ability for income that is derived by the converted asset to be excepted trust income under paragraph 102AG(2)(a).

***The property must satisfy any of three requirements***

1.13 Second, the property must satisfy any of three specific requirements. These requirements are directed at ensuring that assets unrelated to the deceased estate cannot be injected into the testamentary trust and derive income that is excepted trust income for the purposes of Division 6AA. That is, the requirements ensure that there is a connection between the property from which excepted trust income is derived and the deceased estate that gave rise to the testamentary trust.

1.14 The first requirement is that the property was transferred to the trustee of the trust estate to benefit the beneficiary from the estate of the deceased person concerned, as a result of the will, codicil, intestacy or order of a court mentioned in paragraph 102AG(2)(a). This requirement ensures that the income from property that is unrelated to the deceased estate is not treated as excepted trust income for the purposes of Division 6AA. It also ensures that only beneficiaries included in the class of beneficiaries by the deceased, rather than an entity which was later added

to the class of beneficiaries, can have excepted trust income under paragraph 102AG(2)(a). *[Schedule 1, item 2, subparagraph 102AG(2AA)(b)(i) of the ITAA 1936]*

1.15 The second requirement is that the property, in the opinion of the Commissioner, represents accumulations of income or capital from property that satisfies the first requirement. This ensures that further income from property that represents undistributed trust income or capital from such assets in a testamentary trust can be excepted trust income for the purposes of Division 6AA.<sup>3</sup> *[Schedule 1, item 2, subparagraph 102AG(2AA)(b)(ii) of the ITAA 1936]*

1.16 The third requirement is that the property, in the opinion of the Commissioner, represents accumulations of income or capital from:

- property that satisfies the second requirement; or
- property that has already satisfied this requirement.

1.17 This requirement ensures that further income on accumulations of income or capital from property that satisfies the second requirement, and such further accumulations (and so on) in a testamentary trust can be excepted trust income for the purposes of Division 6AA. *[Schedule 1, item 2, subparagraph 102AG(2AA)(b)(iii) of the ITAA 1936]*

### **Example 1.1 Injected asset**

On 1 July 2019, testamentary trust ABC is established under a will of which a minor is a beneficiary. Pursuant to the will, \$100,000 is transferred to the trustee from the estate of the deceased. Shortly after the testamentary trust is established, a related family trust makes a capital distribution of \$1,000,000 to the testamentary trust. The resulting \$1,100,000 is invested in ASX listed shares on the same day. Dividend income of \$110,000 is derived for the 2019-20 income year. The net income of the trust is \$110,000 and the minor is presently entitled to 50 per cent of the amount of net income.

The minor's share of the net income of the trust is \$55,000. \$50,000 is attributable to assets unrelated to the deceased estate and not excepted trust income. \$5,000 is excepted trust income on the basis that it is assessable income of the trust estate that resulted from a testamentary trust, derived from property transferred from the deceased estate.

### **Example 1.2 Income from retained excepted trust income**

Following on from example 1.1, the minor's share of the net income of the trust (being \$55,000, comprising \$5,000 excepted trust income and \$50,000 not excepted trust income) is not paid to the minor by the trustee but is invested for their benefit in ASX listed shares shortly

---

<sup>3</sup> Note also that under existing 102AG(2)(e), income from property that in the opinion of the Commissioner represents accumulations of excepted trust income in relation to the beneficiary can also be excepted trust income. Income on unpaid entitlements, that in relation to the beneficiary were excepted trust income, may also be excepted trust income.

after the commencement of the 2020-21 income year. For the 2020-21 income year, that investment derives income of \$5,500, and the minor is presently entitled to the entire amount.

\$5,000 is attributable to assets unrelated to the deceased estate and not excepted trust income. \$500 is excepted trust income on the basis that it is assessable income of the trust estate that resulted from a testamentary trust, derived from income that was previously excepted trust income.

## **Application and transitional provisions**

1.18 The amendments made by the Bill apply in relation to assets acquired by or transferred to the trustee of the testamentary trust estate on or after 1 July 2019. *[Schedule 1, item 3]*

1.19 Income from assets and accumulations held in a testamentary trust prior to 1 July 2019 can continue to be excepted trust income under existing section 102AG.