Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Additional Estimates 2013

14 February 2013

QUESTION: AET 88-95

Topic: Discretionary Family Trusts

Written:

Senator CAMERON asked:

88. Are there rules in place either under the Tax Act or in accordance with ATO determinations in relation to discretionary family trusts extending loans to individuals or other parties who may or may not be beneficiaries of the trust?

    If so, what are they and how are loans treated as distinct from distributions or present entitlements?

89. Are discretionary family trusts required to report to the ATO, presumably through their tax return, any loans the trust may have made?

    If so, are they required to report the value of the loan and the terms on which it is made including repayment schedules?

90. Can the ATO provide the Committee with the total aggregate value of loans extended by discretionary family trusts in the most recent financial year for which data is available?

91. How does the ATO satisfy itself that loans extended by discretionary family trusts are actually repaid?

92. Does the ATO consider a non-repayable loan made by a discretionary family trust to be a sham loan and thus, in fact, a distribution or present entitlement which is taxable?

93. How does the ATO enforce the Tax Act in cases of sham loans that are in fact taxable distributions?

94. Does a discretionary family trust have the capacity to write off a loan as a bad or doubtful debt?

    If so, in what circumstances and subject to what restrictions?

95. Does the ATO have any data on the aggregate value of loans written off by discretionary family trusts as bad or doubtful debts?

    If so, what is the value of such loans?

Hansard reference – Thursday 14 February 2013, page 104-106

Answers:

88. The tax consequences of loans from trusts will vary depending on the facts and circumstances. The key to understanding the tax consequences of such loans is how the loan is funded by the trust. Certain arrangements involving loans or lending-like transactions will have different tax consequences, having regard to the overall effect and character of the transactions.

For example, where the loan is essentially an advance payment to a beneficiary of their expected trust income distribution, the loan will be extinguished when the relevant beneficiary eventually becomes presently entitled to income. The beneficiary then will include in their assessable income a corresponding share of the trust net income and pay the necessary tax.

There are a number of integrity rules in the income tax laws in relation to loan or loan-like arrangements that may make an amount assessable either to the beneficiary or the trustee:

- Where a private company beneficiary has an unpaid present entitlement to trust income and the trust makes a loan to an entity that is a shareholder or an associate of a shareholder of that private company, the loan may be deemed to be a dividend under Division 7A of the *Income Tax Assessment Act 1936* (ITAA 1936). Any such deemed dividend is then assessable to the shareholder or associate of the company.
- Where the loan is funded essentially out of the unpaid present entitlement of other beneficiaries, then the reimbursement agreement integrity provisions (section 100A of the ITAA 1936) may apply to make the trustee assessable on the reimbursement agreement amount. However, section 100A of the ITAA 1936 does not apply to an agreement entered into in the course of ordinary family or commercial dealings.
- Section 99B of the ITAA 1936 operates to assess a beneficiary on certain loans. This provision is intended to bring to tax an otherwise assessable amount of income that has been accumulated untaxed in a foreign trust.
- The Fringe Benefits Tax provisions might have application if the loan could in some way be linked to the individual's employment with either the trust as the employer or as an associate of the employer.
- Where loans from a trust are not *bona-fide* or are contrived to obtain a tax benefit, there are general anti-avoidance rules that may be invoked to negate the tax benefit of such schemes (Part IVA of the ITAA 1936).

As part of the 2013-14 Budget, the Government has announced $67.9 million in additional funding for the Australian Taxation Office to establish a trust taskforce. The ATO will target the exploitation of trusts to conceal income, mischaracterise transactions and artificially reduce trust income amounts to avoid or reduce tax, including through the use of contrived loan arrangements.

Further details can be found on the ATO website.

89, 90. No.

91 The making of a loan, or the forgiveness of that loan, by a discretionary family trust to (refer comments at answer to AET 88) a beneficiary does not by itself generally give rise to a taxing event. As a consequence, the ATO does not seek to satisfy itself that such loans are repaid.

92, 93. Whether a non-repayable loan is a 'sham' would depend on the facts and circumstances of the case.

The making of a sham loan (or gift) does not in and of itself give rise to a tax liability for the beneficiary. If there is a part of trust income to which no beneficiary has been made presently entitled, then the trustee will be assessed on that share of income at the top marginal rate plus the Medicare levy.

If the trust is unable to pay that tax assessment then the ATO would have to examine the circumstances of that inability to pay. The ATO could, depending on the terms of the 'sham' loan, seek via recovery proceedings to have the trustee tax debt paid by recovering the funds from the loan to the beneficiary.

Failing this, the ATO would have to consider other options including the application of the *Crimes (Taxation Offences) Act 1980* if the circumstances were such that it appeared that an arrangement or transaction had been entered into with the intention of ensuring that the trustee will be unable to pay income tax.

94. Depending on the trust deed, a discretionary family trust may have the power to determine that debts are bad or doubtful for accounting purposes.

For tax purposes, a bad debt can generally only be claimed as a deduction where that amount has previously been returned as income. For example, this may commonly occur where the trustee makes (assessable) sales on credit, which are subsequently defaulted on. In these circumstances, a tax deduction is allowable for the bad debt, as the sale has essentially been negated and there is a real loss to the trustee.

The write-off of loans or doubtful debt in other circumstances are typically not deductible. A provision by the trustee for doubtful debts has no tax consequences as the liability has not yet been defaulted on and therefore is not tax deductible.

95 No.