A MATTER OF TRUST

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The intricacies of the recent tax changes regarding trust distributions to beneficiaries will have an impact on more than 500,000 trusts that are operating in Australia particularly for dentists who operate their business through a discretionary family trust which quite often operates as a service trust.

This article is not designed to be an in-depth review of these changes but more to make you aware of the potential issues and the need to discuss your particular circumstances with your accountant/financial advisors.

The proposed changes released on 23 February 2022 are contained in the draft taxation determination TD2022/D1 which should be noted that they are draft and awaiting commentary before being finalised. The changes are intended to commence from 1 July 2022 but it is unlikely that the draft will be finalised by then. The Federal Court decision handed down in the Guardian case which found against the ATO on similar issues is also likely to delay any finalisation.

The distribution of trust profit provisions have been around for more than 40 years. There has only been one case in the past 13 years which the ATO lost and the complexity of this area has meant that the Tax Office has taken more than 10 years to provide any guidance since tax ruling TR 2010/3 and PS LA 2010/4 were released in 2010. The new tax determination is intended to replace these old rulings.

The profit that accumulates in a dental trust is usually distributed to beneficiaries who are family members and generally on a lower tax rate than the dentist. A company which is controlled by the dentist can also be a beneficiary and may receive distributions of profit and therefore only pay tax at 25%. The individual or company beneficiary will show the income from the trust in their tax return and then pay the appropriate amount of tax. Quite often the allocation of profit is merely that and the beneficiary doesn't actually receive the money that they are entitled to. This creates what is known as an unpaid present entitlement.

This is the area that concerns the Tax Office the most because it believes the tax should be paid by the person or company that actually receives the profit or benefits from the profit. Companies that don't receive the cash component of the profit can comply with the ruling by ensuring that they establish what is known as a Division 7A loan which means the unpaid cash is repaid over a seven-year period with interest charged on an arm's-length basis at ATO approved rates.

Individuals could previously agree to have the unpaid amount remain outstanding or forgive the debt or reduce the debt by a reimbursement agreement. The ATO are now looking at these arrangements where there is an unpaid present entitlement for beneficiary children who are over the age of 18. The ATO considers that tax is being avoided on the net income of the trust by utilising the lower marginal tax rate applying to the (adult) children in circumstances where the benefit is actually being enjoyed by the parents.

The draft ruling (irrespective of whether or not it is finalised) means that all trustees have been put on notice as to what the ATO's intentions are and that they should ensure that they have sufficient cash flow within the trust to physically make payment of any profits to individual/company beneficiaries. Trustees should also take the opportunity to review any existing unpaid present entitlements or exposure to Div.7A loans and ensure they are compliant with current legislation and rulings.

If you have any concerns about your trust distributions (past or present) and would like a confidential review of your trust structure, then please contact Albert on 07 5554 6400 or albert@mwpartners.com.au

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