

# Trustee beneficiary statements

**THE GOVERNMENT'S PROPOSED AMENDMENTS TO THE CLOSELY HELD TRUST PROVISIONS ARE A STEP IN THE RIGHT DIRECTION IN REDUCING THE ONEROUS AND REPETITIVE NATURE OF THE CURRENT PROVISIONS.**



The closely held trust provisions were originally introduced in July 1999. The primary purpose of the provisions was to prevent the avoidance or deferral of tax liabilities through the use of arrangements involving complex chains of trusts which potentially obscured the identity of the ultimate beneficiary of assessable trust income.

The consensus in the accounting and legal community to date has been that although measures should be available to the Commissioner of Taxation ("Commissioner") to identify such arrangements, the reporting requirements imposed on taxpayers as a result of the current closely held trust provisions are far too onerous and costly for taxpayers. This has been acknowledged, most recently in the explanatory memorandum to the proposed amending legislation:

"The size and complexity of the ultimate beneficiary statements prepared by taxpayers have created an unnecessary compliance burden. Furthermore, there are concerns that these provisions have been triggered inadvertently by taxpayers who have not been seeking to avoid tax through the use of more than one trust."<sup>1</sup>

## CURRENT PROVISIONS

The current provisions apply to distributions by closely held trusts which fall within the following categories:

- the closely held trust distributes a share of the net income of that trust to a trustee beneficiary of the closely held trust and there are one or more ultimate beneficiaries in respect of the whole or part of the income distributed; or

- a trustee beneficiary of the closely held trust is presently entitled at the end of a year of income to a share of the tax preferred amount of the trust and there are one or more ultimate beneficiaries in respect of the whole or part of that share.<sup>2</sup>

A closely held trust is defined in the legislation and includes all discretionary trusts and any fixed trust where up to 20 individuals have between them fixed entitlements to a 75 per cent or greater share of the income and capital of the fixed trusts.<sup>3</sup>

The provisions currently require the trustee of a closely held trust to provide the Commissioner with what is known as an "Ultimate Beneficiary Statement" ("UBS") which discloses the identity of the ultimate beneficiaries in relation to the closely held trust's net income and tax preferred amounts. To comply with the reporting provisions, the trustee of a closely held trust must trace distributions of income through trustee beneficiaries to the ultimate beneficiaries and this must be completed and lodged with the Australian Taxation Office ("ATO") by the time of lodging of the tax return for the closely held trust in the relevant tax period.<sup>4</sup> Failure to comply with the legislation results in a liability to pay ultimate beneficiary non-disclosure tax.<sup>5</sup> Ultimate beneficiary non-disclosure tax is a liability to pay tax on the share of the net income of the trust that was distributed to an ultimate beneficiary at the top marginal rate plus the Medicare levy.<sup>6</sup>

The exercise of identifying and tracing the ultimate beneficiaries of a closely held trust is an onerous task with the penalties for failure to comply significant. In response

to concerns associated with the onerous nature of preparing and lodging a UBS, a practice statement was issued in 2001 which provided that the Commissioner would be exercising his discretion to extend the UBS lodging period.<sup>7</sup> The practice statement provides that for the 2000-01 and subsequent income tax years, trustees of a closely held trust need only indicate on the trust return if they are notionally required to lodge a UBS. Lodgment of the UBS will be required only where the trustee has an ultimate beneficiary non-disclosure tax liability for the year in consideration or the Commissioner requests the lodgment of a UBS.<sup>8</sup>

## NEW PROVISIONS

In light of the above criticism of the current closely held trust provisions, it is proposed that Div 6 of the Income Tax Assessment Act 1936 ("ITAA 36") be amended by the *Tax Laws Amendment (2007 Measures No. 4) Bill 2007*, the *Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No.1) 2007* and the *Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No.2) 2007*, with the objective of the proposed amendments being:

"...to reduce the compliance burden and cost for taxpayers of complying with the reporting requirements under the ultimate beneficiary rules in Div 6D of Part III of the ITAA 1936."<sup>9</sup>

The question therefore arises, do the new provisions achieve the objective of reducing the onerous disclosure obligations imposed by the current provisions of ITAA 36?

There are three significant changes to the closely held trust provisions as a result of the amending legislation which reduce

the repetitive and onerous nature of the reporting requirements in the current provisions. The first is the removal of reporting at the ultimate beneficiary level and its replacement with reporting at the trustee beneficiary level which is considered in detail below. The second is the exclusion of specified trusts from the provisions. The third is the introduction of the concept of “untaxed part” resulting in the closely held trust provisions applying only to the untaxed part of a distribution.

### Trustee beneficiaries vs ultimate beneficiaries

The proposed legislation introduces what are to be known as “Trustee Beneficiary Statements” (“TBS”) which will replace the UBS and results in the reporting requirements in relation to closely held trusts being limited to trustee beneficiaries.<sup>10</sup> a trustee beneficiary is an entity which is a beneficiary of a trust (the closely held trust) in its capacity as trustee of another trust. The TBS will be

required to be lodged in respect of each trustee beneficiary to which a distribution of trust income is made by a closely held trust.

The removal of reporting at the ultimate beneficiary level significantly reduces the reporting obligations imposed on the trustee of a closely held trust and eliminates to some extent what was previously seen as multiple reporting in respect of the same income.

For example, if the trustee of a closely held trust had distributed income to a beneficiary which was a discretionary trust (trustee beneficiary) which in turn distributed that income or part of that income to two beneficiary trusts or other entities (ultimate beneficiaries), depending on the facts, a UBS would potentially have been required in respect of all three trusts on the basis that there are distributions to two ultimate beneficiaries and the distribution to the trustee beneficiary would also result in the trustee beneficiary being considered an ultimate beneficiary. Under the new provisions a TBS would

be completed only in respect of the trustee beneficiary.

The new provisions do not remove the requirement of the trustee of a closely held trust to report, however the repetitive nature of the current provisions will be reduced and a common sense approach will be adopted, removing multiple reporting of the same income.

The broad structure of the closely held trust provisions has been retained in that failure to comply with the provisions will result in the imposition of trustee beneficiary non-disclosure tax, being a liability to pay tax on the income distributed to the trustee beneficiary at the highest marginal rate (46.5 per cent). Further, there is no change to the time within which the TBS must be lodged as compared to the UBS and the discretion of the Commissioner to alter the lodging period has not been removed. To date, there has been no indication as to whether the discretion to alter the lodging period will be exercised by the Commissioner

in a similar manner to the way in which it has been exercised in respect of the current provisions.

### Exclusion of certain trusts from the closely held trust provisions

In addition to reducing the extent to which the tracing exercise must be completed by the trustee of a closely held trust, the amendment of the definition of “excluded trusts” results in some trusts being exempt from the disclosure obligations.<sup>11</sup> Of particular relevance is the exclusion of trusts which have made family trust elections or interposed entity elections from the closely held trust provisions. This amendment is supported in the explanatory memorandum to the legislation on the basis that:

“The Commissioner already has an avenue for obtaining information about these trusts and their beneficiaries.”<sup>12</sup>

The Commissioner will also be authorised to determine that a specified class of trustee will not be required to comply with the annual reporting obligations.<sup>13</sup> This power has been confirmed in a press release from the Assistant Treasurer<sup>14</sup> where it was stated that this discretion is to be conferred upon the Commissioner. No guidance as to the class of trusts to which the exercise of this discretion will principally apply has been provided.

### Concept of untaxed part

By virtue of the removal of ss 120UE and 102UF of the ITAA 36 and the introduction of a definition of “untaxed part” in s 102UE ITAA 36<sup>15</sup> and the repeal of s 102UG and replacement with a new s 102UG, the trustee of a closely held trust will not be required to report amounts in a TBS to the extent that those amounts have been taxed to the trustee of the closely held trust, or to an earlier trustee in the chain.<sup>16</sup> The aim of these amendments is to reduce unnecessary reporting and the prospective of double taxation as it is only the untaxed portion of any distribution that the Commissioner is concerned with.

Under the new provisions, a trustee of a closely held trust will not be required to complete a TBS in respect of any share of income which is specified in s 102UE(2) of the ITAA 36. This includes where the following apply:

“(a) the trustee of a closely held trust is assessed and liable to pay tax under subs 98(4) in respect of the share; or

(b) the share is reasonably attributable to a part of the net income of another trust estate in respect of which the trustee of the other trust estate is assessed and liable to pay tax under subs 98(4); or

(c) the share is represented by or reasonably attributable to an amount from which an entity was required to withhold an amount under subdiv 12-H in Schedule 1 to the Taxation Administration Act 1953; or

(d) the share is reasonably attributable to a part of the net income of another trust estate in respect of which the trustee of the other trust estate was liable to pay trustee beneficiary non-disclosure tax.”

This has not always been the case and therefore is another means by which the repetitive nature of the current provisions is being reduced.

It is important to note that in addition to the amendments that reduce the compliance burden of the current provisions, there are new provisions that impose penalty tax in specific circumstances. For example, where a distribution flows through a chain of trusts back to the originating trust, tax is payable on the untaxed amount of income at 46.5 per cent.

The proposed amendments to the closely held trust provisions will apply to the first income year starting on or after the date on which the amending legislation receives Royal Assent.<sup>17</sup>

### CONCLUSION

The proposed amendments to the closely held trust provisions are consistent with the intended objective to remove or at least reduce the onerous and repetitive nature of the current closely held trust reporting provisions. The amending provisions are a step in the right direction in reducing the compliance burden imposed on taxpayers whilst ensuring that the requirement to report arrangements involving closely held trusts is not removed. Trustee beneficiary non-distribution tax will be imposed in the event of failure to comply, confirming that the original purpose of the legislation to prevent the avoidance of tax has been retained by the amending provisions.

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#### Reference notes:

- 1 Explanatory Memorandum to Tax Laws Amendment (2007 Measures No. 4) Bill 2007, the Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No.1) 2007 and the Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No.2) 2007, para 4.57
- 2 Income Tax Assessment Act 1936, s 102UG
- 3 Ibid,s 102UC
- 4 Ibid,s 102UH
- 5 Explanatory Memorandum to Tax Laws Amendment (2007 Measures No. 4) Bill 2007, the Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No.1) 2007 and the Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No.2) 2007, para 4.4
- 6 Income Tax Assessment Act 1936,s 102UK(2)
- 7 Ibid,s 102UH(b)
- 8 PS LA 2001/12
- 9 Explanatory memorandum to Tax Laws Amendment (2007 Measures No. 4) Bill 2007, the Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No.1) 2007 and the Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No.2) 2007, para 4.56
- 10 Ibid, para 4.6
- 11 Tax Laws Amendment (2007 Measures No. 4) Bill 2007, item 13, proposeds 102UC(4)12
- 12 Explanatory Memorandum to Tax Laws Amendment (2007 Measures No. 4) Bill 2007, the Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No.1) 2007 and the Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No.2) 2007, para 4.8
- 13 Tax Laws Amendment (2007 Measures No. 4) Bill 2007, item 19, proposed ss 102UK(1A) and 102UK(1B)
- 14 Press Release: Further improvements to the tax system (NO.0714 – 21/06/2007)
- 15 Tax Laws Amendment (2007 Measures No. 4) Bill 2007, item 14, proposeds 102UE
- 16 Explanatory Memorandum to Tax Laws Amendment (2007 Measures No. 4) Bill 2007, the Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No.1) 2007 and the Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No.2) 2007, para 4.10
- 17 Tax Laws Amendment (2007 Measures No. 4) Bill 2007, item 51