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[287] **Division 6AA and child maintenance trusts: there are advantages, but pitfalls too**

- by Matthew Burgess and Patrick Ellwood, Directors, View Legal

Overview

In the context of deceased estates (and specifically with the use of testamentary trusts), the excepted trust income rules under Div 6AA of the ITAA 1936 are well known.

In particular, the rules allow income derived by infant children via distributions from a testamentary trust to be assessed at the normal, individual adult rates. As a result, each infant beneficiary can receive over $20,000 of income tax-free and the balance is taxed at the adult marginal rates. For most families, this can mean significant tax planning opportunities.

In the vast majority of cases, access to the excepted trust income concessions is only available following someone's death. One key structure that falls outside this general position however is a "child maintenance trust" (**CMT**).

A CMT is another form of trust contemplated by Div 6AA that should be at least considered whenever there is a personal relationship (referred to as a "family") breakdown and either party is responsible for making child support payments. This is because a validly established CMT can also create access to the excepted trust income provisions and the resulting tax concessions.

Given the significant percentage of personal relationships that breakdown irretrievably, many of which then result in child maintenance obligations being imposed, it is important that practitioners are aware of the planning opportunities afforded by CMTs.

What is a "family breakdown"?

Section 102AGA of the ITAA 1936 defines a transfer of property as a result of a "family breakdown" to include legal obligations arising from a range of situations such as:

- The breakdown of a formal marriage.
- The breakdown of a de facto relationship.
- Where a child has been born outside a "traditional" relationship arrangement (for example, a "one night stand").

CMTs are potentially available in relation to children who are:

- born of the union of the relationship that has broken down;
- adopted children; and
- step-children.

ITAA 1936 and excepted trust income

CMTs are specifically provided for in s 102AG of the ITAA 1936. As noted above, the main advantage of a CMT from a tax perspective is the ability for income of the trust to be treated as excepted trust income.

A CMT, like most trusts, must be established by deed but, in contrast to many of the other types of trusts contemplated by the excepted trust income rules, cannot be created by a will.

There are also other requirements that must be met before the income of the trust is treated as excepted trust income, including:

- the children named as the "primary beneficiaries" of the trust must be younger than 18 at the time the trust is established;
- income must be derived by the investment of property transferred to the trustee of the trust for the benefit of the primary beneficiary/beneficiaries, as a result of a "family breakdown", as set out above;
- there is no set time frame in which a CMT must be established following the family breakdown, although they should ideally be set up at the time of the property settlement; and
- the children for whose benefit the trust is established must ultimately receive all of the capital from the trust in equal shares.

Both in relation to tax planning and asset control, it is important to note that potential income beneficiaries of a CMT may include persons other than children of the relationship subject to the family breakdown, without jeopardising access to the excepted trust income concessions.

Non-arm's length arrangements

The income of a CMT can be generated from non-arm's length arrangements. However, any income which results from non-arm's length transactions must be of equal value to that which would have been derived on an arm's length basis in order to be considered excepted trust income.

The arm's length requirement is set out in detail in s 102AG(3). In particular, this section provides that if any 2 or more parties to:

- the derivation of excepted trust income; or
- any act or transaction directly or indirectly connected with the derivation of that excepted trust income,

were not dealing with each other at arm's length, then the excepted trust income (if any) is only so much of that income as would have been derived if they had been dealing with each other at arm's length.

Due to the strict requirements for a valid CMT, particularly on the ultimate vesting of the assets in the children of the relationship that had a family breakdown, one approach often used is to contribute depreciating assets such as plant, equipment and motor vehicles to the trust. These assets can be leased, either to a related individual or business entity for value.

Provided the lease repayments are on an arm's length basis, then the income will be able to be distributed to infant children as excepted trust income.

Other issues to consider

While there can be tax planning advantages to utilising a CMT, there are also a number of potential pitfalls (in addition to the matters set out above).Some of the things to specifically consider before establishing a CMT include:

- Taxation Ruling TR 98/4 which sets out in detail the Commissioner's position in relation to CMTs and should be studied carefully before implementing the structure.
- The CGT relief afforded by Div 126-A of the ITAA 1997 due to a marriage breakdown does not extend to assets transferred to a CMT.
- Similarly, in relation to non-capital assets (eg depreciating assets), there will generally be no roll-over relief available for asset transfers to the CMT.
- Generally there will also be no stamp duty relief available for dutiable assets transferred to a CMT, although anecdotally it appears some State Revenue Offices do allow an exemption.
- It is often extremely difficult to establish a CMT unless both parents work collaboratively, which obviously may not be the case where the personal relationship has otherwise broken down.

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[288] BEPS first incursion into Australia and the contest of ideas

- by Tony Frost, Managing Director, Greenwoods & Herbert Smith Freehills

Paris is a long way from Australia, so perhaps it is not surprising that many in Australia's tax community have viewed the ruminations of OECD officials and the Base Erosion and Profit Shifting (BEPS) project as something that can be left for another day. That "other day" was 2 March 2015 when the ALP revealed it is looking to BEPS for its tax policy concerning multinationals – see report at 2015 WTB 9 [234].

The Opposition likes what it sees in various BEPS Action items, including Action 2 (hybrid instruments) and Action 4 (interest deductibility).

The ALP announcement proposes 4 BEPS-inspired measures with a combined revenue gain over 4 years of $1.9 billion, with the bulk ($1.65 billion) to come from further changes to the thin capitalisation rules.

Of course, our thin capitalisation rules were amended only last year to reduce the amount of interest deductions available to multinational companies.

Labor is proposing to amend the rules again, to further reduce the amount of debt that multinational companies can claim deductions for in Australia. Under its proposals, companies would no longer be able to claim up to a 60% debt-to-equity ratio for their Australian operations. Instead, deductions would be assessed on the debt-to-equity ratio of a company's entire global operations. This means that if a company has an average 30% debt-to-equity ratio across its different subsidiaries, it would only be able to claim tax deductions up to that level.

This ALP announcement has jumped the gun on unfinished work by the G20 and the OECD. The OECD was asked, amongst other things, to "develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense …". Instead, the OECD Discussion Paper on BEPS Action item 4 released in December last year (see 2014 WTB 53 [1760]), came up with a radical proposal of its own: a system of formulary apportionment for interest (and other financing costs), allowing deductions only for the (net) external interest expense of a multinational group, and capping the share of that deduction available for each individual member using a factor such as earnings, EBITDA or assets.