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Four more ways Treasury has radically escalated its War on Trusts

by Matthew Burgess, Director, View Legal

Treasury and the Federal Government have marketed their minimum tax on trusts as a mechanism to redistribute wealth away from 'the rich' (apparently defined as anyone with a trust, or has impure thoughts - that is thinks about trusts).

For taxpayers and advisers, the newly introduced regime has nothing 'minimalist' about it. Instead the new rules seem to be an AI enabled masterclass in creating the maximum amount of density, confusion and unresolved issues. The legislation superimposes extreme complexity over a framework that on any objective assessment has been completely broken for decades.

Attempting to unpack how flawed the new rules are is the very definition Brandolini's Law*; however set out below are four more threshold areas that will cause major trauma for huge number of ordinary Australians (noting any one truly 'rich' will likely be able to access the advice required to find the dozens of 'planning opportunities' specialist advisers have anecdotally already identified).

1. The fixed trust conundrum remains

The new legislation replaces the existing fixed-trust definition.

A trust will be fixed if:

(a) beneficiaries have fixed entitlements to all income and capital; or

(b) there are no material discretionary elements capable of significantly affecting beneficiary rights or entitlements to income or capital.

The legislation then provides broad indicators and gives the Minister power to determine further matters by legislative instrument.

This does not resolve the longstanding uncertainty. It relocates it.

Material questions remain for:

(a) unit trusts;

(b) hybrid trusts;

(c) trusts with broad amendment powers;

(d) trusts with appointor, principal or guardian powers;

(e) trusts where the unitholders have entered into unitholder agreements;

(f) trusts with redemption or reclassification powers; and

(g) trusts whose legal rights appear fixed but whose governing documents retain administrative discretions.

Converting an existing discretionary trust into a fixed trust is also almost certain to create material trust-law issues.

Furthermore, any such conversion is also certain to trigger state duty in most jurisdictions - even NSW; despite recent promises to look to provide carve outs (various professional politicians appear to have conflated the Excluded Entity Trust rules, with either or both the minimum tax on discretionary trust rollover relief and the steps required to convert an existing trust into a fixed trust).

The definition therefore promises certainty while preserving enough uncertainty to ensure years of further advice, disputes and administrative guidance.

2. The restructuring rollover

The rollover is broader than originally expected in some respects. It is not confined to active businesses or small entities.

However, its utility remains heavily constrained around issues such as:

(a) all relevant trust assets must generally be transferred;

(a) all assets must generally go to the one nominated transferee;

(b) the restructure must move the assets out of the discretion-based trust structure;

(c) the transferee cannot be an exempt entity, complying superannuation entity or trustee of another minimum tax trust;

(d) both transferor and transferee must make irrevocable choices;

(e) continuity and residency requirements apply;

(f) relief can be lost if material discretionary elements arise during the statutory integrity period.

The one-transferee rule is particularly problematic. Practically it will often force operating assets, passive investments and at risk assets into the same single entity, defeating a range of fundamental asset-protection and succession principles. As any adviser with experience in relation to trusts would attest, asset protection and succession planning are the dominant purposes of almost every Australian operating or considering a trust; not tax evasion (that being the narrative of Treasury and the Government about why the War on Trusts is necessary).

Most importantly, the rollover addresses specified federal income-tax consequences. It does not switch off:

(a) transfer duty;

(b) landholder duty;

(c) state based anti-avoidance rules.

(d) foreign-person surcharges;

(e) land tax changes;

(f) GST;

(g) financing consequences; or

(h) third-party consent requirements.

A federal rollover is not a transaction-cost rollover and broadbrush pre-election promises (even if made "For the 50th time") from would be state government decision makers will likely provide little comfort for those being slugged with the taxes.

3. Excluded income: more tracking, not less tax complexity

Specified income is said to be excluded, in areas such as:

(a) taxable primary production income;

(b) qualifying testamentary trust income;

(c) certain income relating to vulnerable minors;

(d) certain shares of income of registered charities and deductible gift recipients;

(e) certain income of other exempt entities;

(f) specified non-resident withholding income; and

(g) specified amounts already taxed to trustees under other provisions.

Some exclusions depend on future ministerial conditions, processes, integrity rules, notifications or caps.

A trust deriving both excluded and non-excluded income will therefore need to identify, characterise and track each component.

The new regime does not replace any of the existing taxation of trusts legislation (eg Division 6 of the Tax Act). Instead, it 'simply' sits on top of it.

4. The only certainty: compliance costs increase (AKA simply another form of tax on taxpayers)

Before 1 July 2028 (but not before the new legislation becomes law, and then possibly not until after the next Federal election), every affected taxpayer and their advisers will need to consider at least the following; essentially imposing a further tax on taxpayers (no rational taxpayer would voluntarily choose to incur advice costs in these areas in the escalating inflationary economy that is likely to be in a recession in the immediate term, if not already):

(a) trust classification;

(b) fixed-trust status;

(c) deed amendment powers;

(d) excluded income;

(e) beneficiary profiles;

(f) asset protection;

(g) EET eligibility (including permanent nominated percentages);

(h) corporate beneficiary constitutions and share rights;

(i) shareholder changes;

(j) rollover eligibility;

(k) asset-transfer requirements;

(l) integrity periods;

(m) trustee obligations and trustee duties;

(n) beneficiary tax offsets;

(o) franking-credit adjustments;

(p) stamp duty; and

(q) succession implications

For testamentary trusts, the work will likely have to start immediately - despite there being no clarity about how the rules will play through. This is because a willmaker needs to be alive and with full testamentary capacity at the time they sign a new will.

Every will containing testamentary trust provisions must therefore be reviewed against the new beneficiary restrictions. Any will permitting companies, other trusts or other non-permitted entities to benefit would (it appears) need to be amended before 1 July 2028, or be subject to the 30% minimum tax regime; noting that the 30% minimum tax will in fact in many instances be a 32% minimum tax given the Medicare tax (marketed as a 'levy').

Any adviser condoning a deferral in updating wills until there is certainty about the new regime may be at risk of claims in professional negligence.

And as a reminder, all of the above issues are simply stacked on top of the existing trust-taxation regime, including:

(a) Division 6;

(b) section 100A;

(c) Anti avoidance (Part IVA);

(d) Division 7A;

(e) unpaid present entitlements;

(f) family trust elections;

(g) interposed entity elections;

(h) family trust distribution tax;

(i) trust loss rules;

(j) income injection tests;

(k) control tests;

(l) capital-gain and franked-distribution streaming;

(m) Division 6AA;

(n) corporate beneficiaries;

(o) non-resident beneficiaries (including non-residents);

(p) small business CGT concessions;

(q) GST;

(r) land tax; and

(s) foreign-person surcharges.

And in conclusion, a question for consideration: how did #BigGovs War on Drugs (including tobacco) turn out.

* Brandolini's Law is more commonly known as the ‘Bullsh%t Asymmetry Principle’; that is "The amount of energy needed to refute bullsh%t is an order of magnitude larger than that needed to produce it."