

Exposure draft legislation:

Minimum tax on discretionary trusts

ACOSS submission to Treasury, September 2026

About ACOSS

The Australian Council of Social Service (ACOSS) is a national voice in support of people affected by poverty, disadvantage and inequality and the peak body for the community services and civil society sector.

ACOSS consists of a network of approximately 4,000 organisations and individuals across Australia in metropolitan, regional and remote areas.

Our vision is an end to poverty in all its forms; economies that are fair, sustainable and resilient; and communities that are just, peaceful and inclusive.

Summary

For context and to avoid repetition, this submission should be read in conjunction with our [previous submission](#) to Treasury on this topic. We reaffirm the points made there. Broadly speaking, ACOSS strongly supports the proposed 30% minimum tax on trust income and denial of a tax offset to corporate beneficiaries ('bucket companies'). In this submission, we analyse the exposure draft legislation with a view to ensuring that the intent of the broad policy (to impose a minimum 30% tax) cannot be circumvented and to minimise disruption for individuals who use trusts for purposes other than tax avoidance.

Restrict the 30% tax offset to paid distributions to beneficiaries and reset the foundations of the taxation of trusts

We acknowledge that it would be challenging at this stage of the process to alter the underlying structure and definitions of the taxation of trusts. Nevertheless, as a first step towards removing inconsistencies between tax law and trust law that give rise to complexity and tax avoidance opportunities, the proposed 30% tax offset should only be available for *paid* distributions to beneficiaries, not unpaid present entitlements.

Recommendation 1:

Restrict the proposed 30% tax offset to distributions *paid* within each financial year or within two months afterwards.

Recommendation 2:

Longstanding inconsistencies between trust law and tax law, which generate complexity and confusion and facilitate tax avoidance, should be resolved by:

- (i) Replacing the use of 'present entitlement' with 'paid distributions' made by 31 August of each year to determine the taxing point (beneficiary or trustee) to end the fiction of 'unpaid present entitlements'; and
- (ii) Replacing 'shares of the trust estate' with 'shares of net income' for the purpose of allocating tax liabilities among beneficiaries.

We support the proposed legislative definitions of fixed and discretionary trusts

Prima facie, this is based on existing tax principles and practice and should remove any uncertainty around common commercial arrangements inadvertently attracting the minimum 30% tax.

The 30% tax offset should be denied to beneficiaries where discretionary trusts are used to avoid income tax

Recommendation 3:

- (i) In addition to any other penalties (including the 47% tax applied to the trustee), the 30% tax offset should be denied where income is derived as a result of a scheme for the purpose of avoiding income tax, including:
 - reimbursement agreements where value is shifted from a presently entitled beneficiary to another individual or entity in a non-arm's length transaction;
 - distributions to tax exempt entities where the entity does not receive the full benefit of the distribution; and
 - circular distributions.
- (ii) Tracing rules should be developed to ensure that distributions of income which was not included in the net income of the trust and therefore did not attract the 30% minimum tax (such as distributions from asset revaluation reserves) does not attract the 30% tax offset.

Excess franking credits must not be used to undermine the intent of the reforms

Recommendation 4:

- (i) Consistent with the draft legislation, trustees that receive franked dividends should be required to use their franking credits to offset their tax liabilities as a trustee in the first instance.
- (ii) For any excess franking credits refunded to the trustee after offsetting its tax liabilities, consideration should be given to integrity measures that prevent the economic benefit of the excess franking credits being distributed to beneficiaries in a manner inconsistent with the distribution of underlying franked income.

Donations to deductible gift recipients (DGRs), but not other tax-exempt entities, should be exempted from the 30% tax

We support the draft legislation's provision to deduct donations to DGRs – but not other tax exempt entities – from the assessable income of a trust before the 30% minimum trusts tax is applied. This maintains the integrity of tax concessions for charitable giving and consistency of tax treatment between donations from trusts and individuals.

Recommendation 5:

To ensure consistent tax treatment of donations by individuals and trusts and the integrity of the income tax system:

- (i) Donations paid to *Deductable Gift Recipients* (DGRs) should be exempted from the 30% minimum tax.
- (ii) Only donations with the character of *gifts* should be exempted.
- (iii) Trustees should report to the ATO in timely fashion the name and financial account

details of the DGR, and the timing and amount of each donation.

- (iv) Donations to other income tax exempt entities that are not DGRs should not be exempted from the 30% minimum tax, and they should not be eligible for the related tax offset.

Modernise DGR status:

Recommendation 6:

As part of the legislative package implementing these trusts reforms, the Government should extend DGR status to all charities registered with the Australian Charities and Not-for-profits Commission (ACNC), except those whose purposes and activities are solely for the advancement of religion, or the advancement of education through childcare and primary and secondary education (unless the activity is sufficiently related to advancing another charitable purpose) – as recommended by the Productivity Commission.

Special tax concessions for testamentary trusts should not extend across multiple generations, nor to minor beneficiaries with a living parent

Recommendation 7:

- (i) If testamentary trusts are exempted from the minimum 30% tax, then at the least such exemption should be time limited (for example, until the youngest direct descendant reaches 18 years).
- (ii) Investment income distributed by the trustee of a testamentary trust to minors should be taxed at the standard rate of 45% unless the child is an 'excepted person' (e.g. has a disability or is orphaned) or the income is 'excepted income' (for example from loss of parental support or personal injury).
- (iii) If testamentary trusts are exempted from the minimum tax, we support the proposed integrity measures that extend the minimum tax to those post-2028 testamentary trusts:
 - whose beneficiaries are not all individuals or exempt entities; or
 - where income was derived directly or indirectly under or as a result of a scheme that was entered into or carried out for the purpose of avoiding the minimum tax.
- (iv) In any event, the minimum tax should apply to income from property injected into a testamentary trust after 12 May 2026 which is unrelated to the deceased estate.

We support the proposed electable regime for discretionary trusts (EET) provided distributions cannot be made to entities with 'material discretionary elements' including other discretionary trusts, or to companies

Recommendation 8:

To reduce transition costs while removing tax avoidance opportunities arising from trustees' discretion to shift income to lower-taxed individuals or entities:

- (i) Trustees of existing discretionary trusts should be exempted from the 30% minimum tax if they make an election during 2028-29 to list the current beneficiaries whom they intend to make presently entitled to certain shares of trust income, to the extent that those shares remain unchanged.
- (ii) The exemption should not apply to trusts that intend to distribute to entities with 'material discretionary elements' including discretionary trusts or partnerships.
- (iii) The exemption should not apply to trusts that intend to distribute to a company or a superannuation entity.
- (iv) We support the integrity measures associated with this exemption, including revocation of the exemption, together with the 47% penalty tax on the trustee, if the requirements

of the election are materially breached.

- (v) We support extension of the exemption to trusts that change their list of beneficiaries and allocations of income in response to the death or relationship breakdown of beneficiaries. If this concession is extended to new family members, this should be limited to children of existing beneficiaries born after July 2028, provided they are taxed at the 45% rate applying to their investment income while they are minors (under 18 years).

We support the proposed CGT rollover relief provided distributions cannot be made to entities with 'material discretionary elements' including partnerships

We support the proposed transitional roll-over for assets transferred by a 'minimum tax trust' provided the transferee entity is not a tax-exempt entity and does not have material discretionary elements, and all assets are transferred within the prescribed period.

Recommendation 9:

Consistent with the objective to encourage transfers to entities without material discretionary elements:

- (i) The transferee entity should not be a discretionary trust, a partnership or a company with different classes of shares.

Contents

Summary	1
1. Restrict the 30% tax offset to paid distributions to beneficiaries and reset the foundations of the taxation of trusts	6
2. The proposed definitions of fixed and discretionary trusts in the legislation are appropriate ..	7
3. The 30% tax offset should be denied to beneficiaries where discretionary trusts are used to avoid income tax.....	7
4. Excess franking credits must not be used to undermine the intent of the reforms	9
5. Donations to deductible gift recipients, but not other tax exempt entities, should be exempted from the 30% tax.....	10
6. Special tax concessions for testamentary trusts should not extend across multiple generations, nor to minor beneficiaries with a living parent.	12
7. We support the proposed electable regime for discretionary trusts (EET) provided distributions cannot be made to discretionary trusts, private companies or entities with 'material discretionary elements'.	13
8. We support the proposed income tax rollover relief provided distributions cannot be made to entities with 'material discretionary elements', including partnerships	14
Contact	14

1. Restrict the 30% tax offset to paid distributions to beneficiaries and reset the foundations of the taxation of trusts

We acknowledge that it would be challenging at this stage of the process to alter the underlying structure and definitions of the taxation of trusts. Nevertheless, there are few opportunities for governments to resolve serious discrepancies between trust law and tax law that give rise to complexity, confusion and avoidance opportunities. Previous governments attempted to do so in reforms considered following the *Bamford* judgment over a decade ago,¹ but those reforms were not followed through to conclusion.

At the least, the present legislation should point in the direction of fundamental reform and make it easier to implement later. In particular, the 30% tax offset should only be available to beneficiaries who receive *paid distributions* (not unpaid present entitlements) from a trust.

The taxation of discretionary trusts rests on an unstable foundation that combines trust law and tax law

The basis for the taxation of trusts in tax law is that the 'net' (taxable) income of trusts is calculated in like manner to individual taxpayers. In theory, when this is distributed among beneficiaries, each one (individual or entity) is taxed at its own tax rate, and any undistributed income is taxed in the hands of the trustee – often at the penalty rate of 47%.

The trust law basis for taxation of trusts is the 'present entitlement' of each beneficiary of the income of the trust estate, as defined in the trust deed. This determines the share of trust income for each beneficiary that is used to calculate their tax liabilities.

This mix of trust and tax law is unstable and gives rise to tax avoidance opportunities which experts refer to as the 'income tax shuffle'.²

The use of the trust law concept of 'present entitlement' gives rise to tax avoidance though 'unpaid present entitlements'

Australia is unusual among common law countries in not applying an upfront tax on the taxable income of discretionary trusts and using the trust law concept of '*present entitlements*' to the trust estate to determine how beneficiaries are taxed (rather than distributions of the taxable income of the trust).

'Present entitlements' are determined by trustee decisions in accordance with the trust deed (pursuant to trust law), which may or may not be consistent with tax law definitions of income. In particular, distinctions between capital gains and other income in trust deeds often differ from tax law definitions. This can be exploited to avoid tax. Further, where the trust law income of a trust is less than its taxable income, it is not always clear which beneficiaries (or the trustee) should pay any tax that is due on the difference.

Trustees may hold 'unpaid present entitlements' (UPEs) within the trust. For example, a beneficiary's entitlement may be held within a 'sub-trust' assigned to that beneficiary instead of distributing it to them. UPEs are a common feature of discretionary trusts and they provide

¹ See eg Treasury (2011), [Modernising the taxation of trust income – options for reform](#). As that consultation paper explains, in *Bamford* the High Court held that 'income of the trust estate' takes its meaning from trust law, while beneficiaries are assessed on trust income under tax law, and the mismatch between trust law income and taxable income gives rise to anomalous results and opportunities to manipulate tax liabilities.

² See and de Silva A et al (2019), *Current issues with trusts and the tax system*. Report commissioned by the ATO, RMIT University, Melbourne; and Glover J (2014), *Taxing trust income by 'entitlement': The end of the road?*. Australian Tax Review, Vol 43 p101.

opportunities to avoid tax using strategies identified by ATO such as [Potential reimbursement agreements](#), [Value extraction and corpus distributions](#) and [Differences between distributable and net income](#).

By taxing discretionary trust income at the rate of 30%, the proposed minimum tax treats them as taxable entities, bringing their tax treatment closer to that in other common law countries. This helps ensure that trust income is brought to tax in a timely way.

However, when UPEs are used as part of a tax avoidance strategy (for example using the *reimbursement agreements* discussed below) they undermine this objective. For tax purposes, distributions should be treated as *payments from the net income of the trust*, not '*present entitlements to shares of the trust estate*' pursuant to trust law.

Whether or not this fundamental reform is pursued, the proposed 30% trustee tax should only be refunded to beneficiaries in respect of income *paid* to them within two months of each tax year. Contrived distributions, such as those which are reimbursed to the trust via loans, should not be recognised for the purposes of the 30% tax offset.

Recommendation 1:

Restrict the proposed 30% tax offset to distributions paid within each financial year or within two months afterwards.

Recommendation 2:

Longstanding inconsistencies between trust law and tax law, which generate complexity and confusion and facilitate tax avoidance, should be resolved by:

- (i) Replacing the use of 'present entitlement' with 'paid distributions' made by 31 August of each year to determine the taxing point (beneficiary or trustee) – to end the fiction of 'unpaid present entitlements'; and**
- (ii) Replacing 'shares of the trust estate' with 'shares of net income' for the purpose of allocating tax liabilities among beneficiaries.**

2. The proposed definitions of fixed and discretionary trusts in the legislation are appropriate

We broadly support the proposed definitions of fixed and discretionary trusts in this legislation. These are consistent with the well-established approach adopted by the ATO.

3. The 30% tax offset should be denied to beneficiaries where discretionary trusts are used to avoid income tax

The proposed 30% minimum tax together with a non-refundable tax offset should remove many tax avoidance opportunities. However, it is likely that those who control discretionary trusts will find ways to circumvent the minimum tax or claim tax offsets for which they should not be entitled. It is therefore vital that the ATO is given clear discretion to apply the minimum tax, and to deny the offset, where recognised tax avoidance strategies are used to avoid tax.

The draft legislation applies this principle to the exemption for testamentary trusts:

"If the Commissioner is satisfied, having regard to the circumstances in which property is transferred to the trustee and any other relevant matters, that the income was derived directly or indirectly under or as a result of a scheme that was entered into or carried out for the purpose of avoiding the minimum tax, the income is not excluded. This is an integrity provision to prevent testamentary trusts from being used as a tax planning vehicle to make distributions to corporate beneficiaries or other trusts." [p13, Explanatory Memorandum, Minimum tax on discretionary trusts].

The same approach should apply to widely used tax avoidance strategies involving discretionary trusts, including:

- reimbursement agreements where value is shifted from a presently entitled beneficiary to another individual or entity in a non-arm's length transaction;
- distributions to tax exempt entities where the entity does not receive the full benefit of the distribution; and
- circular distributions.

Further, tracing rules are required to deny the 30% tax offset for distributions of income which was not included in the net income of the trust and therefore did not attract the 30% minimum tax (including distributions from asset revaluation reserves).

Reimbursement agreements

A common tax avoidance strategy identified by the ATO is to divert the value of distributions to presently-entitled beneficiaries to other individuals or entities through non arms-length transactions, for example through [reimbursement agreements](#).

In this way, the high-income controller of a trust benefits from an entitlement distributed to a low-income or untaxed beneficiary. For example, an adult child may be asked to compensate their parent for past investment in school fees out of a distribution to them from a discretionary trust. No money actually changes hands – rather, the controller of the trust has avoided paying tax on their own income at a higher marginal rate.

In another common tax avoidance strategy, unpaid distributions to a low-income beneficiary (an individual or private company) are diverted back to the trustee through loans. This was the subject of the recent High Court judgement in the *Bendel* case, which ruled that a corporate beneficiary's UPE to trust income was not a 'loan' so could not be taxed as deemed dividend pursuant to Division 7A of the Income Tax Assessment Act.

Reimbursement strategies undermine the principle that a beneficiary's entitlement to trust income, once awarded by the trustee, is for the exclusive benefit of that person. Otherwise, the distribution is ineffective and the trustee should be taxed at the penalty rate of 47% (Section 99A, Income Tax Assessment Act).

The challenge for the ATO is to distinguish between contrived 'non-arms length' transactions of this kind and 'ordinary family or commercial dealings' which do not attract the penalty tax (Section 100A, Income Tax Assessment Act). The integrity measures in current tax law to curtail reimbursement agreements are unenforceable at scale.

Reimbursement agreements can also be used to shift the value of the proposed 30% tax offset from a beneficiary who pays sufficient tax to take advantage of it (whose marginal tax rate is at least 30%) to the trustee or another beneficiary or entity so that it ultimately benefits the controller of the trust.

Distributions to tax-exempt entities

Distributions to tax exempt entities such as charities where those entities do not obtain the full benefit of their present entitlement have for many years attracted the attention of the ATO. In these tax avoidance schemes, part or all of the value of an entitlement belonging to the charity is shifted to the trustee or a high-income beneficiary. For example, the tax-exempt entity may not be notified of their entitlement by the trustee, payment may be deferred pursuant to the trust deed, or the beneficiary may decline to take up their entitlement.

These tax avoidance strategies undermine trust in charities and charitable giving and deprive them of income they would otherwise receive.

Anti-avoidance rules were developed to counter these strategies (Sections 100AA and 100AB, Income Tax Assessment Act), to ensure that the exempt entity is promptly notified by the

trustee of their entitlement, and so that the ATO can shift the incidence of taxation from the exempt beneficiary to the trustee where that beneficiary is awarded an excessive share of the trust's income.

As with the integrity rules around reimbursement agreements, this is difficult to enforce at scale. The 30% tax offset should be denied to beneficiaries to whom payments to tax exempt entities are shifted under these tax avoidance strategies.

Circular distributions

Another strategy in which economic value is diverted for tax avoidance purposes is [circular trust distributions](#). These strategies transfer income or assets from a trust or private company back to a trust from which they originated.

The 30% minimum tax would help curb these practices, provided it applies to income from a transfer of value to a discretionary trust that is the outcome of a circular distribution among related trusts or companies. Where a discretionary trust receives a transfer from another discretionary trust or private company pursuant to a circular trust distribution strategy, the receiving trust should also be denied the 30% tax offset.

Distributions of income not included in the net income of the trust

Income may be distributed to a beneficiary of a discretionary trust from an untaxed source. An example is distributions of accrued capital gains (which are normally not taxed until realised) from asset revaluation reserves.

Tracing rules are needed to ensure that this income (which does not attract the 30% minimum tax in the hands of the trustee) does not attract the 30% tax offset.

Recommendation 3:

(i) In addition to any other penalties,³ the 30% tax offset should be denied where income is derived as a result of a scheme for the purpose of avoiding income tax, including:

- **reimbursement agreements where value is shifted from a presently entitled beneficiary to another individual or entity in a non-arm's length transaction;**
- **distributions to tax exempt entities where the entity does not receive the full benefit of the distribution; and**
- **circular distributions.**

(ii) Tracing rules should be developed to ensure that distributions of income which was not included in the net income of the trust and therefore did not attract the 30% minimum tax (such as distributions from asset revaluation reserves) does not attract the 30% tax offset.

4. Excess franking credits must not be used to undermine the intent of the reforms

ACOSS supports the measure in the draft legislation that requires trustees receiving franked dividends to first apply available franking credits against their tax liabilities as a trustee, consistent with existing arrangements where a trust is assessed and liable for tax. This helps ensure that income derived through discretionary trusts remains subject to the minimum tax while avoiding double taxation of company profits. Excess franking credits may then arise and

³ Including the 47% tax applied to the trustee pursuant to Sections 100A and 99A of the ITAA.

are refunded to the trustee where the credits exceed the trustee's tax liabilities.

The explanatory materials could more clearly explain the tax treatment of the economic benefit of excess franking credits once refunded to the trustee and how a beneficiary may be taxed if the economic benefit of that refund is capable of being distributed to them. The previous Treasury consultation paper on the proposed minimum tax noted that the treatment of the benefit of excess franking credits for trust law purposes may depend on the terms of the trust deed.

ACOSS is concerned about a situation in which a trustee may be able to obtain a more favourable tax outcome by retaining broad discretion to direct the economic benefit of the excess franking credit to whatever beneficiaries they choose and in whatever proportions they choose, including in a manner inconsistent with the original distribution of the franked income. This could include directing the benefit to beneficiaries with lower effective tax rates due to tax losses, concessions or access to the tax-free threshold, including beneficiaries added after the relevant franked income was received. Such outcomes may undermine the policy intent of the reforms to reduce tax minimisation through income streaming arrangements that are available through discretionary trust structures but not through income earned directly by individuals.

To address this risk, ACOSS recommends consideration of integrity measures to prevent the economic benefit of refunded excess franking credits being allocated in a manner inconsistent with the distribution of the underlying franked income. This could take the form of a tracing or character retention measure that ensures the economic benefit of excess franking credits can only flow to existing beneficiaries who benefited from the underlying franked distribution, and only in proportion to that distribution. As outlined in our previous submission, ACOSS also considers that improved transparency of beneficial ownership would support such integrity measures as well as assist efforts to reduce tax avoidance and evasion more broadly.

Recommendation 4:

- (i) Consistent with the draft legislation, trustees that receive franked dividends should be required to use their franking credits to offset their tax liabilities as a trustee in the first instance.**
- (ii) For any excess franking credits refunded to the trustee after offsetting its tax liabilities, consideration should be given to integrity measures that prevent the economic benefit of the excess franking credits being distributed to beneficiaries in a manner inconsistent with the distribution of underlying franked income.**

5. Donations to deductible gift recipients, but not other tax exempt entities, should be exempted from the 30% tax

As indicated in our previous submission we support the proposed exemption from the 30% minimum tax for deductible gift recipients (DGRs), but not its extension to other charities and tax-exempt entities.

It is not equitable to *deny* deductibility of donations to DGRs through trusts when donations from individuals are already deductible. Following the same principle, it is not equitable to *allow* deductions from trusts to entities that are not DGRs (such as churches and clubs) where donations to the same organisations are not deductible for individuals.

The long-overdue modernisation of DGR status should proceed based on the recent Productivity Commission review, so that deductibility is extended (where appropriate) in an open and transparent manner rather than by the circuitous route of allowing tax deductible donations through trusts. This privileges donations through trusts – which mainly come from people with high incomes.

We support the proposed exemption from the 30% minimum tax for donations to DGRs

This resolves our concern that donations to DGRs from discretionary trusts would otherwise be treated differently to the same donation made by an individual taxpayer.

For tax integrity reasons and to ensure consistency with the DGR rules for personal donations, donations from trusts to DGRs that are exempted from the minimum tax should have the character of *gifts* pursuant to Division 30 of the Income Tax Assessment Act. Section 78A, which strengthens the conditions under which deductions are available and denies deductions for ostensible gifts made as part of tax avoidance arrangements or schemes, is also relevant.

As set out in [Taxation Ruling 2005/13](#), the courts have determined that a gift has the following characteristics:

- there is a transfer of the beneficial interest in property;
- the transfer is made voluntarily;
- the transfer arises by way of benefaction; and
- no material benefit or advantage is received by the giver by way of return.

Given the abovementioned tax avoidance strategies using distributions to tax-exempt entities, integrity measures are needed to ensure transfers to DGR beneficiaries are actually made. The legislation should require the trustee to provide timely information to the ATO on the identity of the DGR, the amount donated, the timing of the donation, and bank account details of the DGR, so the ATO can ensure (if necessary) that the donation was made. This removes the need for the DGR to report this information to the ATO.

We do not support the proposed exemption from the 30% minimum tax for donations to DGRs

A donation from a discretionary trust to a *tax-exempt organisation that is not a DGR* (such as a club or church) is currently treated more generously by the tax system than the same donation made by an individual taxpayer. This is an anomaly, not a conscious policy choice.

The controller of a discretionary trust – usually an individual with a high income – can use the trust to 'split' part of their income with the not-for-profit in the same way that they can split part of their income with a family member on a lower tax rate. In effect, the donation is tax-free since the not-for-profit organisation does not pay income tax.

This subverts the intent of the income tax law to limit deductibility to DGRs. It could facilitate the de facto extension of tax deductibility to fees for services such as private schools. Further, by removing the 30% minimum tax, it could facilitate tax avoidance strategies of the kind discussed previously.

Recommendation 5:

To ensure consistent tax treatment of donations by individuals and trusts and the integrity of the income tax system:

- (i) Donations paid to *Deductible Gift Recipients* (DGRs) should be exempted from the 30% minimum tax.**
- (ii) Only donations with the character of *gifts* should be exempted.**
- (iii) Trustees should report to the ATO in timely fashion the name and financial account details of the DGR, and the timing and amount of each donation.**
- (iv) Donations to other income tax exempt entities that are not DGRs should not be exempted from the 30% minimum tax, and they should not be eligible for the related tax offset.**

The Government should commit to timely reform of the scope of DGR status

As ACOSS has argued for many years, the rules around gift deductibility are out of date and not fit for purpose. For example, a charity that advocates to reduce poverty or environmental harms cannot generally secure DGR status unless it is granted to them specifically by the Treasurer of the day. On the other hand, private school building funds have DGR status even though the 'donations' are in many cases surrogate school fees.

The Productivity Commission recommended reforms to address these problems in its 2024 *Report on Philanthropy*, which ACOSS supported. Two decades earlier, the *Charity Definitions Inquiry* recommended major reform of the archaic *Public Benevolent Institution* rules. Reform of DGR status has not been pursued by successive governments. Now is time for the Albanese government to resolve long-standing inequities.

Recommendation 6:

As part of the legislative package implementing these trusts reforms, the Government should extend DGR status to all charities registered with the Australian Charities and Not-for-profits Commission (ACNC), except those whose purposes and activities are solely for the advancement of religion, or the advancement of education through childcare and primary and secondary education (unless the activity is sufficiently related to advancing another charitable purpose) – as recommended by the Productivity Commission.

6. Special tax concessions for testamentary trusts should not extend across multiple generations, nor to minor beneficiaries with a living parent.

The draft legislation exempts testamentary trusts from the 30% minimum tax on discretionary trusts. Two problems with the proposed exemption should be addressed.

First, many testamentary trusts reach beyond a single generation. Where a wealthy individual settles their estate in a discretionary trust, the beneficiaries could include children, grandchildren and great grandchildren, as control of the trust pass down the generations. To the extent that this structure is used to avoid tax (and the 30% minimum tax does not apply), this would entrench inherited wealth inequality.

Second, beneficiaries of testamentary trusts who are minors (children under 18 years) are exempted from the 45% tax rate that would otherwise apply to their investment income. They are instead taxed at their own marginal tax rate (often zero).

The purpose of this penalty tax rate is to prevent wealthy individuals from assigning investment income to minors (usually through discretionary trusts) to avoid tax. The benefits of this investment income are then diverted to the controller of a trust or another adult within the family.

Prior to 2019, a common tax avoidance strategy took advantage of this concessional treatment of children's investment income from testamentary trusts by injecting income not derived from the estate of the deceased into those trusts. In that year, tracing rules were legislated to restrict this concession to income derived from the estate though it can be difficult in practice to separate that from 'other' income injected into a trust.

The concessional tax treatment of the investment income of minor children from a testamentary trust was based on the idea that such children were more disadvantaged than those who received care and support from parents who were still alive. However, this justification does not apply to grandchildren and great-grandchildren of the deceased whose parents are alive and able to support them. In any event, there is no need to distribute investment income directly to

a minor if an adult in the family is responsible for their care (provided they are not orphaned).

The 45% tax rate should apply to distributions of investment income to minors unless they belong to a group specifically excluded in the 2019 legislation referred to above (for example, if they are orphaned).

Recommendation 7:

- (i) If testamentary trusts are exempted from the minimum 30% tax, then at the least such exemption should be time limited (for example, until the youngest direct descendant reaches 18 years).**
- (ii) Investment income distributed by the trustee of a testamentary trust to minors should be taxed at the standard rate of 45% unless the child is an 'excepted person' (for example has a disability or is orphaned) or the income is 'excepted income' (for example from loss of parental support or personal injury).**

7. We support the proposed electable regime for discretionary trusts (EET) provided distributions cannot be made to discretionary trusts, private companies or entities with 'material discretionary elements'.

A key objective of the present reform - which we support - is to encourage replacement of discretionary trusts with simpler and more transparent business and investment vehicles in which entitlements to income for beneficiaries, shareholders or partners are fixed. Over the last three decades, too many business owners and investors have been encouraged to use discretionary trusts and associated 'bucket companies' when simpler, less costly structures would serve them better for purposes other than tax avoidance.

A key obstacle to this transition is the direct costs of transition, including Commonwealth and State taxes such as Capital Gains Tax (CGT) and Stamp Duty. We discuss the proposed CGT rollovers in the next part of this submission.

We welcome the proposed exemption from the 30% minimum tax for trusts that adopt the EET regime, provided it does not facilitate continued use of 'bucket companies' or transfers to entities that replicate the 'discretionary elements' of discretionary trusts.

We support the proposal that an entity cannot be specified as a beneficiary in the EET nomination if it is a complying superannuation entity, partnership or a company with different classes of shares. For consistency and to close off opportunities for avoidance of the minimum tax where there are multiple layers of associated entities, *discretionary trusts and private companies should not be specified* as beneficiaries in an EET nomination - even though those entities might themselves pay a 30% tax on their income.

Beyond tax avoidance purposes, there is simply no need for most investors and business owners use complex multi-tiered ownership structures where a discretionary trust or private company is a beneficiary of a discretionary trust.

The proposed integrity measures associated with this exemption are essential, including the restriction on transfers to entities with 'material discretionary elements' and the revocation of the exemption (together with the 47% penalty tax on the trustee pursuant to Sections 100 and 99 of the Income Tax assessment Act), where the requirements of an election are materially breached.

A degree of flexibility is appropriate to deal with changes in family circumstances such as relationship breakdown or death. There may be a case for continuing to recognise an election (and the associated exemption from the minimum tax) where a new dependent child is added to the family, in which case any distributions to them should attract the 45% tax rate for investment income of minors until they reach 18 years.

Beyond this, greater 'flexibility' would undermine the intent of the reform. If the EET regime does not provide sufficient flexibility, the controllers of a 'minimum tax trust' can choose to continue to allow the trustee to exercise full discretion and pay the minimum tax.

Recommendation 8:

To reduce transition costs while removing tax avoidance opportunities arising from trustees' discretion to shift income to lower-taxed individuals or entities:

- (i) Trustees of existing discretionary trusts should be exempted from the 30% minimum tax if they make an election during 2028-29 to list the current beneficiaries whom they intend to make presently entitled to certain shares of trust income, to the extent that those shares remain unchanged.**
- (ii) The exemption should not apply to trusts that intend to distribute to entities with 'material discretionary elements' including discretionary trusts or partnerships.**
- (iii) The exemption should not apply to trusts that intend to distribute to a company or a superannuation entity.**
- (iv) We support the integrity measures associated with this exemption, including revocation of the exemption, together with the 47% penalty tax on the trustee, if the requirements of the election are materially breached.**
- (v) We support extension of the exemption to trusts that change their list of beneficiaries and allocations of income in response to the death or relationship breakdown of beneficiaries. If this concession is extended to new family members, this should be limited to children of existing beneficiaries born after July 2028, provided they are taxed at the 45% rate applying to their investment income while they are minors (under 18 years).**

8. We support the proposed income tax rollover relief provided distributions cannot be made to entities with 'material discretionary elements', including partnerships

The proposed rollover relief is also needed to facilitate transitions from discretionary trusts to entities without 'material discretionary elements'.

Consistent with this objective, and the proposed EET regime discussed above, partnerships should not be included among the transferee entities attracting the rollover provisions.

The proposed integrity rule that prevents the transferee from preserving material discretion over the economic rights or interests of its members is essential.

Recommendation 9:

We support the proposed transitional roll-over for assets transferred by a 'minimum tax trust' provided the transferee entity is not a tax-exempt entity and does not have material discretionary elements, and all assets are transferred within the prescribed period.

Consistent with the objective to encourage transfers to entities without material discretionary elements:

- (i) The transferee entity should not be a discretionary trust, a partnership or a company with different classes of shares.**

Contact

Dr Peter Davidson
Principal Advisor
peter@acoss.org.au

James Hall
Senior Advisor
james@acoss.org.au