

How private trusts are used to avoid tax

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Purpose

The Government has drafted legislation to impose a [30% minimum tax on discretionary trusts](#) (commonly called 'family trusts'). ACOSS strongly supports this legislation, which helps ensure that individuals with high incomes at least pay the same rate of tax as an average fulltime employee. The purpose of this briefing note is to explain how those trusts are often used by people with high incomes to avoid income tax, undermining fairness in the tax system.

What are discretionary trusts?

A trust is a legal relationship in which a trustee (an individual or a company) holds and manages property, money, or business assets for the benefit of others, known as beneficiaries. A discretionary trust is one in which the trustee has discretion to allocate income or assets each year to different beneficiaries. They are distinct from fixed trusts, in which each beneficiary is entitled to a fixed share of trust income.

Australia has more than one million trusts, of which roughly 840,000 (around 80%) are discretionary trusts.

Discretionary trusts are marketed as an ideal structure to avoid income tax

Instead of receiving business or investment income directly, individuals with high incomes who control the trust ('high-income controllers') receive it through the trust (e.g. the 'A & B construction trust' or the 'X and Y investment trust'). These trusts are used to reduce their effective income tax rates from 47% to much lower levels.

Discretionary trusts have other purposes such as asset protection and holding assets and income on behalf of family members (for example to pass onto them after death). They are also an ideal device to split income with family members on lower tax rates due to:

- their 'flow-through' tax treatment (the trust itself is not generally taxed but trust income is instead held on behalf of beneficiaries who pay tax at their own tax rates), and
- the broad discretionary powers of trustees to decide what (if any) trust income each beneficiary is entitled to each year.

A privately owned 'bucket company' is often added as a beneficiary of the trust so that if income cannot be shifted to family members paying less than a 25-30% tax rate, it is

passed on to the company to take advantage of the gap between the 25-30% company tax rate and the 47% tax rate for individuals with high incomes:

- Tax on the difference between company tax rates and the personal tax rate of the controller can then be deferred or avoided by accumulating income in the company and only distributing it to the controller when they retire and face a much lower tax rate.

Loopholes in tax law make it hard for the ATO to curb avoidance

In theory, each beneficiary is taxed annually on their entitlement to trust income and any income not distributed is taxed at 47% in the hands of the trustee. However, in many cases the income is not used to benefit the beneficiaries. Instead, they lend it back to the trust or transfer it to the controller minus an amount to cover their tax obligations. Although anti-avoidance rules are available to curb these practices, the Australian Taxation Office (ATO) struggles to apply them at scale.

Discretionary trusts are akin to a washing machine, where income is moved around, tangled up, and cleansed of tax.

Individuals with high incomes benefit disproportionately

The outcomes of tax avoidance through discretionary trusts are that:

- Many people who should be paying tax at 47% end up paying much less:
 - Almost two thirds (63%) of all trust and partnership income in 2022-23 (totalling around \$40 billion) accrued to the highest 10% of income earners, whose average income was over \$250,000.
- Substantial resources – at least \$4 billion annually – are wasted on a tax avoidance industry that markets and administers complex structures that many business owners and investors don't really need:

For decades, the ATO has raised concerns about abuse of trusts to avoid tax

The ATO's efforts to curb tax avoidance using private trusts are akin to a 'whack-a-mole' game in which new strategies emerge as quickly as existing ones are shut down. A lack of transparency regarding beneficial ownership and trust accounts makes the ATO's job even harder. On its website it warns taxpayers and their advisers about [Trust activities that attract our attention](#).

Below is one of the simplest examples of the use of discretionary trusts to split income with a family member. There are many other, more complex, ways in which trusts are used by individuals with high incomes to avoid or evade income tax.

Income-splitting using discretionary trusts - how it works

Discretionary trusts (popularly called 'family trusts') are used by individuals on high incomes to split their income with family members on lower tax rates who are beneficiaries of the trust.¹

In some cases, the income is used to benefit the low-income family member. In others, called 'reimbursement agreements', the income is recycled back to the trust or its high-income controller. Reimbursement agreements may be challenged by the ATO but enforcement is difficult when there are over 800,000 discretionary trusts.²

In this example, a high-income controller of a trust on \$200,000 a year – who would normally pay tax on the next dollar at 47% - secures an extra \$100,000 of income.

If he received it directly he would pay \$47,000 in tax on the \$100,000.

Instead the income is generated through a discretionary trust established by the high-income controller for his and his family's benefit. The trustee distributes it to his adult daughter employed part-time on \$20,000 a year.³

She pays \$28,300 in tax on this income, then pays the remaining \$71,700 to her father to reimburse him for private school fees he paid for her in the past.⁴

Outcome: The high-income controller receives \$71,700 (\$100,000-\$28,300) and avoids paying a higher rate of tax.

Tax avoided: \$47,000 - \$28,300 = **\$18,700** (from 47% to 28% of \$100,000)

¹ In theory 'personal service income' rules prevent individuals with high incomes from splitting their earnings (as distinct from investment income) with a family member for tax purposes, but this is difficult to enforce at scale where a business has a mix of income from the labour of its owner together with investments. See ATO [Practical Compliance Guideline PCG 2025/5](#), *Personal services businesses and Part IVA of the Income Tax Assessment Act 1936*.

² See ATO Taxpayer Alert 2022/1 at [TA 2022/1 | Legal database](#).

³ Generally speaking, the investment income of individuals under 18 years is taxed at 47% to prevent income splitting with minor children. However, this does not apply to testamentary trusts.

⁴ If the ATO successfully challenges such reimbursement agreements, the income may be taxed in the hands of the trust at a tax rate of 47%. However, this compliance action requires a case-by-case assessment so enforcement at scale is challenging for the ATO. The main defence for trustees is that the agreement was part of 'ordinary family or business dealing' rather than a scheme to avoid tax (e.g. it is an 'arms-length' arrangement with an intention to charge a commercial rate of interest and expect repayment).

Income splitting with reimbursement

