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Amendments to the Family Trust Election Rules

Family Trust Election Rules - Historically

The family trust election rules were initially introduced to stop, amongst other things, the trafficking of trust losses. The rules however went well beyond this and placed significant restrictions on the ability of trusts to recoup losses and utilise franking credits.

Essentially, the trust loss rules sought to prevent deductions for losses being transferred to persons who did not bear the economic loss. The legislation achieves this aim by examining whether there has been a change in the underlying ownership or control of the trust.

An important concession to these general rules allows certain losses to be recouped where a family trust election is made. Once a trust has elected to be a family trust, distributions are effectively restricted to those entities and individuals that form part of the family group relevant to the "test individual".

Family Trust Election Rules - Amendments

Recent amendments have the effect of providing greater flexibility for family trusts and interposed entities. This is achieved by:

- Allowing family trust and interposed entity elections to be revoked in certain circumstances.
- Allowing the test individual under an election to be changed in certain circumstances.
- Broadening the definition of "family" to include lineal descendants of family members.

- Ensuring that the death of a family member does not itself result in another family member ceasing to be a member of a family group.
- Including former spouses, former widows/widowers and former step children in the family group.

The amendments will have application in the income year ended 30 June 2008 and later income years.

Summary of the changes

1. Family trust elections

The amendments will allow a family trust election to be revoked in limited circumstances. Family trust elections can not be revoked where a family trust election was required for the utilisation of trust losses, bad debt deductions or accessing franking credits.

Under the amendments, the family trust election can be revoked up to four years after the year specified in the family trust election. For example, if a family trust election was made in 2003, the trust has until the end of the 2007 year to revoke the family trust election. A special transitional rule however applies to those elections made more than four years before 1 July 2007. Where relevant, the trustee of a family trust will have until 30 June 2009 in which to revoke any family trust election already made.

If a revocation is made, it must be made by the trustee in writing and in the approved format. It must also specify the year in which the revocation is to be effective, and is to be made in the trust tax return for the income year in which the revocation occurs.

2. Interposed entity elections

An interposed entity election may be revoked where the election was made for an entity that was already included in the family group, or at a later time, where the entity becomes a wholly owned member of the family group. It should be noted that an interposed entity election made in respect of a family trust will automatically be revoked where the family trust election is revoked.

The same time period and requirements apply as explained in relation to the revocation of the family trust election.

3. Test individuals

The amendments allow a once-off variation to the individual test individual (as specified in the family trust election at the election commencement date). This amendment is intended to deal with the situation where a trust has chosen the wrong person in its family trust election, but has always acted in the past as if the proposed new test person was always the test individual. Accordingly, the new test individual must have been alive at the time the original election was made.

In order to nominate a new test person, that person must be a member of the original test individual's family at the election commencement time and no conferrals or distributions of income or capital must have been made (by the trust or an interposed entity) outside the new test individual's group during the period in which the election has been in force.

The same time period and requirements apply as explained in relation to the revocation of the family trust election.

It will also be necessary to amend the test individual in

relation to, for example, any trusts that have elected to be an interposed entity in relation to that particular family trust.

In addition to the above, the amendments also provide that the test individual may be varied if, as a result of a family law obligation arising from a marriage breakdown, the control of the trust passes to a new test person and / or their family members.

4. Former spouse and family members

Under the amendments, trust distributions made to former spouses, former widows/widowers and former step children will not be subject to family trust distributions tax, as these people are now included in the definition of the family group.

5. Different trusts - same test individual

Family trusts that have made a family trust election in respect of the same test individual are now included within each others family groups (no interposed entity election required) and will not be considered to be an "outsider to the trust" for the purposes of the income injection test.

6. Family groups

The definition of family has been expanded to include any lineal descendant of a niece, nephew or child of the test individual or the test individual's spouse. Furthermore, the death of a family member will no longer preclude another family from ceasing to be a family member.

For more information on any aspect of the amendments to the family trust election rules, please do not hesitate to contact Michelle Saunders on (08) 6311 6911 or Marissa Bechta on (08) 6311 6933

cooper
partners

Level 6, London House, 216 St Georges Terrace, Perth WA 6000
t 08 6311 6900 f 08 6311 6999
enquiries@cooperpartners.com.au
www.cooperpartners.com.au

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