

TAXATION OF DISTRIBUTIONS OF BENEFICIARY INCOME FROM TRUSTS TO MINORS

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Taxation of distributions of beneficiary income from trusts to minors

Introduction

The Government announced in the Budget that it will introduce legislation to tax distributions of beneficiary income from trusts to minors at the trustee rate of 33% (“the minor beneficiary rule”). This income is currently taxed at the minor’s marginal tax rate, which can be as low as 19.5%.

The purpose of the rule is to limit the tax benefits of using a trust as a device for splitting income with minors.

Income splitting can occur within a family unit when taxpayers allocate income to other members of the family who face lower marginal tax rates, in order to achieve tax savings. This may involve a person transferring income-producing assets to a trust. The income arising from that asset is then distributed as beneficiary income to minors who are on a low marginal tax rate. This income is often, in substance, not income of the children.

Other than the general anti-avoidance rules in the Income Tax Act 1994, New Zealand does not have specific rules to limit the ability of trusts to be used to split income. Before 1988, the trust taxation rules did contain some limited rules to counter opportunities for income splitting. These rules broadly provided that income of a trust was taxed to the trustee instead of a beneficiary if it remained within the possession or under the control of the trustee; these rules had particular application to infant beneficiaries. These restrictions, however, were generally considered to be ineffective. For example, income could arguably be taxed to an infant beneficiary by passing it through to a sub-trust in the infant beneficiary’s favour.

Rather than placing further restrictions on the ability of the trustees to have income taxed to beneficiaries, the Consultative Committee that developed the current taxation rules in 1988 recommended the removal of these restrictions on income splitting. This was a reflection of the flatter tax rates that New Zealand was moving towards in 1988 which significantly reduced the benefits of income splitting.¹ However, the incentive to use trusts to split income has subsequently increased as a result of the increase in the range to which the lower marginal tax rates apply, the reduction in the lower marginal rate and the increase in the top marginal tax rate to 39%.

¹ The Consultative Committee on Full Imputation and International Tax Reform. *International Tax Reform. Full Imputation. Part 2. Report of The Consultative Committee.* July 1988, p.79.

A number of detailed issues will require analysis in the design and development of this policy. These issues include exceptions from the proposed minor rule, the definition of a “minor” and operational matters.

Submissions

In developing this policy, the Government is seeking the views of interested members of the public on the details of how the Government’s policy should best be implemented.

In particular, the Government wishes to receive submissions that deal with issues such as:

- Appropriate exceptions to the minor beneficiary rule.
- How the term “minor” should be defined.
- Associated operational matters.

Submissions may be made in electronic form to:

policy.webmaster@ird.govt.nz

Alternatively, submissions can be addressed to:

Minor Beneficiary Rule
c/o General Manager
Policy Advice Division
Inland Revenue Department
PO Box 2198
WELLINGTON

Submissions should be made before 24 July 2000. They should include a brief summary of their major points and recommendations. They should also indicate whether it would be acceptable for officials to consult those making the submission to discuss their submission if required.

Application date of the minor beneficiary rule

Legislation for the minor beneficiary rule will be introduced in Parliament later this year, probably in October. Once enacted it will come into effect in respect of income derived from 1 April 2001, or for the equivalent income year.

The rule and its rationale

In a Budget press statement Hon Dr Michael Cullen, Minister of Revenue, stated:

“The Government will introduce legislation this year to require trust distributions of beneficiary income to minors to be taxed at the 33 percent trustee tax rate. This will limit the benefits of any income splitting through directing trust income to children. Currently this income could be taxed at rates as low as 19.5 percent.”

Under current tax law a trust’s annual income is separated into two classes: beneficiary income and trustee income. Beneficiary income is all income earned by a trust in an income year which vests absolutely in the beneficiary, or is distributed to the beneficiary during or within six months after the end of the income year. Trustee income is all of a trust’s annual income which is not beneficiary income. Therefore distributed income is taxed to the beneficiaries, whereas retained income is taxed to the trustees.

Trustee income is taxed at a flat rate of 33%, whereas beneficiary income is taxed at the marginal tax rate of the beneficiaries, which may be as low as 19.5%.

This can encourage parents who are taxed at the 33% or 39% marginal tax rates to settle income-earning assets on a family trust. In the normal course of events parents will fund activities associated with their children from their after-tax income. By using a trust, however, the income is channelled through the trust to the children. That same amount spent on the children, if it covers expenses over and above normal parental obligations, is claimed to be beneficiary income of the children and is consequently taxed at their marginal rate, which is likely to be 19.5%. This income which is claimed to be income of the children is, in substance, often not theirs, and should not qualify for a tax rate set to apply to lower income earners.

For example, Inland Revenue records show that in the 1998 income year, about 3,500 children under the age of six received beneficiary income exceeding \$27 million in total. This is an average of \$7,700 income for each child under the age of six and excludes interest and dividend income distributed by trusts. It seems hard to argue that such substantial income attributed to minors can fairly be said to qualify for tax rates meant to apply to low incomes.

Australia does not allow trust income of child beneficiaries to be taxed as if it were income derived by a low-income earner. Australia taxes beneficiary income of minors at the trustee rate and top personal income tax rate – 47%.

It is proposed that New Zealand follow a similar approach, at the New Zealand trustee rate of 33%, rather than the top personal tax rate of 39%. However, beneficiaries with total income (including beneficiary income) over \$60,000 will be required to pay 39% on any income over \$60,000. The choice of 33% recognises that the alternative is for the income to be accumulated in the trust for the required period (up to 18 months). In that case the 33% trustee rate applies.

The rule will apply only to beneficiary income from trusts for which current law now requires a trust tax return. This excludes, for example, bare trustees, who are merely nominees of the beneficiary. It is not intended that the rule will apply in respect of assets such as bank accounts in the name of children.

The rule will be limited to beneficiary income of minors. It is not proposed that it apply to beneficiary income of spouses, even though it is recognised that, subject to anti-avoidance provisions, income can be allocated to low-income spouses to produce tax benefits. A spouse's income is more likely to be in substance, income of that spouse.

The minor beneficiary rule will apply to distributions from trusts to a non-resident beneficiary where there is a New Zealand resident settlor, subject to the normal double taxation agreement rules.

The issue of distributions to a minor from group investment funds (GIFs) is especially difficult. On the one hand, GIFs are treated as qualifying trusts and consequently should be subject to the rule unless they fit within one of the exceptions. On the other hand, the restrictions on how investments can be made by GIFs means that income splitting opportunities do not arise. Further consideration on GIFs will be undertaken in consultation.

Distributions from unit trusts to a minor will not be subject to the minor beneficiary rule. Unit trusts are not subject to the normal trust taxation rules, but are taxed as companies.

Exceptions to the rule

It is recognised that minors receive income as beneficiaries of a trust in a wide variety of circumstances, some of which do not involve income splitting. For example, a minor may receive income from a trust established for his or her benefit in satisfaction of a claim for damages for loss of parental support through death or injury.

Consequently, it is appropriate to exclude some of these situations from the application of the minor beneficiary rule.

The Australian rules for minor beneficiaries - in Division 6AA of the Income Tax Assessment Act 1936 - contain a number of exclusions from the 47% rate.

For example, excluded are minors who are:

- In full-time employment.
- Entitled to a child disability allowance or disability support pension.
- Disabled or have a continuing inability to work, or are permanently blind.
- Entitled to a double orphan's pension, and who are not wholly or substantially dependent for support on relatives.

- Are unlikely, by reason of permanent disability to be able to engage in full-time employment, and who are not substantially dependent for support on relatives.

The higher tax rate in Australia also does not apply to certain classes of beneficiary income. For example, it does not apply to:

- Income of a trust which arose out of a will, a codicil, intestacy or a court order.
- Income of a trust from property which was transferred to the trust for the benefit of the minor beneficiary as a result of the death of a person if the property came from a policy of life insurance, the proceeds of a provident, benefit, superannuation or retirement fund, or a payment by the employer of a deceased person.
- Income of the trust from property which was transferred to the trust for the benefit of a minor if the property has been received by the transferor from a deceased estate. The exception applies only if the property was transferred within three years of the death of the person from whom the transferor received the property and the amount transferred would have been received by the beneficiary of the trust if the deceased person had died intestate.
- Income arising from the investment of property transferred to the trust for the benefit of the minor beneficiary by way of or in satisfaction of a claim for damages, in certain specified situations (for example, workers compensation).
- Distributions from public funds established for the benefit of persons in necessitous circumstances and maintained exclusively for that purpose.
- Moneys arising from property transferred as a result of family breakdown.
- Income derived from the investment of property held as a result of winnings in legally authorised and conducted lotteries if the beneficiary was the beneficial owner of the prize.

The Australian exclusions concern situations where the potential for income splitting is limited. The New Zealand exceptions will be similar to those in place in Australia, as modified during the consultation process to suit circumstances in New Zealand.

The relevant provisions of the Australian legislation are included as an appendix to this paper, to allow consideration of the appropriateness of these exceptions to New Zealand. Division 6AA is not limited to income derived by minors indirectly through a trust. It applies equally to income derived directly by minors, such as dividends and interest. Income derived directly by minors will not be covered by the New Zealand rule.

Distributions of beneficiary income to minors from the Maori Trustee and Maori authorities will not be subject to the rule. The Maori Trustee is taxed as a Maori authority except in its capacity as a collection and distribution agent for rents, royalties or interest, in which case the Maori Trustee is taxed as if it were beneficially entitled to the income. The appropriate tax treatment of Maori authorities, including the Maori Trustee, is being considered as part of the review of the taxation of Maori authorities.

Definition of a “minor”

How the term “minor” is defined for the purposes of the minor beneficiary rule is necessarily somewhat arbitrary.

The Age of Majority Act 1970 provides that a minor is a person under the age of 20 years, in the absence of an alternative definition or any indication of a contrary intention in specific legislation. The qualifying age of a person is varied in many pieces of legislation, depending on its purpose. Whether a minor includes a person, who is or has been married also depends on the particular legislation.

The preferred age for the purposes of this rule is under the age of 18. This is the age used in Australia. By the time the child is 18, it is considerably less likely that the income will, in substance, be that of the family, rather than that of the minor. The age of 18 is also, for example, the age at which the Minors’ Contracts Act 1961 provides that a contract will be enforceable against a minor.

Operational issues

There are two options for ensuring that the beneficiary income of minors is taxed at a minimum of 33%.

The first option is to tax the beneficiary income as if it were income of the trust. This income is not trustee income but beneficiary income which is taxed at the trust level at a minimum rate of 33%. However, beneficiaries with total income (including beneficiary income), over \$60,000 would need to include in their annual tax return, so much of their beneficiary income as brought their total income over \$60,000. A credit would be given for tax paid at the trust level at 33%, but additional tax would be liable to ensure tax was paid at the correct 39% rate. Minor beneficiaries will not be required to return this beneficiary income in a tax return unless their total income (including beneficiary income) is over \$60,000.

For example, a child earns \$40,000 directly and receives \$30,000 in beneficiary income. The beneficiary income is taxed at 33% in the trust. The child includes \$10,000 in his or her own income with a credit for 33% tax paid at the trust level. Additional tax is payable by the child of 6 cents in the dollar on this \$10,000.

The second option is to continue to require the minor beneficiary to return all the beneficiary income. As is now the case, tax would be deducted by the trustee as agent for the beneficiary, and the child would include the full amount as income in his or her return with a credit for tax paid at the trustee level. The credit would need to be limited to ensure that the beneficiary did not receive a credit for the 33% rate paid on income below \$38,000.

An advantage of the second option is that it may impose lower compliance costs on trustees in terms of the provisional tax rules, however overall, the first option would seem to have lower compliance and administrative costs.

The second option includes all beneficiary income in the child's income so that it is taken into account for determining his or her eligibility for social assistance targeted through the tax system, such as student loan repayment obligations, child support obligations and family assistance. However, given that the measure applies only to child beneficiaries, this is unlikely to affect many.

AUSTRALIAN LEGISLATION

Income Tax Assessment Act 1936

Division 6AA - Income of Certain Children

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INCOME TAX ASSESSMENT ACT 1936

Part III Liability to Taxation Division 6AA Income of Certain Children

102AA Interpretation

(1) Definitions

In this Division, unless the contrary intention appears -

“*agreement*” means any agreement, arrangement, understanding or scheme, whether formal or informal, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings;

“*occupation*” includes any office, employment, trade, business, profession, vocation or calling, but does not include a course of education at a school, college, university or similar institution;

“*property*” means any property, whether real or personal, and includes money.

(2) Reference to derivation of assessable income

In this Division -

(a) a reference to the derivation by a person of assessable income shall be read as including a reference to the inclusion of an amount in the assessable income of the person; and

(b) a reference to the derivation by a person of any assessable income from particular property shall be read as including a reference to the inclusion of an amount in the assessable income of the person in respect of that property.

(3) Reference to share in trust income

In this Division, a reference to the share of a beneficiary of the net income of a trust estate shall be read as a reference to a share of the beneficiary of the net income of a trust estate -

(a) that is included in the assessable income of the beneficiary under section 97 or 100; or

(b) in respect of which the trustee of the trust estate is liable to be assessed and to pay tax in pursuance of section 98.

(4) Reference to income from particular property

A reference in this Division to income that is derived from particular property shall be read as including a reference to income that is derived from property that, in the opinion of the Commissioner, represents that property.

102AB Application of Division

This Division applies in relation to the year of income that commenced on 1 July 1979 and in relation to all subsequent years of income.

102AC Persons to whom Division applies

(1) Prescribed person

For the purposes of this Division, a person is a prescribed person in relation to a year of income if -

(a) the person is less than 18 years of age on the last day of the year of income; and

(b) the person is not an excepted person in relation to the year of income.

(2) Excepted person

Subject to this section, a person (in this subsection referred to as the “minor”) is an excepted person in relation to a year of income for the purposes of this Division if, and only if -

- (a) (Repealed by Act 135 of 1990)
- (b) the minor was engaged in a full-time occupation on the last day of the year of income;
- (c) the minor is a person -
 - (i) in respect of whom a carer allowance under the Social Security Act 1991 was payable in respect of a period that included the last day of the year of income;
 - (ii) to whom a disability support pension under that Act was payable in respect of a period that included the last day of the year of income; or
 - (iii) to whom a rehabilitation allowance under that Act was payable in respect of a period that included the last day of the year of income and who, immediately before becoming eligible to receive that allowance, was eligible to receive an invalid pension under that Act;
- (d) the Commissioner -
 - (i) has received a certificate issued by a legally qualified medical practitioner certifying that the minor is -
 - (A) a disabled child, or a disabled adult, within the meaning of Part 2.19 of the Social Security Act 1991; or
 - (B) a person who has a continuing inability to work within the meaning of Part 2.3 of the Social Security Act 1991 or is permanently blind; and
 - (ii) is satisfied that, on the last day of the year of income, the minor was a person of the kind mentioned in sub-subparagraph (i)(A) or (B);
- (e) a double orphan pension was payable in respect of the minor under the Social Security Act 1991 in respect of a period that included the last day of the year of income;
- (f) but for section 1003 of the Social Security Act 1991, a double orphan pension would have been payable in respect of the minor under that Act in respect of a period that included the last day of the year of income; or
- (g) the Commissioner -
 - (i) has received a certificate issued by a legally qualified medical practitioner certifying that the minor is a person who, by reason of a permanent disability, is unlikely to be able to engage in a full-time occupation; and
 - (ii) is satisfied that, on the last day of the year of income, the minor was such a person.

(3) Dependent person to whom double orphan pension payable not excepted person

Where -

- (a) a double orphan pension was payable, or would, but for section 1003 of the *Social Security Act 1991*, have been payable, in respect of a person under that Act in respect of a period during a year of income, being a period that included the last day of the year of income; and
- (b) during the whole of the period referred to in paragraph (a), the person was wholly or substantially dependent for support on a relative or relatives of the person,

that person shall not be taken by virtue of paragraph (2)(e) or (f) to be an excepted person in relation to the year of income.

(4) Dependent person unlikely to engage in full-time occupation due to permanent disability not excepted person

Where -

- (a) the Commissioner is of the opinion that, during a period during a year of income, being a period that included the last day of the year of income, a person was a person who, by reason of a permanent disability, was unlikely to be able to engage in a full-time occupation; and
- (b) during the whole of the period referred to in paragraph (a), the person was wholly or substantially dependent for support on a relative or relatives of the person,

that person shall not be taken, by virtue of paragraph (2)(g), to be an excepted person in relation to the year of income.

(5) Persons deemed wholly or substantially dependent

For the purposes of subsections (3) and (4), a person shall be taken to have been wholly or substantially dependent for support on a relative or relatives of the person during any period during which that person resided with a relative or relatives of the person unless the contrary is established to the satisfaction of the Commissioner.

(6) Full-time occupation deemed

Subject to this section, a person shall be taken, for the purposes of subsection (2), to have been engaged in a full-time occupation on the last day of a year of income if, and only if -

- (a) the person was, on the last day of the year of income, a person engaged in a full-time occupation; or
- (b) in a case to which paragraph (a) does not apply - the person was engaged in a full-time occupation during the year of income for a period of not less than 3 months or for periods the aggregate of which is not less than 3 months.

(7) Period of full-time education to be disregarded

Where -

- (a) during a period during a year of income, a person was engaged in a full-time occupation; and
- (b) during the year of income and after the expiration of that period, the person was engaged in a course of full-time education at a school, college, university or similar institution,

no regard shall be had to that period in determining whether the person is to be taken, by virtue of paragraph (6)(b), to have been engaged in a full-time occupation on the last day of the year of income.

(8) Commissioner's satisfaction regarding intention

A person shall not be taken to have been engaged in a full-time occupation on the last day of a year of income unless the Commissioner is satisfied that, on that day -

- (a) the person had the intention of engaging in a full-time occupation or full-time occupations during the whole or a substantial part of the next succeeding year of income; and
- (b) the person did not have the intention of engaging in a course of full-time education at a school, college, university or similar institution at any time during the next succeeding year of income.

102AD Taxable income to which Division applies

The eligible taxable income of a year of income of a person who is a prescribed person in relation to the year of income is the amount (if any) remaining after deducting from the eligible assessable income of the person of the year of income -

- (a) any deductions allowable to the person in relation to the year of income that relate exclusively to that eligible assessable income;
- (b) so much of any other deductions (other than apportionable deductions) allowable to the person in relation to the year of income as, in the opinion of the Commissioner, may appropriately be related to that eligible assessable income; and
- (c) the amount that bears to the apportionable deductions allowable to the person in relation to the year of income the same proportion as the amount that, but for this paragraph, would be the eligible taxable income of the person of the year of income bears to the sum of -
 - (i) the taxable income of the person of the year of income; and
 - (ii) the apportionable deductions allowable to the person in relation to the year of income.

102AE Eligible assessable income

(1) Definition

For the purposes of this Division, the eligible assessable income of a year of income of a person is so much of the assessable income of the person of the year of income as is not excepted assessable income.

(2) Excepted assessable income

Subject to this section, an amount included in the assessable income of a person (in this subsection referred to as the “minor”) is excepted assessable income to the extent to which the amount -

- (a) is employment income or business income;
- (b) is derived by the minor from the investment of any property transferred to the minor -
 - (i) by way of, or in satisfaction of a claim for, damages in respect of -
 - (A) loss by the minor of parental support; or
 - (B) personal injury to the minor, any disease suffered by the minor or any impairment of the minor's physical or mental condition;
 - (ii) pursuant to any law relating to worker's compensation;
 - (iii) pursuant to any law relating to the payment of compensation in respect of criminal injuries;
 - (iv) directly as the result of the death of another person and under the terms of a policy of life assurance;
 - (v) directly as the result of the death of another person and out of a provident, benefit, superannuation or retirement fund;
 - (vi) directly as the result of the death of another person by an employer of the deceased person;
 - (vii) out of a public fund established and maintained exclusively for the relief of persons in necessitous circumstances;
 - (viii) as the result of a family breakdown (see section 102AGA); or

- (c) is derived by the minor from the investment of any property -
 - (i) that devolved upon the minor from the estate of a deceased person;
 - (ii) that was transferred to the minor by another person out of property that devolved upon that other person from the estate of a deceased person and was so transferred within 3 years after the date of the death of the deceased person; or
 - (iii) that was acquired by the minor as the beneficial owner of a verifiable prize in a legally authorised and conducted lottery;
- (d) not being business income, is included in the assessable income of the minor under section 92;
- (e) is included in the assessable income of the minor under section 97 or 100; or
- (f) is derived by the minor from the investment of any property that, in the opinion of the Commissioner, represents accumulations of -
 - (i) excepted assessable income derived by the minor during a year of income in relation to which this Division applies;
 - (ii) assessable income derived by the minor during a year of income in relation to which this Division does not apply, being assessable income that would, in the opinion of the Commissioner, have been excepted assessable income if this Division were applicable in relation to the year of income during which the assessable income was derived; or
 - (iii) exempt income derived by the minor to which subparagraph (i) or (ii) would, in the opinion of the Commissioner, apply if that exempt income had been assessable income.

(3) Reference to income of minor under s 92

A reference in paragraph (2)(d) to an amount (not being business income) that is included in the assessable income of a person under section 92 in respect of the individual interest of the person in the net income of a partnership shall be read as a reference to so much of an amount so included in that assessable income as, in the opinion of the Commissioner, is attributable to so much of the assessable income of the partnership as would, in the opinion of the Commissioner, have been excepted assessable income if the assessable income of the partnership had been derived by that person.

(4) Reference to income of minor under s 97 or s 100

A reference in paragraph (2)(e) to an amount included in the assessable income of a person under section 97 or 100 shall be read as not including a reference to any part to which this Division applies of an amount included in that assessable income under either of those sections.

(5) Reference to business income

Subject to subsections (6) and (7), a reference in paragraph (2)(a), in relation to a person (in this subsection referred to as the “minor”), to business income shall, in relation to any business income derived by the minor during a year of income from the carrying on of a business, be read as a reference to -

- (a) in a case where during the year of income, the business was carried on by the minor either alone or in partnership with another person who was, or other persons each of whom was, under the age of 18 years on the first day of the year of income - so much of that business income as the Commissioner considers fair and reasonable having regard to -
 - (i) the extent to which, during the year of income, the minor had the real and effective conduct and control of the business and participated in the operations and activities of the business;

(ii) the extent to which the minor had the real and effective control over the disposal of income derived by the minor from the business during the year of income;

(iii) the extent to which the capital of the business consisted of property contributed by the minor, being property the income from which would, in the opinion of the Commissioner, be excepted assessable income in relation to the minor; and

(iv) such other matters (if any) as the Commissioner thinks fit; and

(b) in any other case - the amount that, in the opinion of the Commissioner, is reasonable remuneration by way of salary or wages for any services rendered by the minor during the year of income in the production of assessable income of the business increased by such amount (if any) as, in the opinion of the Commissioner, is reasonable, having regard to the extent to which the capital of the business consisted of property contributed by the minor the income from which would, in the opinion of the Commissioner, be excepted assessable income in relation to the minor.

(6) Excepted assessable income not to exceed arm's length amount

Subject to subsection (7), if any 2 or more parties to:

(a) the derivation of the excepted assessable income mentioned in subsection (2);

or

(b) any act or transaction directly or indirectly connected with the derivation of that excepted assessable income;

were not dealing with each other at arm's length in relation to the derivation, or in relation to the act or transaction, the excepted assessable income is only so much (if any) of that income as would have been derived if they had been dealing with each other at arm's length in relation to the derivation, or in relation to the act or transaction.

(7) Subsection (2) not to apply where agreement intended to secure eligible assessable income

Subsection (2) does not apply in relation to assessable income derived by a person directly or indirectly under or as a result of an agreement that was entered into or carried out by any person (whether before or after the commencement of this subsection) for the purpose, or for purposes that included the purpose, of securing that that assessable income would not be eligible assessable income.

(8) Incidental purpose disregarded

In determining whether subsection (7) applies in relation to an agreement, no regard shall be had to a purpose that is a merely incidental purpose.

(9) Application of subs (2)(b) as Commissioner considers fair and reasonable

Where -

(a) any assessable income is derived by a person from the investment of any property transferred to the person by way of, or in satisfaction of a claim for, damages in respect of -

(i) loss by the person of parental support; or

(ii) personal injury to the person, any disease suffered by the person or any impairment of the person's physical or mental condition; and

(b) that property was transferred to that person otherwise than in pursuance of an order of a court,

paragraph (2)(b) applies only to so much (if any) of that assessable income as the Commissioner considers fair and reasonable.

(10) Assessable income of minor from property transferred by another person from estate of deceased person

Where -

(a) the assessable income of a person (in this subsection referred to as the “minor”) of a year of income -

(i) includes an amount derived by the minor from property that -

(A) was transferred to the minor by another person out of property that devolved upon that other person from the estate of a deceased person; and

(B) was so transferred within 3 years after the date of the death of the deceased person,

but does not include any amount that -

(C) was derived by the minor from property that devolved upon the minor from the estate of that deceased person; or

(D) is included in the assessable income of the minor under section 97 or 100 in respect of the share of the minor of the net income of a trust estate that resulted from a will or codicil of that deceased person, an order of a court that varied or modified the provisions of a will or codicil of that deceased person, a partial intestacy of that deceased person or an order of a court that varied or modified the application, in relation to the estate of that deceased person, of the provisions of the law relating to the distribution of the estates of persons who die intestate; or

(ii) includes an amount derived by the minor from property that -

(A) was transferred to the minor by another person out of property that devolved upon that other person from the estate of a deceased person; and

(B) was so transferred within 3 years after the date of death of the deceased person,

and also included an amount or amounts to which sub-subparagraph

(i)(C) or (D) applies; and

(b) the amount to which subparagraph (a)(i) applies or the sum of the amounts to which subparagraph (a)(ii) applies, as the case may be, exceeds the amount that, in the opinion of the Commissioner, would have been included in the assessable income of the minor of the year of income in respect of an amount or amounts derived by the minor from property that, in the opinion of the Commissioner, would have devolved upon or for the benefit of the minor from the estate of that deceased person if that deceased person had died intestate,

the amount of the assessable income of the minor of the year of income that would, apart from this subsection, have been excepted assessable income by virtue of subparagraph (2)(c)(ii) shall be reduced by the amount of that excess.

102AF Employment income and business income

(1) Reference to employment income

Subject to subsection (2), a reference in this Division to employment income shall be read as a reference to -

(a) salary or wages within the meaning of Division 2 of Part VI; and

(b) payments made for services rendered or to be rendered.

(2) Definition of salary or wages in s 221A(1)

For the purpose of the application, for the purposes of paragraph (1)(a), of the definition of “salary or wages” in subsection 221A(1), paragraph (f) of that definition shall be read as if the words “, but not including payments made under a policy of insurance to the owner of the policy” were omitted.

(3) Reference to business income

In this Division, a reference, in relation to a person in relation to a year of income, to business income shall be read as a reference to income derived by the person during the year of income from carrying on of a business either alone or together with another person or other persons.

102AG Trust income to which Division applies

(1) Trust income that is not excepted trust income

Where a beneficiary of a trust estate is a prescribed person in relation to a year of income, this Division applies to so much of the share of the beneficiary of the net income of the trust estate of the year of income as, in the opinion of the Commissioner, is attributable to assessable income of the trust estate that is not, in relation to that beneficiary, excepted trust income.

(2) Excepted trust income

Subject to this section, an amount included in the assessable income of a trust estate is excepted trust income in relation to a beneficiary of the trust estate to the extent to which the amount -

- (a) is assessable income of a trust estate that resulted from -
 - (i) a will, codicil or an order of a court that varied or modified the provisions of a will or codicil; or
 - (ii) an intestacy or an order of a court that varied or modified the application, in relation to the estate of a deceased person, of the provisions of the law relating to the distribution of the estates of persons who die intestate;
- (b) is employment income;
- (c) is derived by the trustee of the trust estate from the investment of any property transferred to the trustee for the benefit of the beneficiary -
 - (i) by way of, or in satisfaction of a claim for, damages in respect of -
 - (A) loss by the beneficiary of parental support; or
 - (B) personal injury to the beneficiary, any disease suffered by the beneficiary or any impairment of the beneficiary's physical or mental condition;
 - (ii) pursuant to any law relating to worker's compensation;
 - (iii) pursuant to any law relating to the payment of compensation in respect of criminal injuries;
 - (iv) directly as the result of the death of a person and under the terms of a policy of life insurance;
 - (v) directly as the result of the death of a person and out of a provident, benefit, superannuation or retirement fund;
 - (vi) directly as the result of the death of a person by an employer of the deceased person;
 - (vii) out of a public fund established and maintained exclusively for the relief of persons in necessitous circumstances; or
 - (viii) as the result of a family breakdown (see section 102AGA);

- (d) is derived by the trustee of the trust estate from the investment of any property -
- (i) that devolved for the benefit of the beneficiary from the estate of a deceased person;
 - (ii) that was transferred to the trustee for the benefit of the beneficiary by another person out of property that devolved upon that other person from the estate of a deceased person and was so transferred within 3 years after the date of the death of the deceased person; or
 - (iii) being a verifiable prize in a legally authorised and conducted lottery and being a prize of which the beneficiary is the beneficial owner; or
- (e) is derived by the trustee of the trust estate from the investment of any property that, in the opinion of the Commissioner, represents accumulations of -
- (i) assessable income derived by the trustee during a year of income in relation to which this Division applies, being assessable income that, in relation to the beneficiary, is excepted trust income;
 - (ii) assessable income derived by the trustee during a year of income in relation to which this Division does not apply, being assessable income that would, in the opinion of the Commissioner, have been excepted trust income in relation to the beneficiary if this Division were applicable in relation to the year of income during which the assessable income was derived; or
 - (iii) exempt income derived by the trustee to which subparagraph (i) or (ii) would, in the opinion of the Commissioner, apply if that exempt income had been assessable income.

(2A) Beneficiary must acquire trust property

Paragraph (2)(c) or subparagraph (2)(d)(ii) does not apply unless the beneficiary of the trust concerned will, under the terms of the trust, acquire the trust property (other than as a trustee) when the trust ends.

(3) Excepted trust income not to exceed arm's length amount

Subject to subsection (4), if any 2 or more parties to:

- (a) the derivation of the excepted trust income mentioned in subsection (2); or
- (b) 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 in relation to the derivation, or in relation to the act or transaction, the excepted trust income is only so much (if any) of that income as would have been derived if they had been dealing with each other at arm's length in relation to the derivation, or in relation to the act or transaction.

(4) Subsection (2) not to apply where agreement intended to secure excepted trust income

Subsection (2) does not apply in relation to assessable income derived by a trustee directly or indirectly under or as a result of an agreement that was entered into or carried out by any person (whether before or after the commencement of this subsection) for the purpose, or for purposes that included the purpose, of securing that that assessable income would be excepted trust income.

(5) Incidental purpose disregarded

In determining whether subsection (4) applies in relation to an agreement, no regard shall be had to a purpose that is a merely incidental purpose.

(5A) Payment for services rendered by beneficiary

In the application of paragraph 102AF(1)(b) for the purposes of the application of paragraph (2)(b) of this section in relation to a beneficiary of a trust estate, payments made for services rendered or to be rendered shall not be taken to be employment income unless the services are rendered or to be rendered by the beneficiary.

(6) Application of subs (2)(c) as Commissioner considers fair and reasonable

Where -

(a) any assessable income is derived by a trustee of a trust estate from the investment of any property transferred to the trustee for the benefit of a beneficiary of the trust estate by way of, or in satisfaction of a claim for, damages in respect of -

- (i) loss by the beneficiary of parental support; or
- (ii) personal injury to the beneficiary, any disease suffered by the beneficiary or any impairment of the beneficiary's physical or mental condition; and

(b) that property was transferred to the trustee otherwise than in pursuance of an order of a court,

paragraph (2)(c) applies only to so much (if any) of that assessable income as the Commissioner considers fair and reasonable.

(7) Assessable trust income shall be reduced

Where -

(a) any assessable income is derived by a trustee of a trust estate from the investment of any property transferred to the trustee for the benefit of a beneficiary of the trust estate by another person out of property that devolved upon that other person from the estate of a deceased person and was so transferred to the trustee within 3 years after the date of death of the deceased person; and

(b) the amount referred to in paragraph (a) or, if the assessable income of that beneficiary of the year of income includes any amount that -

- (i) was derived by the beneficiary from property that was transferred to the beneficiary by another person out of property that devolved upon that other person from the estate of that deceased person and was so transferred within 3 years after the date of death of that deceased person;
- (ii) was derived by the beneficiary from property that devolved upon the beneficiary from the estate of that deceased person; or
- (iii) is included in that assessable income under section 97 or 100 in respect of the share of that beneficiary of the net income of another trust estate, being a trust estate that resulted from a will or codicil of that deceased person, an order of a court that varied or modified the provisions of a will or codicil of that deceased person, a partial intestacy of that deceased person or an order of a court that varied or modified the application, in relation to the estate of that deceased person, of the provisions of the law relating to the distribution of estates of persons who die intestate,

the sum of the amount referred to in paragraph (a) and the amount or amounts applicable by virtue of subparagraphs (i), (ii) or (iii) of this paragraph, exceeds the amount that, in the opinion of the Commissioner, would have been included in the assessable income of the beneficiary of the year of income in respect of an amount or amounts derived by the beneficiary from property that, in the opinion of the Commissioner, would have devolved directly upon that beneficiary if that deceased person had died intestate,

the amount of the assessable income of the trust estate that would, apart from this subsection, have been excepted trust income in relation to that beneficiary by virtue of subparagraph (2)(d)(ii) shall be reduced by the amount of that excess.

(8) Property deemed transferred for benefit of beneficiaries

For the purposes of this section, where -

- (a) any property is transferred to the trustee of a trust estate; and
- (b) the trustee has a discretion to pay or apply the income derived from that property to or for the benefit of specified beneficiaries or beneficiaries included in a specified class of beneficiaries,

that property shall be taken to have been transferred to the trustee for the benefit of each of those specified beneficiaries or for each of the beneficiaries in that specified class of beneficiaries, as the case may be.

102AGA Transfer of property as the result of a family breakdown

(1) Definitions

For the purposes of subparagraph 102AE(2)(b)(viii) or 102AG(2)(c)(viii), the transfer of property (the “**subject property**”) by a person the “**transferor**”):

- (a) to the minor mentioned in subparagraph 102AE(2)(b)(viii); or
- (b) to the trustee mentioned in subparagraph 102AG(2)(c)(viii) for the benefit of the beneficiary mentioned in that subparagraph;

is “**as the result of a family breakdown**” if the requirements of subsection (2) or (3) of this section are met.

(2) Circumstance of family breakdown

The transfer will be as the result of a family breakdown if:

- (a) a person ceases to live with another person as the spouse of that person on a genuine domestic basis (whether or not legally married to that person); and
- (b) at least one of the persons:
 - (i) is the natural parent; or
 - (ii) is the adoptive parent; or
 - (iii) is the step-parent; or
 - (iv) has legal custody or guardianship;

of the minor or the beneficiary; and

- (c) an order, determination or assessment of a court, person or body (whether or not in Australia) is made wholly or partly because the person has ceased to live as the spouse of the other person on a genuine domestic basis; and
- (d) the effect of the order, determination or assessment is that a person (whether one of the spouses, the transferor or any other person) becomes subject to a legal obligation to maintain, transfer property to, or do some other thing for the benefit of, the minor or beneficiary or one of the spouses; and

(e) the transferor transfers the subject property to the minor, or to the trustee for the benefit of the beneficiary, in giving effect to the legal obligation (including in discharging the legal obligation if it falls on someone else, and whether or not the legal obligation could have been given effect in some other way).

(3) Transfer result of family breakdown

The transfer will also be as a result of a family breakdown if:

- (a) when the minor or beneficiary is born, his or her natural parents are not living together as spouses on a genuine domestic basis (whether or not legally married); and
- (b) an order, determination or assessment of a court, person or body (whether or not in Australia) is made wholly or partly because the natural parents are not living together as mentioned in paragraph (a); and
- (c) the effect of the order, determination or assessment is that a person (whether one of the natural parents, the transferor or any other person) becomes subject to a legal obligation to maintain, transfer property to, or do some other thing for the benefit of, the minor or beneficiary or one of the natural parents of the minor or beneficiary; and
- (d) the transferor transfers the subject property to the minor, or to the trustee for the benefit of the beneficiary, in giving effect to the legal obligations (including in discharging the legal obligation if it falls on someone else, and whether or not the legal obligation could have been given effect in some other way).

102AH Commissioner may allow rebate

(1) Fair and reasonable tax rebate

Subject to this section, where it is established to the satisfaction of the Commissioner that, in relation to income derived during a year of income by a prescribed person, or by a trustee on behalf of a prescribed person, under arrangements entered into on or before 26 July 1979, it would be unreasonable that the whole of the additional amount of tax payable in respect of that income by virtue of the application of this Division should be payable, the Commissioner may grant to the prescribed person or the trustee, as the case may be, in an assessment in respect of any such income, a rebate of tax of such amount (if any) as the Commissioner considers fair and reasonable, not exceeding that additional amount.

(2) Condition for rebate where parents of prescribed person have taxable income

In a case where a parent of the prescribed person, or the parents of the prescribed person, has or have in relation to the year of income a taxable income or taxable incomes, neither the prescribed person nor any trustee is entitled to a rebate under subsection (1) in relation to income that is subject to tax by virtue of the application of this Division, unless it is established to the Commissioner's satisfaction that the tax payable in respect of that income under this Act, apart from this section and section 102AJ, is greater than the tax that would have been payable in respect of that income if the parent of the prescribed person who has the higher taxable income (or in a case where the parents have equal taxable incomes, the father) had been liable to pay tax in respect of an amount equal to the taxable income of that parent increased by so much of the aggregate of the incomes of the children of that parent, or of trustees for the children, as represents income to which this Division applies that was derived under arrangements entered into on or before 26 July 1979.

(3) Relevant factors in determining amount of rebate

In determining the amount of any rebate that may be granted to a person in accordance with subsection (1) -

(a) the Commissioner may, if he is satisfied that the aggregated taxable income referred to in subsection (2) was, by reason of any tax avoidance agreement, lower than it would have been but for any such agreement, take that factor into account as a factor operating against the granting of the rebate; and

(b) the Commissioner may have regard to such other matters as he thinks fit.

(4) Discretion to disallow or reduce rebate

Where the Commissioner, in an assessment, has granted a rebate to a person under this section and the Commissioner subsequently forms the opinion that the rebate should not have been granted or that a lesser rebate should have been granted, nothing in section 170 prevents the amendment of the assessment for the purpose of disallowing or reducing the rebate, as the case may be.

(5) Discretion to grant or increase rebate at any time

Nothing in section 170 prevents the amendment of an assessment at any time for the purpose of granting a rebate under this section or increasing a rebate granted under this section.

(6) Definition of “tax avoidance agreement”

In this section, “tax avoidance agreement” means an agreement, not being an agreement entered into or carried out in the course of ordinary family or commercial dealing, that was entered into or carried out by any person for the purpose, or for purposes that included the purpose, of securing that a person who, if the agreement had not been entered into or carried out, would have been liable to pay income tax in respect of a year of income would not be liable to pay income tax in respect of that year of income or would be liable to pay less income tax in respect of that year of income than that person would have been liable to pay if the agreement had not been entered into or carried out.

102AJ Rebate in case of serious hardship

(1) Right to tax rebate

In any case where it is established to the satisfaction of the Commissioner that -

(a) the tax that, apart from this section and apart from section 265, would be payable by a person in respect of a year of income exceeds the tax that, apart from section 265, would be payable by the person in respect of that year of income if this Division had not been enacted; and

(b) for any reason, the exaction of the full amount of tax that, apart from this section and apart from section 265, would be payable by the person in respect of that year of income would entail serious hardship,

that person is entitled, in his assessment in respect of that year of income, to a rebate of tax of such amount, not exceeding the amount of the excess referred to in paragraph (a), as the Commissioner considers reasonable.

(2) Reference to tax payable by a person

A reference in subsection (1) to tax payable by a person shall be read as including a reference to tax payable by a trustee of a trust estate in pursuance of section 98 in respect of a share of a beneficiary of the net income of the trust estate.

(3) Discretion to grant or increase rebate at any time

Nothing in section 170 prevents the amendment of an assessment at any time for the purpose of granting a rebate under this section or increasing a rebate granted under this section.