FINANCIAL REVIEW

'It's all pervasive': ATO's blitz on family trusts threatens financial ruin

Wealthy families are being hit with huge bills for unpaid taxes and penalties as the Australian Taxation Office uses sweeping powers to investigate taxes on family trust distributions dating back more than 30 years.

Experts said the ATO enforcement action could destroy the wealth built up over generations by some of the nation's most successful private businesses.

The crackdown is associated with what are known as family trust elections and the payment of distributions tax dating back to 1998. **Bethany Rae**

Bills were running into the hundreds of millions for some families, leading to their "possible financial ruin", and had the potential to amount to billions of dollars across the country, should the ATO decide to pursue the matter widely, Arnold Bloch Leibler tax partner Jonathan Ortner said.

"The consequences are severe for businesses of all shapes and sizes," Ortner said. "The farmers are impacted by this, the fruit shop owner on the corner, the mum and dad investors and the large private groups. It is all pervasive."

The crackdown is associated with what are known as family trust elections and the payment of family trust distributions tax dating back to 1998, when the tax was first introduced to combat tax avoidance schemes.

At issue is whether incorrect distributions made by some family trusts went untaxed when they should have been taxed at 47 per cent.

Ortner said many of the underestimates of tax payable would have been made in error by suburban accountants trying to apply hideously complex tax laws, rather than with the intent of avoiding tax.

Arnold Bloch Leibler tax partner Jonathan Ortner.

BDO tax partner Mark Molesworth is calling on whoever wins Saturday's election to review whether the family trust distributions tax law remains fit for purpose.

"There are tax rules applying that have unfair and unexpected outcomes where there is no policy rationale for those and no mischief that needs to be addressed," Molesworth said.

Under the law, a family trust election, which nominates one person, such as the patriarch or matriarch, as the "test individual", is what designates a trust as a family trust.

Family trusts can access tax concessions, such as the ability to distribute money tax-free or pass on franking credits to trusts controlled by beneficiaries, provided those trusts are in the same family group and have nominated the same test individual.

But a family trust election can be made only once, and cannot be revoked, and since the law was enacted, family groups have become increasingly complex due to divorces, remarriages and de facto relationships, successive generations being added to family groups and test individuals dying.

Calls for discretion

Ortner says the complexity of the law – and of today's private wealth groups – means that "mistakes are very common".

"I truly believe that neither parliament nor the ATO in the 1990s fully thought through, or could comprehend, what a private group might look like in 2025."

The ATO recently named the tax risks associated with succession planning as a key focus of its private wealth division for 2025, and sources say all tax office risk reviews of private groups now contain a question about their family trust elections.

But they are critical of the way the ATO is pursuing the matters – its investigations date back to 1998 in some cases, resulting in the interest charges outstripping any back taxes found to be owing.

An ATO spokesperson confirmed that it had seen an increase in the number of family trust election issues because of factors such as "poor tax governance and a lack of understanding by taxpayers of how the relevant law applies", but said that it did not "actively review periods back to 1998".

Molesworth said the ATO had "no explicit discretion under the law to 'excuse' a mischief-free technical breach", but Ortner said it did have some discretion over how far back it chose to look for mistakes.

He said that in the context of other trust tax liabilities, "the ATO – to its credit – adopts a practical administrative practice of only going back four years unless there has been fraud or evasion".

"This very practice should be adopted by the ATO in relation to family trust distribution tax to give certainty to the market that innocent and inadvertent errors (of which there are many) will not put that family group at risk of financial ruin."

But the ATO said that because the family trust distribution tax – if due – automatically became a debt due to the Commonwealth 21 days after a distribution was made, "compliance administrative approaches ... are not able to be applied".

Ortner said the pursuit of back taxes and the interest on these was costing some family trusts hundreds of millions of dollars and that the ATO's actions had the potential to force some trustees into insolvency and directors into bankruptcy, if they were unable to meet their tax liabilities.

"If the trustee can't pay the debt, the commissioner can go after the individual directors. And if they can't pay the debt, the family group may go insolvent and the directors may go bankrupt," Ortner said

"That is on the horizon for groups in reviews at the moment. It is certainly a real risk, and it will depend on how the matter proceeds between the taxpayer and the ATO."

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