

Please consider the following.

Taxation of Non-fixed Trusts
Comments on draft legislation

- 1) Amongst the assets to be disregarded in the calculation of available profits is, at Item 1.2, "Rights that the non-fixed trust has under a loan by the trust that is a distribution". Paragraph 4.10 of the Explanatory Memorandum says that such a loan is disregarded "as this asset has already been dealt with as being distributed to members". This treatment ignores the circumstance that the debt is repayable and fails to deal with the situation that will apply where such a loan is repaid. Assume that a trust has contributed capital of \$10 and available profits of \$90, represented by cash of \$100. If a loan is made to the beneficiary of \$100, the beneficiary would be taxed on the distribution as an unfranked distribution and, for tax purposes, the trust would then have no available profits. When the beneficiary repays the loan, the asset of the trust becomes cash and for tax purposes the cash would represent available profits of \$100. Any subsequent distribution of the available profits would again be treated as a distribution, although frankable.
- 2) A non-fixed trust is taken to make a distribution to a member of the trust if the trust makes a payment to the member and the payment is remuneration for services rendered, or a retiring allowance and the amount of the payment exceeds an amount that the Commissioner considers reasonable. The amount of the distribution is the amount of the excess. The excess is not an allowable deduction for the trust (s.156-92). The provision that is intended to prevent double taxation of distributions, in this case, as a salary or termination payment and as a distribution, does not appear to apply ie. because there is no reference to s.156-92 (see below). 156-115 Distribution benefits otherwise assessed, or not included in assessable income, under other provisions [109L]
“(1) A *non-fixed trust is not taken under section 156-75 (distribution benefits) or 156-80 (loans) to make a distribution because of:
(a) a *distribution benefit the trust provides to you; or
(b) a *loan the trust makes to you;
to the extent that the distribution benefit or loan would be included in your assessable income apart from Subdivision 156-C.”(Words in brackets inserted)
Quite apart from this, the provision appears to be inconsistent with the Reasonable Benefit regime applying to superannuation and other termination payments. Under the existing law, a termination payment in excess of the recipient's Reasonable Benefit Limit attracts tax at the rate of 48.5% and if the payment is made directly by the employer to the employee, it may attract the termination payment surcharge, resulting in a further 15% tax.
- 3) A non-commercial loan made by a non-fixed trust to a member or an associate that is not repaid at the end of the year in which the loan is made is treated as a distribution. This provision does not apply to loans made before 1 July 2001 but, if the terms of a loan made before 1 July 2001 are varied by extending the term of the loan or increasing its amount, the provisions apply as if the loan were made on the new terms when the variation occurred. This treatment is harsh; ie the whole of the loan is treated as having been distributed on the date that the variation occurs. A fairer treatment would recognise that the benefit to a borrower of a loan (that has to be repaid) is not the principal of the loan but is the benefit of the use of the money for a period that is calculated by reference to an interest rate. Thus, the taxable value of a loan fringe benefit is calculated by applying an interest rate to the loan.
- 4) In relation to commercial loans made by the non-fixed trust, there will not be any amount treated as a distribution unless the minimum yearly repayment (of interest and principal) requirements are not satisfied. The amount of the distribution is taken to be the amount of the loan that remains unpaid at the end of the year in which the shortfall in repayment occurs. A shortfall in repayments by \$1 would give rise to the unpaid balance of the loan being treated as a distribution. The policy objectives of the legislation could still be achieved by simply treating the amount of the shortfall as the amount of the distribution.
- 5) A distribution of bonus units is treated as a distribution from profits equal to the amount of the distribution taken to have been provided for by the issue of the units. It is difficult to see how there would be a distribution of anything if the bonus units were issued to all unit holders in proportion to their existing holdings

- 6) Under this legislation any taxpayer who borrows from a trust or is repaid a loan to the trust is walking into an ambush and there will be many casualties from unknown unfranked distributions. Riding a bicycle at night without lights should not be a hanging offence. Why does a commercial loan have to be made under a written agreement? Why must the agreement be made before the loan is made? Most taxpayers will not be aware of these provisions until after the event when it will be too late.
- 7) Division 6 avoids all the unnecessary complexity of the profits first rule. Why change? Under Division 6 taxpayers can limit tax to 30% if a company is made presently entitled to the income. Under this legislation the tax can be limited to 30% also. All the legislation will achieve is to heavily penalise anyone who does not follow the precise steps required to withdraw funds from a trust in a tax efficient way.

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