31 October 2000

The Assistant Commissioner
Law Design and Development (Entities)
P O Box 900
CIVIC SQUARE ACT 2608

Dear Sir/Madam

ENTITY TAXATION – *NEW BUSINESS TAX SYSTEM (ENTITY TAXATION) BILL 2000* (DRAFT)

This letter is written to provide comment on the exposure draft of proposed legislation under the title "*New Business Tax System (Entity Taxation) Bill 2000".*

I will confine my remarks to one aspect of this proposed Bill which I believe has not received significant publicity, and in respect of which, I suggest, the Overview document *Entity Taxation – Taxing Trusts Like Companies* may in part be misleading.

On page 7 of that Overview, the following paragraph appears in a comparison of entity taxation rules and the current law:

> Fixed trusts (and companies) to be able to frank distributions to their members, so that income tax paid at the trust level is imputed to members.

This remark, which appears in a table that has received wide circulation, is only modified after a careful reading of the following sentence appearing on page 5 of that Overview.

> Consistent with the current rules governing the flowthrough of franking rebates to beneficiaries of non-fixed trusts, beneficiaries of a non-fixed **family** trust will be entitled to a franking rebate (emphasis added).

You will have received numerous representations, I am sure, criticising the definition of fixed and non-fixed trusts, drawing on the definition of a fixed entitlement found in Division 272, which in turn is found in Schedule 2F to the *Income Tax Assessment Act 1936*, and in particular to the requirement that under that definition a beneficiary has a fixed entitlement only where there is a "fixed and indefeasible interest" to income as it arises and to the capital of the trust.

Suffice it to say that many trusts falling outside of the scope of discretionary trusts will be non-fixed trusts. In particular, many of these will be unit trusts, a form adopted widely for the conduct of businesses or the making of investments by parties at arms length from the other, where no individual or group is dominant.

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If this definition remains unchanged, double taxation will follow if other amendments are not made to Division 272 or unless the criteria for the availability of franking credits is modified.

The reason for this is simply that many non-fixed trusts will be unable to make a family trust election, which I presume is a requirement eluded to (but not spelt out) by the use of the word "family" in the sentence quoted above from the Overview. As is pointed out in paragraph 7.1 of the Explanatory Memorandum to the draft bill, the imputation system ensures that "tax paid at the entity level is, in appropriate circumstances, imputed to the entity's members to avoid double taxation of entity profits". Where a non-fixed trust is simply unable to make a family trust election through lack of family control, the resulting double taxation could scarcely be regarded as being appropriate. If the trust has been used instead of the partnership for example, and more than one family is involved, it will be unable to pass the family control test found in Section 272-87 of Schedule 2F.

Furthermore, there are gross deficiencies in the definition of a "family". These will frequently be encountered in areas such as the estates of deceased persons, because the test individual in Section 272-95 cannot be a deceased person and the reference to the test individual's "spouse" is inappropriate to describe the relationship between a deceased and that person's widow or widower. As many deceased estates provide mechanisms for the support of children in their infancy, they frequently remain unfoot for extended periods of time. The double taxation of income of such a deceased estate in the hands of the trust and then again when distributed to beneficiaries is intolerable and must be addressed.

Yours sincerely

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