



MASTER BUILDERS
A U S T R A L I A

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**'A NEW BUSINESS TAX SYSTEM
(ENTITY TAXATION) BILL 2000'**

SUBMISSION BY

MASTER BUILDERS AUSTRALIA

TO

**THE ASSISTANT COMMISSIONER
LAW DESIGN & DEVELOPMENT (ENTITIES)
AUSTRALIA TAXATION OFFICE**

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INTRODUCTION

The prime objectives of the Government's tax reforms, as stated in *A New Tax System* (ANTS), were to enhance the stability of taxation arrangements and improve simplicity and transparency.

Consistent with these objectives, the Ralph Review of Business Taxation made recommendations that would have the effect of tax equity under company tax arrangements, regardless of the type of business structure used. In other words, the intention was to introduce measures that would remove the current inconsistency in the taxation treatment of business structures. We do not, however, believe that the Exposure Draft meets any of the objectives set by the Government's tax reform agenda and the John Ralph Review of Business Taxation.

We recognise that one of the political imperatives was the view that there was widespread tax avoidance taking place through the use of trusts. It does not follow from this, however, that every business entity that uses such structure is engaged in tax avoidance activity.

We had accepted the thrust of the Government's overriding philosophy that sought to redress the situation where the same investment attracts different tax treatment because it is put through a trust rather than a company.

Indeed, in our submission of 16 April 1999 to the Review of Business Taxation we expressed our concern that the taxation of trusts as companies, where they are operated legitimately, would disadvantage small businesses by reducing their flexibility to manage their financial affairs and by increasing their compliance costs. This is exactly what the Exposure Draft will do, thereby confirming our worst fears.

We understand the concern that discretionary trusts could distribute tax-preferred income tax-free to individual beneficiaries. Fixed trusts, on the other hand, are seen as allowing the distribution of tax-preferred income which have already been taxed, but not until the beneficiaries' interests in the trust have been sold.

It would appear that one of the significant areas of concern that the reforms sought to address was the ability of high wealth individuals to arrange their tax affairs through highly complex trust structures. In the ANTS document the Government stated its intention to introduce a framework to achieve consistent entity taxation.

We are willing to accept that the ATO has evidence of certain tax payers using complex chains of trusts to minimise tax and that, therefore, there are legitimate reasons for introducing anti-avoidance measures to clamp down on such abuses.

However, in introducing anti-avoidance measures, the Government should not stray from its original and overriding objective of achieving equity and uniformity across business entities. If the abuse is perpetrated by high wealth individuals then the reform measures should be properly targeted and not focused against genuine businesses, particularly small businesses, who choose to operate a trust.

Our membership has serious concerns with the inequity that will be created by the Exposure Draft between non-fixed trusts and companies and fixed trusts. The proposed measures will see discretionary trusts and other non-fixed trusts effectively taxed more harshly than companies and other business entities. Such an outcome is not only inconsistent with the Government's overall objectives but is totally unacceptable for the majority of businesses that choose to legitimately carry out their operations through such a structure.

The Profits First Rule

The Exposure Draft will see distributions from a non-fixed trust coming from, firstly, the available profits and also from its contributed capital and unrealised gains.

The available profits from a non-fixed trust will be deemed to be the net market value of the assets less the contributed capital less any prior tax paid. The Exposure Draft determines that available profits are money at the time of distribution and include the difference between unrealised gains and unrealised losses. This methodology is at odds with business reality and the Government's own policy objectives.

The effect of this proposal would be to require, at the practical level, market valuations to take place every time a distribution is made. This is simply not practical and is fraught with inequities. Valuing the assets that are to include the value of unrealised gains in determining the available profits can create inequities because the same rules will not apply to fixed trusts or companies.

However, the most inequitable proposal is the inclusion of unrealised capital gains. This gain will be taxed in the hand of the trust member and taxed again upon the actual sale of the asset, thereby making it, in effect, a form of double taxation. There is an assumption also that the capital gain of an asset will always be positive over time. The Exposure Draft does not recognise

that assets can lose value over time and the ability to claim such losses is not available under in the proposed measures.

The treatment of unrealised capital gains will not apply and currently does not apply to non-fixed trusts and companies. There are very good reasons for this arrangement, and these were articulated in the Ralph Review of Business Taxation.

These inequities severely disadvantage businesses that use trusts compared to companies and should therefore be redressed.

Non-Commercial Loans

Our second major concern relates to the proposed treatment of non-commercial loans.

Non-commercial loans by family members to the trust are a critical feature by which businesses grow and are kept afloat. Without such loans the viability of the business is seriously challenged.

However, under the Exposure Draft it is proposed that loans from family members will be deemed to be non-commercial if there is no written agreement or no interest charged. In the event that such non-commercial loans are not repaid within the income year, they will be deemed to be distributed and will be taxed. The proposal is harsh and is likely to impose considerable hardship, particularly on small businesses. It does not recognise the reality of how small businesses operate and survive.

The charging of interest is not an issue for the members of the trusts. To therefore enforce or deem interest to have been paid at the benchmark rate is draconian. While there may be a case for the entering of a written agreement where loans are made, there is no reason to enforce the paying of interest if this is the express wish and agreement between the parties.

Further, and to underscore the Government's departure from ensuring that tax reform measures do not tax different business structures at different rates, we note that the Exposure Draft will not apply to companies. Such an outcome flies in the face of the Government's prime objective.

Restructuring Arrangements

The inequity in the Exposure Draft continues into arrangements for rollover relief for those non-fixed trusts who wish to restructure into a different business entity.

The Exposure Draft only provides rollover relief for fixed trusts and widely held companies who wish to move to companies and widely held trusts respectively. As if to underscore its breach of the equal treatment objectives, we note that no similar provision is made for non-fixed trusts.

In the case where the provisions of the Exposure Draft are implemented, there will be a rush by some companies to restructure their business arrangements. While that would be a most undesirable outcome and totally opposed by the MBA, full rollover relief should be made available. This principle was espoused in the ANTS document but is absent in the Exposure Draft. The rollover relief should be complete and must include relief from capital gains tax, retention of pre-CGT status, relief from GST and State stamp duties.

SUMMARY / RECOMMENDATIONS

The inequities in the Exposure Draft are an attack in particular on small business, without dealing with the fundamental objective of implementing equity and anti-avoidance provisions.

The MBA has focused on the key areas of concern to its members in the Exposure Draft and, for the reasons outlined, strongly opposes the entity tax arrangements in the Draft.

There are many other issues in the Exposure Draft that are also of significant concern to our membership and we can only support the concerns put by the accounting groups and other key industry associations in expressing our dismay and opposition to the Exposure Draft.

The MBA's opposition is based on the fact that the Exposure Draft has significantly deviated from the principles enunciated by the Government in the ANTS document. It fails to provide a level playing field in the tax treatment of business entities. The proposed measures are perverse in their effects in that small businesses will pay more effective tax. The measures will also introduce a new tax akin to a wealth tax as well as introducing double taxation.

MBA recommends therefore that, as a minimum, the proposed provisions dealing with the Profits First rule, the treatment of non-commercial loans and restructuring relief be removed and rewritten in accordance with the principles contained in the ANTS document.