

30 October 2000

Assistant Commissioner
Law Design and Development (Entities)
PO Box 900
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Dear Assistant Commissioner

I am writing to express my deep concern over the proposed changes to the taxation regulations relating to discretionary trusts.

The change in regulations, designed to catch and stop large-scale tax evasion will have a serious effect on the viability of many small businesses.

Our clients conduct their operations through a company and family trust. The company's sole task is to act as corporate trustee. Many farmers use a trust to own livestock and plant, to derive all farm income, to employ workers and distribute income to beneficiaries.

There have always been good reasons to use a trust structure. Trusts can be the easiest way to pass livestock and plant to succeeding family members in the event of the retirement or death of the older generation. Trusts provide legal protection from unsecured creditors and minimise risk by separating land ownership from the trust operating the business.

A trust is also an effective way of distributing income and capital gains to trust beneficiaries according to their individual needs and tax liabilities.

The taxation of trusts as companies from 1st July 2001 will mean that trusts will pay tax at the rate of 30% with beneficiaries eligible for tax refunds if their individual tax rates are below the corporate rate. Many farmers do not pay an average rate of 30% and would therefore suffer a cash flow disadvantage whilst waiting for their tax refund until after the end of the income year.

Where the individual tax rate exceeds 30%, trustees may decide to retain profits after paying the flat tax rate of 30%.

Most discretionary trust deeds will have to be reviewed to ascertain whether trustees can accumulate income in the trust at 30th June, in order to defer the tax liability. If a favourable clause does not exist, then a choice will have to be made whether the trust deed can be amended without adverse income tax or stamp duty consequences.

Any future payments (distributions) to beneficiaries or their associates will be subject to the "profits first" rule which means that any withdrawals will be taxable where there are profits or unrealised capital gains retained in the trust.

This taxing of unrealised capital gains has been described as a defacto wealth tax and the capital gains tax on the eventual sale of the asset means double taxation.

Using trusts to hold appreciating assets or to act as a business vehicle will not be as attractive in the future, particularly as a result of the profits first rule.

Even more disappointing, the Government is not providing any worthwhile rollover relief to allow assets to be transferred to say partnerships without incurring potential capital gains tax liabilities.

If I were a cynic I would suggest that these changes have been foreshadowed at a time when everybody is too busy with the Business Activity Statements to notice what's happening.

I urge the Government to desist from implementing the changes.

Yours sincerely

MIKE STEPHENS
DIRECTOR
MIKE STEPHENS & ASSOCIATES