

NATIONAL SECRETARIAT

Level 22, 68 Pitt Street, SYDNEY NSW 2000
GPO Box 1595, SYDNEY NSW 2001

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Telephone: (02) 9221 1983 / 9221 2404
Facsimile: (02) 9221 2639



Trustee
Corporations
Association
of Australia

Mr Simon Matthews
Australian Taxation Office
PO Box 900
Civic Square
ACT 2608

Dear Mr Matthews,

**Amendments to Part IIIA of the Income Tax Assessment Act 1936 -
Impact upon Beneficiaries of Discretionary Trusts**

Following your recent discussions with Mr Keith Drewery, Senior Tax Manager of Perpetual Trustee Company Limited in Sydney, we set out below details of our Association's concerns in relation to proposed amendments to Part IIIA of the Income Tax Assessment Act 1936 (the Act) for your urgent consideration.

Concerns

The legislation is far reaching and has unintended consequences

The amendments are aimed at curbing schemes concerning trading in franking credits. However, we believe that, as drafted, the legislation will have the unintended consequence of affecting the entitlement to franking credits of beneficiaries of:

- discretionary trusts where the trust income results from damages for loss of parental support, mental or physical injury, workers compensation or criminal injury;
- certain death benefit trusts where the interests of the beneficiaries are subject to a contingency; and
- discretionary trusts created by way of Will ("testamentary trusts").

Two exceptions do exist for beneficiaries of 'family' trusts, as defined, and deceased estates during the course of administration by executors. However, the exclusions are not sufficiently wide to cover discretionary trusts created to protect the interests of the poor and disadvantaged.

It appears to us unlikely that the Government meant that the poor and disadvantaged in society would be exposed to the penalties imposed by the proposal.

ANZ Executors &
Trustee Company Ltd

Austrust Ltd

Equity Trustees Ltd

Guardian Trust
Australia Ltd

IOOF Australia
Trustees Ltd

National Australia
Trustees Ltd

National Mutual
Trustees Ltd

Permanent Trustee
Company Ltd

Perpetual Trustees
Australia Ltd

Perpetual Trustees
Tasmania Ltd

Public Trust Office SA

Public Trustee of Qld

Public Trust Office NSW

Sandhurst Trustees Ltd

State Trustees Ltd

Tasmanian Trustees Ltd

Trustees of Western
Australia Ltd

The legislation is at odds with the aims of "Prudent Person" legislation

"Prudent Person" legislation now operates in South Australia, Victoria, Northern Territory, Western Australia, Tasmania and was most recently passed in New South Wales. We believe that the proposed legislation is at odds with the "Prudent Person" legislation. Under "Prudent Person" legislation a trustee is required to make investment decisions which are 'prudent' and develop an investment strategy which considers the nature and purpose of the Trust.

A trustee may therefore make a decision to create a balanced investment portfolio including exposure to Australian equities. The result of that decision could be that a beneficiary is denied a franking credit on franked dividends received on investments forming part of a 'prudent' investment strategy.

Thousands of beneficiaries will suffer unintended effects

Members of our Association have advised that the proposals have the potential to impact upon approximately 20,000 trusts, with an equally substantial number of beneficiaries. The Public Trust Office in New South Wales and State Trustee Limited in Victoria have both advised that together they administer over 17,000 trusts which are potentially impacted by the proposals. (You will by now have received separate comments from the Public Trustee in New South Wales).

In such trusts, the beneficiaries depend upon the income generated by the trust. Such beneficiaries typically include the physically and mentally disabled and young people who cannot access funds from a trust until they reach a nominated age. The trustees administering these trusts would be extremely unlikely to have engaged in franking credit trading or enter schemes designed to exploit the benefit of franking credits at the direction of such beneficiaries. Such trustees and the relevant beneficiaries are not part of those taxpayers who are apparently targeted under the proposals.

Should testamentary trusts be subject to the arrangements?

The creation of a testamentary trust under a Will to provide for the deceased dependents are not included under the list of potential exclusions to the operation of the legislation - family trusts and deceased estates during administration. Indeed it seems to be a misunderstanding of such trusts that the explanatory memorandum specifically states that the exclusion for deceased estates should not include Testamentary Trusts (para.1.54).

Income generated in a testamentary trust for the benefit of minors as former dependents of the deceased is regarded as 'excepted trust income' and taxed at adult rates as opposed to the penalty tax rates that apply to minors unearned income ordinarily. However, these beneficiaries may, in future, be unable to qualify for franking credits on franked dividends included within their assessable income. The legislation has the effect therefore of diluting the intentions of section 102 AG of the Act.

We believe that at the least the exclusion for deceased estates should be extended to include trusts created by Will after the administration of the estate has been completed, where the income of the Trust would be 'excepted trust income', as defined in section 102AG to the beneficiary.

Trusts and the process of tax reform

The proposals have unfortunately not considered the nature of many trusts but rather considered that trusts as a whole are all created as a vehicle for tax avoidance. This is regrettable. The above comments reinforce the view of our Association that trusts fulfil a number of functions and should not automatically be viewed as tax avoidance vehicles.

If you wish the Association to provide further information, or if you wish to discuss any of the issues raised, please contact me on 9221 1983.

Yours sincerely



Kerrie Kelly
National Director