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6 November 2000

The Hon Peter Costello MP
Treasurer
Parliament House
CANBERRA VIC 2600

Dear Sir

ENTITY TAX EXPOSURE DRAFT LEGISLATION

We are writing to express our concerns in relation to the exposure draft New Business Tax System (Entity Taxation) Bill 2000.

In particular:

i) the exposure draft bill is **enormously complex***;*

ii) it will dramatically impact some hundreds of thousands of trusts and therefore an enormous number of taxpayers but the **costs and benefits** have not been made available for public scrutiny;

iii) the added complexity will add considerably to the **cost of compliance***;*

iv) the integrity of the tax system will be undermined as the added cost and complexity will result in **reduced compliance;**

v) the list of **excluded trusts** has not been made available;

vi) there is inadequate relief for **restructuring** both from an income tax and CGT perspective and a stamp duty perspective;

vii) the proposal to tax trustees and then **refund excess franking credits** to objects of trusts undermines the purpose of many trusts. It takes cash out of the trust and puts it in the hands of beneficiaries. This should be a decision of trustees, not dictated indiscriminately by a tax system;

viii) the **boundary** between what is an fixed or non fixed trust is critical but still very complex and unclear. The integrity of the system requires clear and simple rules. Reference to obscure principles in the explanatory memorandum (not even the legislation itself) accompanying the trust loss rules, is, with respect, wholly inadequate;

ix) the **PAYG** system must be amended if tax credits are to arise during the first year of operation of the entity tax regime, otherwise it will not be possible to frank first year distributions;

x) we need clear and comprehensive **consolidation rules** if we are to understand how the entity regime will work in its entirety;

xi) similarly, the absence of many of the **international rules** leaves a very large whole in our ability to analyse this proposal;

xii) the **contributed capital** (account and sub account) rules are terribly complex and will add considerably to compliance costs;

xiii) the **profits first rule** is harsh and unconscionable and quite unnecessary. If the Government is concerned about distributions out of asset revelation reserves it should introduce specific targeted measures (in addition to the proposed strengthening of the general anti avoidance rule).

The profits first rule will in all likelihood result in tax on the advance of capital to pay for **wheel chair ramps** for disabled beneficiaries, the advance of capital to pay for a child's **cochlear implant,** and a range of other inappropriate outcomes. This is imposing a tax on the use of family savings. Hardly the sort of outcome to take into an election year;

xiv) the enormous difficulties associated with the exposure draft bill could be reduced dramatically if non–fixed trusts which elect to be treated as **family trusts,** and thereby accept those restrictions, are excluded from those proposals;

xv) the exposure draft doesn't make it clear when an amount will be **credited** to an object of a trust, eg will it be as of 30 June when cash is drawn weekly and when the accounts are done after year end? What about the problem of there being a tax liability based on crediting early in the year when the full year reveals a tax loss?

xvi) if only the value of **pre CGT assets** up to 30 June 2001 goes into contributed capital, we face a 15 year retrospective wealth tax;

xvii) if **unrealised gains** are taken into account for profits first purposes, subsequent realisation of a loss would result in a quite unreasonable tax burden;

xviii) the requirement that trustees distribute certain gains within 12 months to preserve tax preference (see section 157-55) is unnecessary and would work particularly harshly on elderly and infirm **widows and widowers**;

xix) transplanting **Division 7A** with all its flaws into the trust rules merely replicates bad law. Now is the time to fix Division 7A and, if necessary, delay the introduction of (only) these rules;

xx) the average business person will simply not understand why they cannot **lend money** into their business and later pull it out as a tax free return of capital.

Business people have to be free to lend cash to their businesses and to withdraw it tax free and the tax laws need to be designed in such a way that they catch any perceived mischief in some other way.

The Solutions

If the entity tax regime is to go ahead as of 1 July 2001, in our view, the key issues are:

i) the missing pieces must be made public without further delay;

ii) trusts which elect to be family trusts should be carved out; and

iii) the profits first rules should be removed, and perhaps replaced by more targeted measures.

A number of representatives of this firm have been involved in the consultation process on a number of tax reform issues. We would be pleased to discuss further any aspect of the above.

Yours faithfully,
WILLIAM BUCK (VIC) PTY LTD
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PAUL HOCKRIDGE
DIRECTOR - TAX CONSULTING