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The General Manager
Business Tax Division
The Treasury
By email : trust_rewrite@treasury.gov.au

Submission to Treasury
Modernising the taxation of trust income – options for reform

This is a submission from Cummings Flavel McCormack, Chartered Accountants.

Our clients

The proposed trust reforms are directly relevant to our clients who are predominantly family-owned businesses and private investors. Significant changes to both the trust law and ATO practices over recent years have unfortunately increased the complexity and cost of compliance for our clients. We therefore request that future changes have regard to the welfare of ordinary business operators and investors who, like our clients, do not seek to manipulate the tax system but still bear the cost of complying with associated tax reforms and feel increasingly frustrated by the complexity.

Our submission

In the interests of our clients, we make the following comments in response to Treasury's consultation paper on trust reform:

The key issues for trust reform

In our view, the primary issues to be resolved through trust reform are:

1. Preserve the character of trust income in the hands of the beneficiaries:
2. Preserve streaming of different classes of income and capital gains;
3. Allow present entitlement to be determined within a reasonable time after year end;
4. Avoid any suggestion that trust distributions must be physically paid contrary to the current law of "present entitlement". This would severely inhibit the availability of business working capital and the prospects for future business growth and investment;

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5. Introduce effective anti-avoidance measures to deal with the manipulation of trust income, however, those measures should not increase the complexity for the vast majority of trustees and advisors who are not engaged in aggressive tax strategies;

6. Repeal the interim trust streaming measures of Subdivision 6E and introduce simpler and more practical amendments to achieve the above (1-5).

Of secondary importance are the proposed reforms dealing with trustee assessments, "notional income", fixed trusts and the breadth of section 99B of the *Income Tax Assessment Act 1936*

"The patch model"

This proposal does not deal with any of the key issues identified above and specifically contemplates the retention of the interim trust streaming measures of subdivision 6E . As tax advisors, we have found subdivision 6E to be needlessly complex for even the simplest real-life examples of streaming capital gains and dividends. Subdivision 6E is part of the current problem and cannot be seriously contemplated as part of any long-term solution.

"Proportionate within class model"

This proposal has some attraction in respect of dealing with classes of income and streaming, however, this is clearly an incomplete solution in terms of the key reform issues.

"Trustee assessment and deduction model"

Presumably, many would favour this option by a process of elimination. However, this model should not gain credibility simply because the "Patch Model" and "Proportionate with Class Model" are incomplete. In our view, none of these proposals represents a considered and structured solution to the key trust issues.

The "Trustee Assessment and Deduction Model" appears to contradict some fundamental concepts of trust law and taxation law. For example, every student of taxation law learns that a distribution of profit by a partnership, joint venture, company or trust is not deductible. Put simply, it is not a loss or outgoing incurred in deriving income or carrying on a business. This model would necessarily require a statutory deeming rule to achieve an outcome that contradicts accepted taxation principles and common sense.

Further, the proposal creates a significant disparity between the tax law and the legal obligations of the trustee to deal with income, expenses, taxes and beneficiary rights under the trust deed. Changes to the trust deed to achieve uniformity with the tax law would substantially alter the trust relationship, involve significant legal cost and potentially trigger CGT and/or stamp duty (ie. if the changes constitute a resettlement of the trust).

A practical concern with this model is the emphasis on physical distributions of net income. Under the current system, the beneficiaries are made presently entitled to trust income and can choose to make those funds available to the trust for business growth or further investment (as an unpaid present entitlement to which the beneficiary has a vested and infeasible interest). This aspect is critical to funding the working capital of a business. Likewise, an investment trust should not be required to sell investments merely to fund

income distributions until the beneficiaries call upon their entitlements. The retention of funds in this manner contributes to the growth of trust assets and ultimately the welfare of the beneficiaries (which is generally why a trust is established).

The economic cost of inhibiting small and medium sized business in this manner should also be considered given the material contribution of these enterprises to the Australian economy.

Further development and consultation

In our view, none of the proposed models represent more than a partial solution. Further development and consultation is required. We submit that Treasury should utilise realistic examples to test any proposed solutions or model. This is best achieved through consultation with interested practitioners who deal with trust issues on a regular basis for their clients. As discussed, any future reform must have regard to the welfare of ordinary business operators and investors who ultimately bear the cost of compliance and complexity.

If you have any queries in relation to this submission, please contact me on 03 9252 0800 or via email at dkent@cfmc.com.au.

Yours faithfully

Cummings Flavel McCormack Pty Ltd

David Kent

Director