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REAL ESTATE INSTITUTE OF AUSTRALIA

The Real Estate Institute of Australia

# Submission to The Treasury on the **Modernising the Taxation of Trust Income - Options for Reform - Consultation Paper**

*Prepared by the Real Estate Institute of Australia*
*February 2012*

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# MODERNISING THE TAXATION OF TRUST INCOME - OPTIONS FOR REFORM CONSULTATION PAPER

## BACKGROUND

The Treasury is seeking submissions on its Consultation Paper on Modernising the Taxation of Trust Incomes – Options for Reform.

REIA represents around 80% of real estate agencies and is an important element of the broader property and construction sector, which makes a significant contribution to Australia's social climate and economic development. The real estate profession employs approximately 77,000 persons and contributes $300 billion annually in economic activity.

The REIA's members are the State and Territory Real Estate Institutes, through which around 80% of real estate agencies are collectively represented.

Importantly, REIA represents an integral element of the small business sector. According to the ABS statistics, 73% of real estate agency businesses employ fewer than 10 employees (over 50% of this portion employed fewer than 5 employees). Only 0.6% of businesses employ 50 or more persons

REIA has the commitment of providing and assisting research and well-informed advice to the Federal Government, Opposition, professional members of the real estate sector, media and the public on a range of issues affecting the property market.

The REIA welcomes the opportunity to provide a submission to Treasury on the Consultation Paper.

## ISSUES

Trusts are a common structure used by small business to conduct their normal business operations or for investment purposes or a combination of both. Trusts have become a common structure for small business to house their trading business. Through their asset protection and succession planning advantages trusts are also used as a way of holding assets. The outcomes of the review will therefore have implications for the nearly 700,000 trusts already in existence, many of which are held by small businesses

The REIA notes and welcomes the opening comments in the Consultation Paper that the review is not intended to be a crack down on the use of trusts. Similarly reassuring is the acknowledgement that trusts are a legitimate structure through which taxpayers are able to conduct their personal and business affairs.

The interaction of trust law and the income tax treatment of trusts has been an ongoing issue for some time now. Whilst Division 6 of the Income Tax Assessment Act 1936 has been in place for some time, recent Court decisions have created much uncertainty in its application requiring legislative clarification. The need for reform was also highlighted by Australia's Future Tax System Review (Henry Review) which recommended that the trust rules be updated and rewritten to reduce complexity and uncertainty around their application

This complexity and uncertainty has had a detrimental impact on compliance costs for those small businesses and other taxpayers that use a trust structure. Current taxation treatment of trusts is long overdue for change.

*The REIA thus urges the current review to recommend changes that increase certainty and reduce compliance costs.*

It is also important to ensure that the existing attributes of trusts remain intact and are protected for existing trusts.

*The REIA thus urges the current review to recommend that any changes leave existing trusts intact.*

Following the introduction of any changes to trust legislation taxpayers who have already established trust structures may wish to move to a different structure if the changes result in adverse outcomes. There should be provision for transitional arrangements which allow taxpayers to move to another structure without tax implications.

*The REIA thus urges the current review to recommend the inclusion of transitional arrangements.*

The timetable for the review proposes to introduce any legislation into Parliament in November 2012, for a start date of 1st July 2013. The REIA is concerned that this may be an unrealistic timetable given the complexity of the issues to be covered. The REIA believes a longer lead time for the introduction of any changes is required. As the Consultation Paper recognises, there are a wide variety of trusts differing in their deeds, structure, use and size. There will be a need to educate trustees ahead of the implementation timetable. Given the number and diversity of trusts in existence, an extensive education process over several months will be required.

*The REIA thus urges the current review to recommend that any changes be implemented only after a comprehensive education campaign.*

The consultation paper outlines three possible alternatives to taxing trust beneficiaries. They are a: patch model; proportionate within class, and; trustee assessment and deduction model. REIA's response on each model follows.

**Patch Model**

The model involves retaining the existing structure of Division 6 and the Consultation Paper canvasses three options for defining 'income of the trust estate" to improve the operation of the proportionate approach under the existing arrangements.

These are:

(i) tax concepts;
(ii) accounting concepts, and;
(iii) retain current approach relying on general trust law.

REIA believes that the preferred option should be to use tax concepts as these would be least problematic.

**Proportionate within a class**

This model operates in a similar way to the current present entitlement model with an additional step to ascertain the classes of income and the proportionate entitlement in relation to these classes. This approach, until recently, had been in utilised for over 18 years and had become accepted practice and as such was reasonably well understood. The treatment of losses under this model would need further consideration, in particular how to treat losses at a class level if a proportionate within class model was adopted.

**Trustee assessment and deduction model (TAD)**

A TAD model is one where the trustee of a trust is assessable on the income they derive but a deduction is provided to the trustee for distributions it makes to the beneficiaries of the trust. It effectively taxes the taxable income of a trust in the hands of those beneficiaries that receive the economic benefits related to that taxable income. Assessable amounts not distributed are taxed in the hands of the trustee. If the trustee distributes all of the taxable income no tax is payable by the trustee. The distributions made by the trustee are then taxable in the hands of the beneficiaries who receive the distributions. Under this model trustees will only be assessed on taxable amounts that are retained in the trust.

The definition of a distribution under this model will therefore, be critical. If actual 'cash' distributions are likely to be required for the trustee to obtain a deduction, this could impose financing difficulties for small businesses unless unpaid distributions are also allowed. The consultation paper does not address the issue of subsequent distributions by trustees of unallocated amounts which have already borne a level of trustee tax. Despite this reservation, in REIA's view, the TAD model has the potential to reduce complexity and compliance costs in determining the tax liabilities of the beneficiaries and trustees of the trust.

**REIA Recommendations**

***The REIA recommends that Government:***

- ***Put in place changes to the taxation treatment of trusts that increase certainty and reduce compliance costs.***
- ***Leave existing trusts intact***
- ***Include the provision of transitional arrangements***
- ***Introduce any changes only after a comprehensive education campaign***

Prepared by:
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