Stockbrokers and Investment Advisers Association
Building prosperity for Australian investors

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Assistant Secretary
Individuals and Indirect Tax and Superannuation Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

Consultation Paper: Minimum tax on discretionary trusts

The Stockbrokers and Investment Advisers Association (SIAA) is the professional body for the stockbroking and investment advice industry. Our members are Market Participants and wealth management firms that provide securities and investment advice, execution services and equity capital-raising for Australian investors, both retail and wholesale, and for businesses. Practitioner Members are suitably qualified professionals who are employed in the securities and derivatives industry.

SIAA members represent the full range of advice providers from full-service and online brokers to execution-only participants and provide wealth advice and portfolio management services.

The history of the stockbroking profession in Australia can be found here.

Thank you for the opportunity to provide feedback to Treasury's consultation paper on minimum tax on discretionary trusts (Consultation Paper).

Overview

Trusts are an important and legitimate investment vehicle that allows everyday Australians to protect assets, structure their affairs to run businesses and provide for extended family. They are established and administered under long-standing trust law. The proposed changes do not adequately recognise that discretionary trusts have legitimate purposes beyond tax planning, including asset protection, succession planning, business continuity and family wealth management.

Overall, the policy design of this new tax has significant issues for implementation and management.

The announced targeting of the equalisation of tax across personal exertion income and passive investment income is likely to impact lower income individuals and overall, not increase the net tax take from this measure. A significant proportion of the capital held in discretionary trusts has already been contributed from post-tax income. Imposing a flat 30% floor on trust income risks penalising ordinary families and small businesses rather than the narrow set of high-wealth arrangements the measure is said to target as it conflates the marginal tax rate with the effective (average) tax rate. Because of the tax-free threshold and the progressive scale, the median effective tax rate for working Australians is well below 30% - broadly in the 20-25% range for many. A flat 30% floor is not an 'alignment'. For a large share of beneficiaries, it is a higher rate that they would pay on the same income as wages. When taking into account the 2% Medicare levy, the rate payable by a beneficiary is increased to 32%.

Our members are considering a range of potential responses to mitigate the impact on <u>after-tax returns</u> for clients, and the market impact should not be underestimated. A change of this quantum should not be without significant lead-in time and the proposed start date of 1 July 2028 results in less than a 2-year runway. It should be noted that this issue is a "no action" change until such time as legislation is passed into law.

The new law that applies to the calculation of taxable capital gains is a significant new regime that practitioners must skill themselves in and attend to the advice needs of impacted clients. The start date, one year earlier than the proposed tax distribution tax start date, means that our member firms will be grappling with significant new law for several years. When advisers are forced to shift their focus to administrative duties, overall productivity declines. Investment advisers' contribution to the functioning of capital markets should be the main objective of their work - not dealing with overly complex and layered changes to the law.

For our members, this proposed significant change to the tax arrangements for the vehicle will require significant time and resources to re-assess individual balance sheet positions and implement all the necessary change processes.

At a time when regulatory red tape is a central productivity issue for wealth advisers, this complex new law is unwelcome

We provide our responses to the specific discussion questions below notwithstanding that we do not support the proposed changes.

Overview of the minimum tax

Question 1 How should discretionary trusts be defined to appropriately distinguish them from fixed trusts for the purposes of the minimum tax?

SIAA recommends that the legislation define a fixed trust with a discretionary trust being the default. It can be achieved by requiring the deed to issue units to determine the unitholder's income and capital rights. Unit classes could also be considered. If distribution requirements in the deed are aligned to the unitholder's economic interests in the trust, then the trust is a fixed trust.

All trusts should retain the scope for the nomination of default beneficiaries without tainting the trust status as fixed.

Question 2 What is the appropriate minimum tax treatment for income tax-exempt entities?

The minimum tax treatment for income tax-exempt entities is self-evident in the name – they should be exempt from income tax. As such, income tax exempt entities should retain the ability to claim franking credits annually when received via a trust in keeping with broadly accepted tax principles.

Any changes that reduce this capability will mean the reduction of real revenue to the organisation which will mean reductions in provision of critical services in a time of generally increasing needs. This will create additional burden at a time when these entities are facing significantly increasing costs through inflation (wages, energy, technology) and compliance burdens, and pressure on other funding sources such as private philanthropy (which is also being affected by cost-of-living pressures).

This will be a significant negative consequence of the proposed trust distribution tax and will hinder the ability of these For Purposes entities to sustainably deliver the type of social outcomes the government is committed to.

Question 3 Are there any other implementation matters not addressed in this paper that should be considered in designing the minimum tax on discretionary trusts?

The exemption for testamentary trusts requires explicit wording and would benefit from design changes.

It appears the income from assets derived from an estate is not subject to the minimum tax regime. Clarity is required that replacement assets are included in the exemption. While it would appear the intention of the wording was to ensure injected capital would be exempt from the tax, the distinction between injected capital and replacement assets needs to be more clearly articulated.

The requirement for a testamentary trust to only benefit individuals or charitable entities requires the wording to be more transparent.

Ideally, a testamentary trust could have a range of beneficiaries but only benefit from the distribution tax exemption for the distributions to those specified classes of beneficiaries.

There may be a range of reasons to have other beneficiaries that are not associated with a tax impost.

If the final form of the law design insists on only the two classes of beneficiaries, the government is imposing a requirement for existing arrangements to be modified. Estate planning processes are usually long and complex. To require a significant change to the drafting of the trust terms in a will is onerous and would seem unnecessary if the tax could be the trustee responsibility in conjunction with their distribution responsibility.

Specific topics for feedback

4. Are the proposed rollover relief arrangements appropriate?

The Consultation Paper refers to the rollover not requiring the legal owner to remain the same, just the economic owner. Beneficial ownership is a key term that needs clear definition for restructuring based on rollover relief to be undertaken.

Not allowing the transfer to qualify if the assets are lodged in a company that has multiple share classes is a consequential amendment to the Corporations Act. This aspect of the conditional rollover relief seems unnecessarily restrictive. It is important to remember that a company has discretion as to when it distributes to shareholders so can retain income indefinitely if it wishes. Restricting share classes will complicate succession planning and could lead to many more inter-generational entities that never distribute the capital.

Question 5 Are existing integrity rules sufficient to address arrangements that substantially preserve discretionary economic outcomes through alternative legal structures?

Question 6 Is it appropriate that the rollover is designed to prevent Family Trust Distribution Tax from applying where a discretionary trust with an existing family trust election and/or interposed entity election(s) transfers property to an entity that is not a member of the family group?

Question 7 Are there any other matters that should be considered in finalising the design of the rollover relief?

Once capital is out of a trust there are no restrictions around tax planning due to minimum taxing imposts. If, the policy objective is the destruction of discretionary trusts as an investment vehicle, because passive income is not being taxed at comparable levels as personal exertion income, we question whether future policy apply to all investment income.

We consider that the policy design may not fully achieve its stated objective, as the impact is likely to be felt at the lower income levels.

A transfer of assets from a discretionary trust can attract stamp duty and other state charges even where CGT relief applies federally. Unless the states agree to corresponding duty relief, the cost of restructuring will exceed the benefit for many, and the rollover relief will not be realised.

Question 8 Are there other approaches that could reduce the need for upfront restructuring? What practical or legal considerations would arise in implementing these approaches, including their interaction with trust law and trustees' obligations?

We consider that there are the following:

- **Allowing existing trusts to convert to a hybrid trust whereby there are fixed unit holders as well as discretionary beneficiaries.** The existing capital in the trust is not subject to rollover relief and the trust is not deemed to have been resettled provided the trust deed provided the power and, the beneficiaries of the trust were unaltered. The unit holders would obtain units in the trust via the conversion of Unpaid Present Entitlements. The proposed distribution tax of 30% would still apply to the discretionary beneficiaries whereas the unitholders are entitled to a fixed distribution from the capital associated with their application

- **Allowing a corporate beneficiary to utilise the tax credit paid in the trust against corporate tax.** The tax result is still 30% and the company continues to pay a flat 30% tax on subsequent income including gross capital gains as there is no cost base adjustment available to a company. The integrity of the franking system is challenged by refusing the utilisation of distributed tax credits to companies. The distribution to the company cannot be distributed to the shareholder unless a dividend is declared. A taxpayer on a marginal tax rate of greater than 30% must pay the additional income tax on the capital extraction from the company. The integrity of the baseline 30% tax could be achieved by making tax credits not refundable but able to offset the current year tax.

In this flow, the original company pays tax of 30% to the ATO. The trust offsets a credit for its tax obligation as does the company that receives a trust distribution. The capital within the company is extracted via a taxable dividend which allows the tax credit to 30% and no refund.

Treatment of excess franking credits

Question 9 Having regard to tax system integrity, compliance costs and administrative simplicity, should excess franking credits be refundable to the trustee? Why or why not?

Absent a refund of franking credits, the trust is obliged to carry a franking account which creates additional compliance obligations for the trust. However, providing a refund neutralises the ongoing benefit from the tax credit received in the first distribution. That is, the trust does not have additional franking to provide to beneficiaries from the refunded tax credit.

Question 10 What compliance costs or tracing requirements may arise under a carry-forward model? Could existing integrity rules adequately address these matters?

As above. In effect a trust would be a pseudo company from a tax account perspective.

11 Are there any other matters that should be considered when finalising the treatment of excess franking credits?

We have no further feedback on this matter.

Collection mechanisms

Question 12 What additional safeguards, administrative modifications, or beneficiary notification requirements should be considered to support the effective operation and collection of the minimum tax, particularly for arrangements involving corporate trustees?

A private trust is not obliged to provide specified reporting to beneficiaries. With the trust being a tax collector, the distribution notice regime will need to be specified. A form of Tax Statement may be required as required for private companies.

The Statement of Distribution – Item 58 of the Trust Tax Return will need additional label(s).

Question 13 What notification arrangements would be most effective for trustees and beneficiaries to give effect to the minimum tax in a way that minimises compliance costs?

The notification to beneficiaries is just one part of the additional compliance and complexity the new regime imposes. The withholding obligations imposed on many trusts will be a change process that will require advice and additional costs to ensure compliance.

Question 14 Are the complementary collection mechanisms for trustees and corporate trustees proportionate to support the effective collection of the minimum tax?

Question 15 Are there any other matters that should be considered in the design of the collection mechanisms?

Providing the Tax Office with a right to re-imbursement from trust assets seems logical.

Making directors liable for the minimum tax could mean a change is required to the Corporations Act and possibly the state Trustee Acts. We do not support this.

PAYG collection is not supported as it is an unwelcome administrative addition. If a trustee is not likely to pay the correct tax on time, a PAYG system will not improve that sentiment.

High Court decision in the Bendel case

Question 16 What, if any, consequential interactions arise between the minimum tax on discretionary trusts and the revised 2018-19 Budget measure?

Treating an Unpaid Present Entitlement as a loan for Division 7A purposes does not impact the tax on the initial distribution.

If an existing discretionary trust was able to convert to a hybrid trust, the units would be capitalised from Unpaid Present Entitlements. Care is urged not to close off this opportunity by enacting the announced but unenacted measure from the 2018-19 Budget.

Question 17 Are there any other issues or implications as a result of the High Court's decision in Bendel that should be considered as part of the design and implementation of the revised 2018-19 Budget measure?

Applying Division 7A to trust beneficiary accounts appears unnecessary. The initial distribution is taxed in the beneficiary(s) hands and the capital is either retained or distributed, not being subject to tax unless it is paid out to a shareholder in the case of the company beneficiary.

Income derived from the capital is subject to tax. The new trust distribution tax would see the income taxed at a minimum 30% in the trust and that is equivalent to the tax in a company.

So long as there is no tax mischief apparent, it is difficult to reconcile the ATO view on Division 7A applying to trust Unpaid Present Entitlements.

Integrity could perhaps be added by adding a trust purpose as a requirement for the Unpaid Present Entitlements to remain outside Division 7A. A passive investment trust is not generally able to garner better tax outcomes than the company beneficiary. Trust distribution tax and the minimum 30% tax on capital gains ensures parity.

Conclusion

If you require additional information or wish to discuss this submission in greater detail please do not hesitate to contact SIAA's policy manager, Michelle Huckel, using the contact details in the covering email.

Yours faithfully

Maria Lykouras

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