Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates 3-5 June 2008

Question: bet 23

Topic: **Family Trusts**

Hansard Page: **Written**

Senator Chapman asked:

With regard to the Rudd Labor Government's pre-election policy to reverse the previous Howard Government's family trust changes concerning the definition of the family group and the capacity to change the "test individual" in certain circumstances:

1. Were the claimed Budget savings of up to $8 million per annum derived from the previous Government's estimate that its changes would be a cost to revenue of $8 million per annum?
2. If not how was the figure calculated?
3. Given that the measure appearing on page 12 of Budget Paper No. 2 " Family Trusts – Savings Measure" differs in scope from the Labor Party's pre-election policy " Reversing Family Trust Flexibility" and implies that this policy can be disaggregated into a number of sub-policies, only two of which are now proceeding, that is a) limiting lineal descendants in the "family" to children and grandchildren of the test individual; and b) restricting the capacity to make a change to the test individual to circumstances of marital breakdown:
   a) "Can Treasury explain the costing of page 12 of Budget Paper No. 2 which is said to raise $6 million per year?
   b) How many trusts and beneficiaries will be affected by this measure?
4. Given that the respected Taxation Institute of Australia has said that:
   a) "There has been no suggestion of any tax avoidance" arising from the previous government's initiatives, is the only purpose of this measure a minor revenue gain of $6 million per annum?
   b) If not, what is the purpose of this measure?
5. Is the Government aware that taxation experts have declared that this measure will increase that compliance burden on small business, farmers and professional people and that this is inconsistent with Labor's National Platform to "ensure that the taxation system minimises compliance and collection costs"?
6. For discretionary trusts which had made a family trust election, how many people over the age of 18 years beyond the generation of grandchildren of the person who became the test person following the previous government's introduction of the family trust election, received trust distributions in the decade prior to the introduction of the family trust election requirement and how may after the introduction of the requirement?

   What has the amount of income so distributed in total and disaggregated according to the marginal tax rates of recipients?

7. Have any revenue estimates been made of the longer term receipts from Capital Gains Tax as a result of trusts which have made family trust elections, vesting earlier than would otherwise be the case or vesting where otherwise they would not have to vest at all where the laws against perpetuity have been abolished, because the generations up to and including grandchildren of the test person have died out, so that subsequent generations do not suffer family trust distribution tax?
8. If so, what are these estimates? If not why not?
9. In particular, has any assessment been made of the longer term consequences of this change to the previous Government's legislation in the circumstances identified in question 7, in relation to the long term intergenerational transfer of the assets of farmers and small business people who may have to make family trust elections because the hold franked dividends paying equities in the trust which also owns their farm or business?
10. If not, why not, given that the likely impact of such a Capital Gains Tax imposition will be similar to long abolished death duties, which, in particular, made many farmers unviable through being required to sell portions of their farms to pay death duty assessments, meaning this measure can fairly be described as a "de facto death duty"?
11. In the light of its intention to proceed with this measure, who does the Government believe that the inter-generational transfer of assets held in a family trust should be subject to such a capital taxation, when such assets held in any other form of ownership are not? Or is this an unintended consequence?
12. In the light of this measure, to ensure equity, is it the intention of the Government to tax all inter-generational transfers of assets, that is to re-introduce some form of death duties?
13. If not, why not? If not will the Government not proceed with this proposed change?
14. Why was this decision to reverse the previous government's legislation taken without adequate consultation with the experts or the small business, farming and professional people to be severely detrimentally affected by the decision?
15. Is it the Government's intention that the issue of death duties will form part of the review into the Australian taxation system by Dr Ken Henry?

Answer:

1. Yes – This costing is consistent with the election costing presented under the Charter of Budget Honesty on 23 November 2007.

2. Not applicable.

3a. Yes – the financial implications of this measure are an increase in revenue as the policy reverses a concessionary measure.

3b. Around 185,000 – 200,000 trusts have made family trust elections and potentially could be affected by the changes. It is however expected that only a small number of these trusts will actually be affected by the changes.

As the impact of these changes will be primarily on discretionary trusts, the number of beneficiaries affected by the changes is also unknown.

4a. The purpose of this savings measure, as announced in the 2008-09 Budget, is to reduce the scope for family trusts to be used to lower income taxes.

4b. Not applicable.

5. Before finalising the implementation details of this measure, the Government considered representations and submissions from various bodies, including the Institute of Chartered Accountants in Australia, CPA Australia, Taxpayers Australia, the Taxation Institute of Australia, the National Institute of Accountants and Pitcher Partners about the impact of these changes on taxpayers who have structured their affairs to take advantage of the changes introduced by the previous government in 2007.

The amendments, as stated in the explanatory memorandum to Tax Laws Amendment (2008 Measures No. 4) Bill 2008, are expected to have a small impact on compliance costs.

6. The detail of information required to answer this question is not available.

7. No.

8. The trust loss measures are designed to protect the integrity of the income tax system by preventing the tax benefits arising from the recoupment of a trust's tax losses and bad debt deductions being transferred to persons who did not bear the economic loss or bad debt when it was incurred. It is in this context that the amendments to the definition of 'family' to limit lineal descendants to children or grandchildren of the test individual or of the test individual's spouse have been made. The amendments do not directly affect the current capital gains tax (CGT) law and therefore no revenue estimates of possible future CGT consequences have been made.

9. No.

10. This measure has nothing to do with death duties. It simply reverses some of the changes introduced by the previous government in 2007, which had the effect of making family trusts even more concessionally taxed.

The CGT treatment of inheritances and trusts vesting differs legally and factually from death duties. Death duties applied to the value of the entire estate, with the tax liability falling on the deceased's executors while CGT only applies to the increase in value of an asset from acquisition to disposal.

More generally, Australia's small business CGT concessions provide for a range of circumstances and mean that eligible small business owners, including farmers, may pay a reduced amount, if any, CGT when disposing of their business. There are four small business CGT concessions including the 15 year exemption, the retirement exemption, the 50 per cent discount and the roll-over. This 50 per cent discount is in addition to the 50 per cent discount that is available for assets held by individuals or trusts for at least 12 months.

11. The current CGT treatment of the vesting of a trust is based on the general principle that a change in ownership gives rise to a CGT taxing point. When a trust vests, the trustee may distribute the various items of trust property to particular beneficiaries. The vesting has the broad effect of transferring title to the trust property to beneficiaries, which would typically trigger a CGT taxing point.

Consistent with this general principle, if a company disposes of an asset it owns, the disposal will typically trigger a CGT taxing point. Likewise, a CGT taxing point will typically arise when a shareholder disposes of shares they own in a company.

Although there is typically no CGT taxing point upon an individual's death, this does not mean that accrued capital gains on assets owned by the deceased are not taxable. Instead, any accrued CGT liability in effect 'rolls over' to the person inheriting the asset until that person disposes of it (other than through their own death). This ensures that the person inheriting the asset pays CGT on any increase in value from the date of death.

12. It is not appropriate for Treasury to comment on questions pertaining to policy.

13. On 3 September 2008 the Senate amended Tax Laws Amendment (2008 Measures No. 4) Bill 2008 to remove the family trust savings measure. The Government reluctantly accepted the amendment on 17 September 2008 as it was important to ensure that the amendments in Schedule 1 of the Bill, which apply from 1 July 2007, received royal assent.

14. As noted in 5 above, as part of the 2008-09 Budget process the Government considered representations and submissions from various bodies before taking the decision to reverse two of the previous government's changes to the trust loss measures.

15. The Treasurer announced in the 2008-09 Budget that the Government will conduct a comprehensive review of Australia's tax system to create a tax structure that positions Australia to deal with the demographic, social, economic and environmental challenges of the 21st century.

The Review will encompass Australian and state government taxes and interactions between the tax and transfer systems.

The terms of reference state that the review should reflect the Government's policy not to increase the rate or broaden the base of the goods and services tax; preserve tax-free superannuation payments for the over 60s; and the Government's announced aspirational goals for personal income tax.