# AUSTRALIAN SENATE

# ECONOMICS LEGISLATION COMMITTEE

# CONSIDERATION OF LEGISLATION REFERRED TO THE COMMITTEE

***Taxation Laws Amendment (Trust Loss and Other Deductions) Bill 1997, Family Trust Distribution Tax (Primary Liability) Bill 1997, Family Trust Distribution Tax (Secondary Liability) Bill 1997,and Medicare Levy Consequential Amendment (Trust Loss) Bill 1997.***

**November 1997**

**Parliament of the Commonwealth of Australia**

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Commonwealth of Australia

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# Senate Economics Legislation Committee

(As at 29 September 1997)

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# Report

## Background to the inquiry

The bills were introduced into the House of Representatives on 1 October 1997. The Senate Selection of Bills Committee referred the bills to the Economics Legislation Committee on 23 October 1997 for examination and report by 20 November 1997. The Committee subsequently sought and was granted an extension of time till 2 December 1997.

The Committee received 69 submissions (see APPENDIX 1) and held a public hearing on Thursday 13 November 1997 (see APPENDIX 2).

## Status Quo

The *Taxation Law Amendment (Trust Loss and Other Deductions) Bill 1997* will insert Schedule 2F, dealing with trust losses, into the Income Tax Assessment Act 1936. This Schedule sets out rules that have to be satisfied by trusts before a deduction is allowed for prior year and current year losses and certain debt deductions.

There are also three complementary Bills. Two of these impose a special tax which may become payable under the measures. These are the *Family Trust Distribution Tax (Primary Liability) Bill 1997* and the *Family Trust Distribution Tax (Secondary Liability) Bill 1997*. The third complementary Bill, the *Medicare Levy Consequential Amendment (Trust Loss) Bill 1997*, makes a consequential amendment to the *Medicare Levy Act 1986*. Separate Bills are necessary for constitutional reasons.

The proposed trust loss legislation was presented to the Parliament by the previous Government as part of the *Taxation Laws Amendment Bill (No. 4) 1995*. The Government announced in the 1996-97 Budget that it would proceed with the trust loss measures and that the general commencement date in relation to these measures would remain as 9 May 1995.

The Bill is broadly along the same lines as the 1995 Bill. However, a number of significant changes have been made generally to reduce the adverse impact on taxpayers. Many of the changes were made having regard to representations received on the measures including submissions made on an exposure draft of the legislation which was released for public comment on 10 February 1997.[1]

## The Bills

The government's intention for the Bills is to ensure that the trust loss measures restrict the recoupment of prior year and current year losses and debt deductions of trusts in order to prevent the transfer of the tax benefit of those losses or deductions. The tax benefit of losses is transferred when a person who did not bear the economic loss at the time it was incurred by the trust obtains a benefit from the trust being able to deduct the loss. The measures are

[1] Taxation Laws Amendment (Trust Loss & Other Deductions) Bill 1997, Explanatory Memorandum

intended to prevent a significant leakage of revenue that has resulted from the transfer of the tax benefit of trust losses.

The measures achieve this aim by examining whether there has been a change in underlying ownership or control of a trust or whether certain schemes have been entered into in order to take advantage of a trust's losses.[2]

The proposed rules will not apply to family trusts that make distributions (broadly defined) only to members of a family group. The income injection test applies to a family trust only where income is injected into it from outside the family group. A family trust is defined for the purposes of these measures.

The rules that are to apply to trusts will differ from those that apply to companies, reflecting the different characteristics of trusts. Accordingly, the particular rules that apply to a trust will depend on the type of trust. The three basic types of trusts that are dealt with differently in the legislation are fixed trusts (including widely held unit trusts), non-fixed trusts and excepted trusts. Excepted trusts include family trusts.

## Financial implications

Persons who use trusts to operate businesses or to carry on investment activities will be impacted by the proposed amendments. The trusts that will be affected are those which have deductions including prior year losses. In the 1995-96 income year the number of trusts that lodged tax returns as at 7 July 1997 totalled 372,449. The return data shows that these trusts operate across all industry sectors. The number of trusts with prior year losses in the income year 1995-1996 from primary production income was 5,636 and 49,166 from non-primary production income. The total amount of prior year losses returned was $5,160 million.

The proposed measures will prevent significant erosion of the tax base that would otherwise arise from the transfer of the benefit of trust losses.

The gain to revenue is estimated to be:

| | |
|---|---|
| 1995-96 | $90 million |
| 1996-97 | $185 million |
| 1997-98 | $160 million |
| 1998-99 | $75 million |
| 1999-2000 | $20 million |
| 2000-2001 | $20 million |

The trust loss measures are intended to prevent leakage of revenue that was occurring through the transfer of the tax benefit of trust losses. There are no provisions in the income tax law similar to those that apply to companies that effectively regulate the deductibility of trust losses against current and future income.

These measures deal with what is considered to be an anomaly in the current treatment of trusts and the government believes it will improve the efficiency and equity of the taxation system.

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[2] Taxation Laws Amendment (Trust Loss & Other Deductions) Bill 1997, Explanatory Memorandum

The Bills will have no significant impact on Commonwealth administrative expenditure. However, persons who use trusts to operate businesses or to carry on investment opportunities will incur some compliance costs.[3]

## Issues raised in evidence[4]

Each witness held similar views that the legislation is flawed, manifestly unfair and that it focuses on the loss rather than the trafficking. They supported many of their arguments with real life or hypothetical examples. Their main concerns are summarised below. A more detailed explanation on the more important points follows.

1. The Bills exceeds the Government intention of just stopping trafficking in trust losses;

2. Making the legislation effective from 9 May 1995 could mean many trusts are unable to claim a deduction for losses legitimately incurred during the past few years where there was in fact no trafficking in those losses. It is also claimed that losses incurred prior to May 1995 could be affected in the same way;

3. The complexity of the legislation may cause significant compliance costs for trust users. The industry estimates the cost could be as high as $60 million[5];

4. The family definition is too narrow;

5. A family trust election or an interposed entity election should not be irrevocable.

6. The pattern of distribution test is needless, too difficult, too expensive and is too easily failed;

7. The income injection test and the definition of benefit are both too broad;

8. The continuity of ownership test is easily failed and is more than a 50% stake test.

***Trafficking in trust losses.***

On 9 May 1995 the former government announced that the main reason it was introducing the legislation to stop trafficking in trust losses.

> *The tax law contains tests that limit the deductibility of losses incurred by companies. Their main purpose is to prevent a company with undeducted prior year losses being sold by its shareholders to a purchaser needing a vehicle in which tax sheltered income could be accumulated. These provisions do not apply to the deductibility of trust losses.*[6]

According to the National Tax & Accountants' Association trafficking to trust losses could be easily stopped by the continuity of ownership test and the same business test in the similar

---

3 Taxation Laws Amendment (Trust Loss & Other Deductions) Bill 1997, Explanatory Memorandum
4 For brevity we use 'evidence' and 'witness' to include written submissions.
5 Trust Loss Amendment Campaign submission No. 50, p. 275
6 Former Treasurer's press release of 9 May 1995

way these tests apply to companies. They believe that this would result in a greater degree of compliance and would reduce the level of abuse the provisions intend to subdue.[7]

Although paragraph 1.4 of the Explanatory memorandum supports the government's policy aim, the NTAA believe that a deduction for tax losses will be prohibited even where there was no transfer of the tax benefit of a tax loss.

Paragraph 1.5 of the explanatory memorandum details the likely revenue that will be gained from these provisions. Mr Wardle, NTAA said that there should be no changes in the revenue base if these provisions only attack the transfer of the trust losses.[8]

> *Provided the provisions do what the policy objective is — prevent the transfer of these tax benefits — there will be no change to revenue or no loss to revenue. Everything that we are putting forward today should have no impact on the revenue according to what the explanatory memorandum is talking about.*[9]

The Law Institute was of the strong opinion that the Bill was fatally flawed for two reasons. First, the attempt to stop trafficking in trust losses and the measures to regulate the carry forward of losses in trusts to them requires different pieces of legislation. Second, the provisions go far beyond what is necessary to ensure trust losses can be carried forward and be deductible in the future.[10]

> *Our attitude from the Law Institute has been from the outset that this is bad legislation; it ought not to be allowed to proceed. The concepts are different, separate and can be made to work. It is bad legislation, and we have not been prepared at any point to talk about alternatives and compromises*.[11]

Every witnessed claimed that they did not know anyone who was trafficking in trust losses. According to them, the practiced ceased on the day the measures where announced. Any client that approached them with a proposal that potentially involved trafficking, they all consistently advised their clients against it.

***Retrospectivity***

Following is a history of the legislation since the announcement on 9 May 1995 by the former Treasurer. On 28 September 1995 the legislation was introduced into Parliament and it varied from the announcement. The federal election in March 1996 resulted in a change of government. The August 1996 budget altered some of the provisions introduced into Parliament in September 1995.

In February 1997 the government released an exposure draft for comment that was different again. As a result of this consultation process the Treasurer announced in the May 1997 budget more amendments mainly relating to family trusts. The revised bill was introduced into Parliament on 1 October 1997. So over a period of 2 1/2 years the legislation has change considerably from the original announcement and that makes its very difficult for accountants and taxpayers to understand what is their legal position. It could be argued that these people

[7] National Tax & Accountants' Association submission No.53.
[8] Evidence, p. E104
[9] Evidence, p. E104
[10] Law Institute of Victoria submission No. 54.
[11] Evidence, p. E86

would be unfairly prejudiced if the legislation is enacted retrospectively ie May 1995 and beyond.

The Law Council of Australia argued strongly that there was no legitimate reason to have the legislation applied retrospectively as since the former Treasurer's announcement on 9 May 1995, trafficking in trust losses had ceased altogether. They stated that the existing anti-avoidance provisions in Part IVA of the *Income Tax Assessment Act* 1936 is sufficient to ensure that no further trading in trust losses occur. A recent court decision was cited where the Court made it clear that a scheme involving the diversion of assessable income to a loss trust was a tax benefit and thus subject to the provisions of Part IVA.[12]

The Law Council of Australia submitted that the retrospectivity measures were unnecessary and unjustified and strongly recommended that the legislation should only apply from the time the redrafted legislation was introduced into Parliament. If this did not occur it would deny the rights of people to conduct their affairs in an environment of certainty and in accordance with the established law of the day.[13]

The Law Institute of Victoria submitted that retrospective legislation is a very serious step for politicians. Its introduction has been justified in the past when blatant tax avoidance schemes are identified that clearly go against the spirit and intention of existing legislation and threaten Commonwealth revenue if not stopped. In the current situation however, the retrospective operating date and the "claw-back" of prior year losses before that date will affect a large number of innocent taxpayers who have not trafficked in trust losses or avoided paying tax.[14]

The Australian Society of CPA's submitted that there are three aspects to the retrospective provisions of the Bills. These are:

- They deny the benefit of losses that occurred before the announcement of the legislation on 9 May 1995;
- A large number of small and medium sized businesses are conducted in joint venture unit trusts established prior to 9 May 1995 and these will be affected by the retrospective provisions;
- The pattern of distribution test takes into account distributions made up to five years before the new provisions were announced.[15]

Mr Wardle of the NTAA added that the legislation should not take effect until it is passed as law.

> *The first point I want to make is that people who do have trust losses incurred prior to 9 May 1995— before the legislation was actually announced and before the press release was even issued that these losses were going to be in danger— are in danger of losing the tax benefit of those losses under these provisions. It is simply that, even if they try to keep those losses in their own business, when their business generates income, say this year, they will not be able to use those losses which they*

[12] Law Council of Australia, submission No. 46.
[13] Law Council of Australia, submission No. 46.
[14] Law Institute of Victoria, submission No. 54.
[15] Australian Society of CPA's, submission No. 47

> *have generated prior to 9 May 1995. That is the danger of the provisions in their current state. I believe the provisions can be rectified and certainly simplified to prevent that, but at the moment, as they stand, they will catch both those losses generated prior to May 1995 and losses incurred after that date. At the very least, I submit that these provisions should only apply to losses incurred after 9 May 1995. I would certainly submit that they do not apply until losses are incurred after the date they were actually introduced as law.*[16]

Arthur Andersen submitted that backdating complex and administratively difficult legislation such as this is unreasonable and inconsistent with normal government practice in relation to taxation measures. They believe it is inappropriate to prescribe retrospective legislation (9 May 1995) and impose a new set of rules that may penalise ordinary taxpayers and small business operators, by demanding that their actions since that date be reviewed and possibly amended to comply with rules that did not exist at that time.[17]

### *Complex legislation*

Mr Leibler said the complexity associated with this bill is such that it is impossible, in his view, for any members of parliament who are not specialists in this area to come to grips with what they are likely to be inflicting on their constituencies.[18] He accused the tax office of running its own agenda in relation to trusts by developing a very complex piece of legislation that subverts the clear intention of the government. The tax office did this by redefining the word "benefit" so it no longer meant benefit. He said:

> *What it really encompasses is any transaction, whether or not the transaction involves any element of benefit or compensation. If you doubt that, have a look at some of the examples in the explanatory memorandum transactions going back and forth pursuant to an arrangement even though there is no element of compensation and no element of benefit. The reality is that that is defined as a benefit. So in essence that is subverted.*[19]

Mr Wardle, NTAA informed the Committee that the legislation is very complex and hard to understand for a lot of individual taxpayers and small businesses. Although they are honest and hardworking people, who pay their taxes, they will not be aware whether they are complying or not with these complex provisions.

> *The most overwhelming feedback that I have received from the people that I have spoken to is about the complexity of the provisions. Because they are so complex, it is very hard for any adviser — and I am talking about the small firm accountant, the sole practitioner, tax agent, et cetera — to advise their people, let alone the individual taxpayers and small businesses to understand them without receiving professional advice. It is, I think, a simple fact that if laws are simple then people can comply with them. If they know the law and it is simple, they can comply with it. The more complex they are, the less they will comply with these laws. That has certainly come through from the people that I have spoken to. Because the laws are so complex, they just throw their hands up and say, `We don't know whether we are*

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16 Evidence, p. E104
17 Arthur Andersen submission No. 45
18 Evidence p. E76
19 Evidence p. E76

> *complying with them or not. We can't understand the laws. They are just so complex. They are too difficult.' Therefore, I think a lot of people will not comply.*[20]

***Income Injection Test***

The income injection test prevents the use of deductions by a trust to shelter assessable income from tax. The test operates to limit the trust's capacity to deduct prior year losses or current year deductions in certain circumstances. It does not apply to a family trust.

The Law Council of Australia informed the Committee that the income injection test is highly restrictive and will prevent the legitimate recoupment of trust losses by the people who bore the economic effect of the losses when they were incurred by the relevant trust.[21] The anti-avoidance provisions in Part IVA of the Act substantially deal with the situations that the income injection test seeks to cover.

The Law Institute of Victoria recommend that the anti-avoidance measures of the income injection test be removed from these provisions for the carry forward of losses and be dealt with in separate legislation.[22] The proposed income injection test should be modified to ensure that legitimate trust operators are not adversely affected. This could be achieved by an appropriate "dominant purpose of benefiting from the tax loss" test, and redefining the term "benefit" so it covers transactions that have commercial reality.

Mr Riley provided an example of how a genuine unit trust would be affected by the income injection test:

> *Let's assume that there is a unit trust and that the units are owned by a brother and his sister either personally or through family trusts, and that they own them 50 per cent each; so effectively the unit trust is owned 50 per cent brother and 50 per cent sister.Let's assume it made losses during the recession. Let's assume that the brother and sister or their associated entities funded those losses. We are talking about losses within the unit trust. In 1997 the brother and the sister see a new business opportunity. They resolve to enter into it and they say, `We've got this existing trust there. We recognise that it's got losses, so on the presumption that this business is going to be successful, we will put it in that trust because the profits will be able to be offset against the losses.*
>
> *The brother and the sister then lend the unit trust the money necessary to commence the new business opportunity. The new business opportunity is successful, the losses are recovered and the loans are repaid. Nothing is left to the family group. In fact, I should not even be referring to family there because I think I need to come back and reflect upon the fact that the brother and the sister, in a sense, are two different individuals. But nothing is left to the group that originally incurred the loss. However, there has been no transfer of units. There has been no transfer of control. In my view, there has been no income injection. However, the income injection test will apply to that scenario.*
>
> *We have losses there and arguably we have a scheme but under that scheme the brother and the sister provide a benefit, being the loans to the trust. The trust uses those loans to commence the business activity. The business activity generates the assessable income, which is another requirement. In due course the business is successful and those loans are repaid, which is the provision of a benefit back out of the trust. Then one asks oneself the question: can it be reasonably concluded that was done partly and little more than incidentally because of the existence of the*

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[20] Evidence p. E104
[21] Law Council of Australia submission No. 46.
[22] Law Institute of Victoria, submission No. 54

*losses? And that is not a difficult conclusion to reach."*

*The point that I have illustrated in that example is that when you have a situation that virtually anything is a benefit; that everybody, broadly speaking, except in the context of a family trust, virtually is an outsider, then you fail the first thresholds pretty easily and then you fail the test entirely once you reach the point that it is reasonable to conclude that something was done partly because of the existence of the losses. There is no dominant purpose test there. That, in my view, is the whole difficulty with the income injection test. Benefit is defined to mean something, outsider is too restrictive, and ultimately the onus, before somebody can deny the right to recover the losses, is far too easy to fail.*[23]

Mr Riley added the tax office solution to the above situation would be to suggest that you move out of the unit trust into a family trust. This is not that simple because of stamp duty, and capital gain tax considerations and possible contractual arrangements within the trust that will not allow you to restructure.[24]

***The family trust and the interposed entity elections***

A trust becomes a family trust for the purposes of the measures if it makes a family trust election. The family trust can include companies, partnerships and trusts that are owned by the family group if an interposed entity election is made by the family trust.

The main cause of concern with these elections is that both are irrevocable, and the current provisions are overly restrictive and inflexible to the commercial needs of businesses. The Committee was informed that once the losses were recouped, the effect of the election should cease, say after a period of 5 years.[25]

*No one is going to go into some tax scheme out of which it will take them at least five years or more before they can actually get the benefit. No one in their right mind will be involved in any such thing.*[26]

The narrow definition of "Family" has the potential to cause friction and lead to disputes. An example was provided where two brothers conduct a family business within a family trust. One brother must nominate as the test individual when making a family trust election. The family trust is able to make distributions to the grandchildren of the nominated brother however any distributions to the grandchildren of the other brother is subject to family trust distribution tax.[27]

It was suggested the definition of a family member should be extended to include uncles, aunts and great grandchildren to better reflect our multicultural society. The NTAA recommended the provisions of the legislation should include all lineal descendants as precedents show that family trusts can last 80 or more years.[28]

***Joint Unit Trusts***

[23] Evidence p. E91-92
[24] Evidence p. E92
[25] Evidence p. E105
[26] Evidence p. E105
[27] Shaddick and Spence submission No. 52, p. 328.
[28] Evidence p. E105

The Committee was advised that amendments announced on 1997/98-budget night to the Trust Loss Bills did not address joint venture schemes that are conducted through unit trusts. Many legitimate business activities are conducted through unit trusts but the income injection test denies relevant families the ability to recover losses incurred by the unit trust.

Mr Leibler provided an example of a joint venture between two distinct family groups who decide to conduct a legitimate business through a unit trust. The unit trust incurs a loss but under the legislation cannot claim a deduction for that loss because each family group can never qualify to make a family trust election as the unit trust is treated as a single unity. He argued that the legal form of the entity should not make a difference.

If unit trusts are to be excluded under these measures to gain a benefit he suggested that the government could at least amend the legislation to include a transitional arrangement so losses incurred by a unit trust up to 9 May 1995 are eligible.[29]

It was contended further amending the definition of “outsider” in the income injection test could easily rectify this. This would allow a fixed trust with units owned by a family trust who have made an election, to recover losses incurred by the unit trust, so neither the family trust nor any parties covered by the election are regarded as “outsiders” to the fixed trust. This would require consequential amendments to other provisions and possible transitional provisions so they are limited to fixed trusts existing on the August 1996 budget date.[30]

### *Continuity of Ownership Test*

The continuity of ownership test applies in determining whether there has been a change in ownership of a trust with fixed entitlements. It does not apply to family trusts. The Committee was advised that the test is too rigid and should only apply where there is a substantive change of ownership; not be triggered in cases where little or no change has occurred.[31] The MTAA highlighted the inequity of the 50% stake test in the following example.

> *The requirement is that if you have a unit trust, more than 50 per cent of the unit holders have to continue owning the trust after obtaining the tax losses. Say we have a unit trust and it has tax losses. You own 50 per cent of the units; I own 50 per cent of the units. Let us assume the business is not going very well at the moment so I say to you, `Look, this business is not going very well and we are losing a lot of money. I am getting out.' You say to me, `Yes, I want to stay in it. I think we can make a go of our business.' I get out of the business; you buy me out at whatever price it is. The business has had losses for a number of years and all of a sudden, without me there, you turn the business around and you are making profits. Unfortunately, under that scenario I have just given you, you cannot claim a deduction for those losses that you have actually suffered the economic burden of. All those losses that have been generated are now lost.*[32]

### *The Pattern of Distribution Test*

[29] Evidence p. E77
[30] ASCPA’s submission No. 47
[31] Taxation Institute of Australia submission No.63, p.391
[32] Evidence p. E105

A pattern of distribution test applies to discretionary trusts and only if those trusts have distributed income or capital. There was genuine concern the test applied to distributions made back as far as 1990.[33]

> *At the time you made them, five years before the provisions were a twinkle in somebody's eye; it may now well mean that you cannot carry forward those losses or carry forward or recover those losses.*[34]

The Committee was advised that this very complex test was not necessary, as the other tests were sufficient. Due to its complexity a large number of innocent taxpayers will fail the test because they just will not understand it. The cost of seeking professional advise will be prohibitive and discourage trust holders who have suffered losses from claiming them back at some time in the future.

> *The first point I would like to make is: why have the pattern of distributions test at all? All the other tests are more than sufficient but why do we need such a complex test at all?*
> *The other problem about the pattern distribution test, again, is its complexity. It really is very complex. Due to its complexity, a lot of taxpayers, a lot of individuals and small businesses will fail solely because they just do not understand how it works and that is the major concern. A lot of small businesses, a lot of mums and dads, will fail these tests because they do not understand how they work. They will not be able to prove that they have passed it. You need very detailed record keeping.*[35]

## The Government's View

The government advised the Committee that there was widespread consultation on this matter. The current government accepted the principles behind the legislation introduced by the former government and agreed to the start date of 9 May 1995. In February 1997 the government issued an exposure draft and sought views from a large number of interest parties. As a result of this process the legislation was amended to protect family trusts within a family group from these measures. This concession was generally well accepted.

On the issue of trafficking in trust losses the tax officials advised the Committee that there are two issues involved. The first one which consists of two parts is were some one buys a loss trust from its owner, then injects income into that trust to make use of those losses. The second part, and quite a significant practice, is where a person does not buy a loss trust, but just injects income into it and by an arrangement receive back that income tax free. Mr Manoranjan provided the following example:

> *Say a trust has $1 million of losses and I have $1 million of profits for the year. If I can get those profits into that loss trust under some arrangement whereby I pay say $100,000 to those people who own the trust and get back $900,000 tax-free that is a clear case of trafficking in trust losses. That part of it has not been I think clearly put to the committee. That is why I thought I might emphasise that aspect of it.*[36]

[33] Evidence p. E94
[34] Evidence p. E94
[35] Evidence p. E106
[36] Evidence p. E117

The other issue relates to discretionary trusts. A discretionary trust gives the power to the trustee to distribute the income of that trust to any beneficiaries, as the trustee desires. In year one beneficiary A receives all the income and in year two beneficiary B receives all the income and similar in later years. From this example it is difficult for the tax office to determine who has economically borne the loss. The beneficiary who was benefiting from the trust at the time the loss was incurred may be quite a different person from the beneficiary who is using the loss at a later date.[37] Mr Manoranjan said:

> *What we are looking at is a beneficiary who has income in his own right that would have been taxable and who is able to inject that income into the loss trust. They pay a consideration to others who are beneficiaries of the trust and they extract some of that income tax-free which is a big advantage. This is trafficking.*[38]

The Committee was advised although the anti-avoidance provision of Part IVA of the *Income Assessment Act* 1936 deals to some degree with trafficking in trust losses, this legislation is required to cover all possibilities in trafficking trust losses.

The tax office said they were concerned with Mr Leibler’s example were two particular family groups entered a joint venture using a unit trust but could not offset their losses under this legislation. They submitted that the family groups could have conducted their joint venture through a partnership. In a partnership if a loss occurs, that loss is past down to the partners. The partners in preparing their tax returns can use that loss to offset income that they have earned.[39]

Mr Leibler argued that the same business test should apply to trusts as it does for companies and the two family groups should be able to inject their taxable income into this loss trust to offset the loss. As mentioned above the tax office recognise this arrangement as a form of tax avoidance and drafted the legislation to ensure this situation does not occur.

> *I think the argument is that these trusts should be able to inject their taxable income into this loss trust and not pay any tax on that as a result. The problem is that this trust could inject income into this unit trust to use all of those losses in that unit trust, then pay a fee to these people and get their money back out tax free.*[40]

The tax office did not agree with the suggestion that the same business test should apply to trusts in the same way that it does for companies. Under our current tax laws trusts and companies are taxed significantly differently and this is where you run into problems trying to apply a test designed for companies to trusts. If you try to inject income into a unit trust with losses then it becomes a tax free distribution, for example:

> *The unit trust might be set up to acquire some property on the Gold Coast or wherever. In the initial years there may well be significant tax losses but not necessarily accounting losses. Those tax losses will be created through tax deductions that are available, such as capital allowances, and depreciation. So there could still be accounting profits coming through that particular trust. The losses may be used to offset that accounting income for quite some years. However, with a company, if you have tax preferred income and a distribution is made, it does not come out as tax free income. It comes out as an unfranked dividend, and tax is paid at the marginal rate by the shareholder who received it.*

[37] Evidence p. E117
[38] Evidence p. E118
[39] Evidence p. E124
[40] Evidence p. E124

> *There is a significant difference between the taxation of trusts and the taxation of companies. We consider that there is a rational basis for the same business test not applying. If the same business test applied to trusts, these measures would be significantly affected, if not wholly ineffective.*[41]

Although the two family groups cannot inject their taxable income into the unit trust, the tax office advised that as the losses are trapped within that trust they can still be used in the future to offset income that the trust earns,.[42]

On the question of retrospectivity the tax office informed the Committee that the major reason for the measures is to stop the trafficking in trust losses prior to 9 May 1995.

> *…. I would like to point out that the trust loss measures are designed to prevent the transfer of the tax benefit of trust losses to those who did not economically suffer them. A major purpose of the measures was to stop the trafficking in trust losses that was occurring before 9 May 1995.*[43]

The tax office rejected the allegations of retrospectivity and pointed out that the legislation will not prevent the use of losses incurred prior to 9 May 1995, unless certain action is taken by the taxpayer.

> *Only if certain action takes place after that date which affects the ability to carry forward the loss. Let me give an example. If there is a fixed trust and there is no change of ownership of the fixed trust and income is not injected into that fixed trust, then you can carry forward the losses without limit.*[44]
>
> *However, a trust will only be prevented from deducting losses if something happens after the commencement date that demonstrates that the tax benefit of those losses has been transferred to some other person. It is essential that some other things should have occurred for the trust loss measures to cut in.*[45]

There are number of transitional provisions in the Bills that only take effect from the date of that change. The pattern of distribution test only applies to distributions made after 9 May 1995, and the change to the provisions to include bad debts was announced on 20 August 1996 and applies only from that date.

> *Every change that has been made which is going to help taxpayers goes back to 9 May 1995. Every change which has been made which has the potential to make this situation worse for them only takes effect from the date that that change was stated to occur.*[46]

The government in considering the concession for the family group decided that in order to maintain the probity of the measures it was not necessary to define the definition of family too broadly. According to the tax office there is still a large number of potential beneficiaries

[41] Evidence p. E125
[42] Evidence p. E125
[43] Evidence p. E120
[44] Evidence p. E118
[45] Evidence p. E118
[46] Evidence p. E119

within a family group and it also includes family entities such as trusts, partnerships and companies wholly owned by individuals within the family group.[47]

The tax office said in response to the complaints about the complexity of the legislation that it was required because it wanted to avoid compliance costs on family trusts. The legislation has grown in length following consultation with industry and is also repetitive because it deals with different types of trusts.

> *Apart from some initial compliance costs, which will be minimal, a trust used to run a small business that elects to be a family trust and distributes income and capital only to members of the family group will not be affected by the measures.*[48]

According to the tax office the continuity of ownership test is designed to stop the transfer of tax benefit of losses. There must be more than a 50% change in ownership of fixed, partially fixed, and partially non-fixed trusts before a trust is unable to carry forward its losses.[49]

The pattern of distributions test commences from the date the original legislation was introduced into parliament, ie 28 September 1995 and only applies to distributions made after that date.[50]

## Comment/Conclusions and Recommendation

The Committee received 69 submissions and spoke to a range of representatives from the legal and accounting bodies in relation to this legislation. Despite the government’s consultation process and draft legislation it was clear that significant differences remain between the views of the groups providing evidence to the Committee and the view of government.

The Committee believes that the legislation has legitimate purpose and should proceed.

The Committee notes concerns that were raised in relation to the issue of retrospectivity in regard to the tax years prior to the announcement that would be affected by the legislation. It also notes concerns raised in regard to the complexity of the legislation and the changed arrangements in relation to the definition of family for the purposes of establishing family trusts.

The Committee notes the Bills are not to be debated in the Senate until the Autumn session next year. In the meantime the government should consider the evidence received by the Committee and subsequent supplementary submissions to determine whether there is any justification for further amendments to the Bills, particularly in relation to retrospectivity.

### The Committee recommends that the bill be passed.

[47] Evidence p. E122
[48] Evidence p. E124
[49] Evidence p. E126
[50] Evidence p. E119

Senator Alan Ferguson
Chairman

# Minority Report

The Opposition Committee members support the broad thrust of the summary of the submissions and evidence presented in the Majority Report. However, we disagree with the presentation of certain key aspects of the issues and have submitted this alternative Minority Report on some aspects of the legislation.

**Background**

For many years the Parliament has recognised that the availability of prior and current year tax losses incurred by companies for tax deduction purposes should be regulated. Legislation has been enacted which limits the circumstances under which losses are deductible. The limitations which apply to the recoupment of company losses have never applied to trusts. Accordingly, a market developed where losses incurred by trusts were "sold" between taxpayers. This activity is known as trafficking in trust losses.

Trafficking can be achieved in two ways, either by transferring the ownership of the trust (eg by selling the units in a unit trust with losses) to those who wish to purchase the losses or by allowing people to inject income into the loss trust and thereby gain the benefit of the losses against that income.

The net result of this activity is a reduction in the amount of income tax which is collected by the Commonwealth.

By 1995 trafficking in trust losses had become a serious threat to the income tax base. Accordingly, former Treasurer Ralph Willis announced proposals to deny the tax benefits associated with loss trafficking in the 1995 Budget. The legislation before the Committee arises from that announcement.

**Delay**

This legislation (and the related bills) comes before the Senate under irregular if not unique circumstances. The delay since the legislation was originally announced is unprecedented, and is without any justification.

The Majority Report (at page 10) partially details the extraordinary history of the bills. However, the Report makes a material omission by failing to state the reason why Labor's 1995 legislation was not passed prior to the March 1996 election. *Taxation Laws Amendment Bill (No 4) 1995* was considered by the Senate and was passed in 1995.

However, during consideration of the measures on 1 December 1995 a majority of non-government Senators successfully excised the trust loss provisions from the bill and referred them to Committee. Thus it was due to a deliberate and conscious action of these non-government Senators that the huge delay in this legislation has arisen, not from any lack of priority being given to the measure by the former Government.

This delay has, in turn, lead to the real concern in the community on a number of aspects of the package of legislation, including retrospectivity, now before the Senate.

**Retrospectivity**

One major area of concern in the evidence provided to the Committee by almost all of those providing submissions is the retrospective application of the legislation. Most of these submissions proposed that the commencement of the legislation, or some parts of it, be delayed from the dates proposed.

Whilst considering the issue carefully the Opposition cannot support such a recommendation.

It is common and accepted practice that income tax legislation often applies from the date of an official announcement by the Treasurer, rather than from a date after the legislation is introduced into Parliament or is granted royal assent.

This practice is a necessary evil, reflecting the need to protect the revenue by clamping down immediately on schemes and practices which have been identified by the Government as contrary to public policy objectives. Accordingly, there is nothing extraordinary about a taxation bill having a retrospective effect. That said, the amount of retrospectivity in these bills is truly extraordinary.

In evaluating whether the retrospective aspects of the bill should be altered, the Opposition has considered the consequences of any such change. If the application of the legislation were to be delayed there would be two effects.

Firstly, trafficking in trust losses would be effectively sanctioned by the Parliament for a further three financial years (1995-96, 1996-97 and part of 1997-98) with the Commonwealth losing an estimated $435 million in revenue as a result - only some taxpayers would enjoy this unwarranted windfall.

Secondly, a precedent would be set whereby the commencement of anti-avoidance legislation could be delayed significantly through affected stakeholders encouraging Government procrastination. The example of this legislation would undoubtedly be used as justification for further examples of this type of behaviour in the future.

The only beneficiaries of such a precedent would be those seeking to subvert future anti-avoidance moves and thereby avoid contributing their fair share of taxation.

Neither of these outcomes are acceptable to the Opposition.

Accordingly, whilst acknowledging that there may be some anomalies in the application of this legislation, the Opposition will not introduce, nor support, any amendments which seek to delay the application of this legislation.

**Family Trust Concession**

The legislation divides trusts into various categories reflecting the differing structures and membership profile of the differing types. One such category is family trusts. A family trust is a trust where the trustee has made a family trust election in respect of the trust. Family trusts typically involve a parent as the trustee with the beneficiaries including parents and children and, sometimes, other relatives. These are generally non-fixed trusts.

The Opposition accepts that family trusts should be treated as a separate category and supports the system of the trustee making an election for the family trust provisions to apply. This simple system will avoid the need for costs to be incurred in amending trust deeds to comply with the definition of a family trust.

Furthermore, Labor accepts that special rules of a concessional nature should apply to family trusts in the situation of income injections into the trust made by beneficiaries of the trust. Provision was made in the original legislation introduced in 1995 to exempt family trusts from the income injection test in some limited circumstances.

These situations were limited to those where *beneficiaries* injected income into a loss trust. However, even that limited concession was also subject to the possible application of the general anti-avoidance rule.

The legislation before the Committee goes far beyond that reasonable concession, by effectively providing that family trusts may continue to traffic in losses with most members of the extended family of the trustee and with any entity controlled by any of these relatives irrespective of whether these members of the family are beneficiaries or not.

The Opposition is resolutely opposed to the extension of the concession and considers that it will be regressive in its impact. Wealthy family groups will be able to continue to traffic in trust losses within the family group completely immune from the consequences that other taxpayers will face from this legislation.

Evidence provided to the Committee by the Australian Taxation Office confirmed that this increased concession will result in less revenue being collected, even though this will be offset to some extent by the tightening of the definition of family member for the purposes of the legislation.

Although Labor does not support this unjustified extension of the family trust concession, we recognise that taxpayers have acted in good faith on the basis of the official announcement by the Treasurer on this matter and that therefore it would be harsh and unreasonable to retrospectively abolish the broader concession.

The loosening of the family trust concession also raises anomalies between family trusts and non-family trusts. The differences in taxation liabilities attaching to the different entities could be material, especially if they are operating as competitors in the same market.

**Conclusion**

The legislation should be passed without delay to ensure the considerable revenue at risk is collected and so that certainty is delivered to taxpayers. No-one gains from any further delay of these bills.

The legislation creates many anomalies which cannot be adequately addressed from Opposition. Accordingly, Labor in government will review the whole issue of the taxation treatment of trust losses.

**Recommendation**

Despite the reservations expressed, above Opposition Committee members agree with the Majority Report that the Bills be passed.

Senator Jacinta Collins
Australian Labor Party

# ECONOMICS LEGISLATION COMMITTEE

**Consideration of**

***Taxation Laws Amendment (Trust Loss and Other Deductions) Bill 1997***

**plus three complementary bills**

***Family Trust Distribution Tax (Primary Liability) Bill 1997***
***Family Trust Distribution Tax (Secondary Liability) Bill 1997***
***Medicare Levy Consequential Amendment (Trust Loss) Bill 1997***

## MINORITY REPORT

**Senator Andrew Murray**
**Australian Democrats**

**December 1997**

**Economics Legislation Committee**

***Taxation Laws Amendment (Trust Loss and Other Deductions)Bill 1997***
**and three complementary bills**
***Family Trust Distribution Tax (Primary Liability) Bill 1997***
***Family Trust Distribution Tax (Secondary Liability) Bill 1997***
***Medicare Levy Consequential Amendment (Trust Loss) Bill 1997***

**Minority Report : Senator Andrew Murray : Australian Democrats**

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## 1. TRUSTS

Trusts are an extensively used and legal mechanism for conducting family and business affairs, and have long been so used in Australia. There are varying kinds of trusts. All trusts have characteristics which make them less transparent and often more complex than corporations. Tax benefits are derived from the use of trusts. These tax benefits and less transparency than corporations make trusts a target for reformers.

For some, trusts have a reputation that they can be used in a manner which is not conducive to good social conduct. However, there is no proof that the majority of families and businesses using trusts operate in this way, or that they operate outside the law. Successive Federal and State Governments have continued to support the use of trusts by Australians.

There are those who take a very dim view of trusts indeed. The eminent economist Professor John Quiggin, for instance :

> *"There are almost no trusts in Australia established for legitimate purposes.....The vast majority of trusts are set up with the primary purpose of avoiding tax that should be paid by high-income earners, thereby transferring the burden onto the rest of us. It is these trusts that are typically referred to as 'legitimate family trusts' ".*[51]

Professor Quiggin does not, in the article quoted, indicate what research informs him on the 'vast majority of trusts.'

Those characteristics of trusts which distinguish trusts from corporate entities may be summarised for the purposes of this report as follows :

- the beneficial and ultimate control of a trust is shielded from public disclosure
- the distribution of income in a trust is generally discretionary and can vary between the beneficiaries year by year
- the beneficiaries of trusts are shielded from the public eye
- trusts may be used to maximise tax effectiveness and tax planning in ways which are not available to incorporated bodies

In a trust arrangement there is a separation of the management powers of the trustee and the beneficial interests of the beneficiary. The trustee holds the legal interest in the trust property and has a fiduciary obligation to the beneficiaries. Legislation for the control of trustees is a

[51] John Quiggin, Professor of Economics, James Cook University. Australian Financial Review 16 April 1997

matter for the States and Territories. The Commonwealth largely derives its control over trusts from its taxation power (Section 51 (ii) of the Constitution.) However, depending on the trust concerned, the corporations power (section 51 (xx)), the pensions power (section 51 (xxiii)), and the marriages power (section 51 (xxi)) may come into play.

Nearly 28% of small business proprietors surveyed use trusts.[52] Robert Gottliebsen, of the BRW[53] described "income-splitting trusts" as "the cornerstone of the structure of a large number of the country's very small businesses."

I have had sight of the 1994/5 Taxation Statistics. The Treasurer would have relied on such statistics in making his trust losses announcement of 9 May 1995. Those statistics do not identify the number of family trusts, or of other trust types, and do not distinguish between trust types. Partnerships and Trusts are analysed together. Consequently it is difficult to draw conclusions on the nature of trustees, beneficiaries, income, losses, and taxation from these statistics, not only on trusts generally, but specifically by type of trust.

In 1997 the Australian Taxation Office (ATO) still somewhat surprisingly does not have complete analytical data concerning trusts. They do of course know that in the 95/6 tax year there were 372 449 trusts that lodged tax returns. On this number, it would be safe to assume that one to two million Australians are therefore involved in trusts, a substantial number of Australians.

In May 1997[54] I asked the ATO the following question concerning family trusts :

> **Senator Murray** - *Has the tax department done any detailed analysis of the constituent parts of family trusts - in other words, the average size of family trusts in terms of numbers of beneficiaries; whether they are ....adults or children, and the ratios and relationships; and how often they are Australian residents and citizens, as opposed to foreign residents and citizens ? Have you got that sort of analysis or snapshot picture of the typical trust?*
>
> **Mr Simpson** (ATO) - *The answer to that question is no. We have started some work on that but it has not reached any stage of being able to give an answer to that.*

As a result of my request the ATO subsequently randomly selected 224 trusts in Sydney and Melbourne out of 16 000 trusts which used 'family' in their title. They reported that there were an average of 2.49 beneficiaries per trust. 87% of individual beneficiaries were adults. 87% of beneficiaries were individuals, 8% companies, and 5% trusts. 109 (half) of the 224 trusts had business income. Total average business income was $929 000, average net business income was $103 000, average assets were $1.2m, and average liabilities $966 000. Of the 115 trusts that did not have business income, that were investment trusts, average assets were $542 000, and average liabilities $211 000. While better off than the average, these trust statistics do not seem to reflect the high wealth individuals and trusts, on which publicity has focussed.

Practitioners in this field do not appear to have analytical data available on trusts either :[55]

[52] Yellow Pages Small Business Index November 1997 page 8
[53] Business Review Weekly, September 8 1997, page 8
[54] Senate Economics Legislation Committee Hansard Thursday 8 May 1997 pages E22 and E23
[55] Senate Economics Legislation Committee Hansard Thursday 13 November 1997 page E98

> **Senator Murray** - *If you took 100 trusts which were within your accounting practice, you would be able to get a valid sample out of that, and extrapolate that across the range of 360 000 trusts, if you did some reasonable calculations. Now, none of that work has been done has it ?*
>
> **Mr Riley** (Chair, National Tax Practice Committee, Australian Society of Certified Practising Accountants.) - *No.....We could certainly, within our respective bodies, see if we could put some form of sample together for you.*

At the time of tabling this report, Mr Riley's sample had not yet been received.

I believe that neither the ATO nor the practitioners and representative organisations have a clear analytical picture, by type of trust, of trustees, beneficiaries, assets, liabilities, income, taxation, and so on. That must surely make it difficult to develop appropriate policy responses.

It also makes it problematic for Government or Parliament to reach firm conclusions to substantiate some trust policy legislative intentions.

**Recommendation 1**

a) That the ATO conduct appropriate analysis to establish relevant data by type of trust.
b) That the appropriate accounting and legal representative bodies themselves conduct sample analysis to verify and cross-check the ATO's work.

## 2. TRUSTS AND TAXATION REFORM

Significant legislative change has been initiated since 1980 to curb the legal minimisation or legal avoidance of tax by the use of trusts and discretionary trusts in particular. Illegal tax evasion is of course subject to the full force of the law.

Trusts gained particular attention in recent years as a result of Treasurers' Willis[56] and Costello both highlighting tax avoidance by high wealth individuals.

A proposal to tax trusts as companies was made in a Treasury submission to the Tax Summit of 1985. The House of Representatives Standing Committee on Finance and Public Administration in its report *Follow the Yellow Brick Road* in March 1991 recommended that Government should examine the feasibility of taxing all trusts in the same way as companies. The Australian Democrats believe that there are sound reasons to favourably consider a common taxation structure for all entities engaged in business activity.

The Treasurer and the ATO are presently conducting a review of trusts.

Professor Quiggin believes that

> *"A very simple reform which would eliminate much of the abuse of trusts would be to treat trust income as accruing to the trustee for taxation purposes, except in cases*

[56] Press Release 11 February 1996

> *where the trustee is a genuinely independent third party, like the Public Trustee for deceased estates."*[57]

There is undoubtedly momentum for tax reform of trusts.

These bills are complex and lengthy. The *Taxation Laws Amendment (Trust Loss and Other Deductions) Bill 1997* alone is 142 pages long, and the explanatory memorandum on all four bills is 187 pages long. This from a Government supposedly committed to less red tape, and which proposes substantial tax reform to deliver a simpler and fairer tax system.

It seems to me that it would be best if the Government had evaluated these bills against three criteria - its current review of trusts, analysis as per Recommendation 1 above, and the place this legislation will have in its overall tax reform package.

**Recommendation 2**

Significant changes to trust taxation should not be made in isolation of the Government's proposed overall tax reform package.

## 3. TRAFFICKING IN TRUST LOSSES

Trafficking in trust losses means that a person or entity who did not bear the economic loss, gains a tax benefit by buying a trust loss from another unconnected person or entity who did bear the economic loss. The ATO identifies two types of trust loss trafficking. One is where a trust with a loss is bought, and the new owner injects otherwise taxable income into it, to set the income against the loss and produce a tax benefit. The other is where a fee is paid to a trust so that otherwise taxable income can be injected into it by an unrelated party, is set against the loss, and then extracted tax free.

The ATO did not provide the Committee with empirical evidence or hard data to outline either the prevalence or extent of these types of trust loss trafficking.

It is apparent from the public debate, and from the evidence to the Committee, that there is no disagreement between the political parties, the Government, the ATO, accountants, lawyers, and the private sector on trafficking in trust losses. All are in agreement that trafficking in trust losses must be outlawed.

Evidence was led that in this respect trafficking in trust losses *had* been outlawed, and that the legislation was largely unnecessary. The witnesses to the Hearing were all in agreement that trafficking in trust losses had already ended as a result of the Treasurer's announcement of 9 May 1995. All anyway, were of the opinion that the anti-avoidance provisions of Part IVA of the *Income Tax Assessment Act 1936* already gave the ATO ample powers to prevent trafficking in trust losses.

The ATO is of the opinion that Part IVA does not give it sufficient powers to cover all trust loss trafficking possibilities.

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[57] Australian Financial Review 16 April 1997

What was surprising at the Hearing was that only one witness, Mr Mark Leibler, seemed to have any real knowledge of how the market for trafficking in trust losses operated.[58] Every witness claimed that they did not know anyone who was or had been trafficking in trust losses, and none had, or would, advise their clients to engage in the practice.

> **Senator Murray** - *....the evidence you have before yourselves as practitioners is that trafficking in trust losses - in other words, the deliberate manipulation of the system to distort the intention of the law - is minimal in your experience.*
>
> **Mr Wardle** Institute of Chartered Accountants of Australia -
> *Absolutely, certainly in my experience.*[59]

When questioned as to the size of the market in trust losses, there was again no hard data available. The evidence was that trafficking in trust losses had largely been achieved by advertising. It emerged that the extent of advertising was actually very small. This implies that trafficking in trust losses might not have been significant in terms of numbers of trusts affected. It is possible of course, that it could have been significant in terms of the quantum of losses trafficked in just a few trusts. Once again, hard data from the ATO would be useful.

> **Senator Murray** - *If there were 360 000 trusts, how many advertisements would have appeared in the year in Melbourne and Sydney? One per cent would be 3 600. Would there have been 3 600 advertisements?*
>
> **Mr Warnock** Legal Counsel National Tax and Accountants Association -
> *Certainly not. At the time there would have been very few advertisements -*
>
> **Senator Murray** - *Three hundred and thirty six advertisements? Thirty six?*
>
> **Mr Warnock** - *No, I would say the advertisements for trust losses would have been under 10.....In my experience, when it was around, it was more that everybody heard about it, not many people had an actual involvement in it.*[60]

Most telling of all, the ATO has not identified any improvement in its revenue as a result of trafficking in trust losses ending on 9 May 1995. All witnesses agreed that trafficking in trust losses ceased on 9 May 1995. If there was significant trust loss trafficking prior to that date, then there should have been a revenue improvement after that date. Are the ATO in fact able to identify revenue gains arising from cessation of the practice?

The witnesses believe that the $550 million gain to revenue projected by the ATO to accrue in the six tax years from 1995/6 to 2000/1 as a result of these bills, arises from attacking trust losses, not from attacking trafficking in trust losses.

**Recommendation 3**

The Australian Democrats support legislation that outlaws trafficking in trust losses.

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[58] Evidence Mr Mark Leibler, Member Taxation Committee, Law Council of Australia Senate Economics Legislation Committee Hansard Thursday 13 November 1997, pages E81 and E82
[59] Senate Economics Legislation Committee 13 November 1997 pages E99 and E100
[60] Senate Economics Legislation Committee Hansard Thursday 13 November 1997 page E108

## 4. DOES THE LEGISLATION TARGET TRUSTS, AND TRUST LOSSES, RATHER THAN TRAFFICKING IN TRUST LOSSES?

It is worth repeating the Majority Report's summation of evidence : 'Each witness held similar views that the legislation is flawed, manifestly unfair and that it focuses on the loss rather than the trafficking'. I have seldom experienced a Committee where the evidence offered in submissions and by witnesses is so opposed in content and conclusions from that of the ATO and the Government. The submissions and witnesses universally believe that the legislation targets trusts and trust losses rather than trafficking in trust losses, and that the net effect was similar to extensive tax penalties being wrongly imposed.

Further, evidence was offered that this legislation treats trusts detrimentally relative to companies.[61]

The evidence was persuasive, that the Government has moved from the consideration of tighter anti avoidance measures, to regulatory measures designed to change tax policy and the tax regime for trusts.

The nub of the non-ATO evidence is that some categories of trust losses, legitimately incurred, which should be capable of being set off against future profits, with legitimate connection between persons and entities, will now lose that tax benefit because of this legislation. These bills are seen as aimed at legitimate non-traffickers, and as using the excuse of trafficking legislation, to attack trusts at large.

In passing, it is worth noting that the ATO can not necessarily be relied on to get its revenue estimates right. This is often understandable. Sometimes the ATO's miscalculations are spectacular, such as with the introduction of FBT, and CGT. The precedent for ATO error in this difficult area of revenue forecasting does require us to be cautious, especially when, as in this instance, the ATO can not justify its revenue gain estimates.

Critics contend that the ATO figures are unsubstantiated and are derived from limited sample and field audits. There is a $550 million gain to revenue projected by the ATO to accrue in the six tax years from 1995/6 to 2000/1 as a result of these bills. It is not known how many trusts will fund this revenue gain, and how many will be spared. The gain to revenue for 1995/6 is projected by the ATO at $90 million. Since the evidence was that trafficking in trust losses ceased as a result of the Treasurer's announcement on 9 May 1995, these revenue gains must presumably be as a result of other measures now introduced.

We are advised by the ATO that out of 372 449 trusts, the number of trusts with prior year losses in 1995/6 was 54 802. The total amount of prior year losses in 1995/6 per the tax returns is computed by the ATO at $5,160 million. Dividing the one into the other gives us an average of nearly $100 000 of trust losses per trust. If we revert back to the analysis I provided at Section 1 above, that loss per average trust seems unlikely. It appears that most trusts do not carry forward losses, and most trusts with losses are at the lower end of the scale. It may be therefore that high losses are accumulated in a few trusts only :

> **Mr Meredith** Acting Assistant Commissioner ATO - *I can give you one example of one unit trust in which there are $40 million in losses in one trust.*[62]

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[61] Senate Economics Legislation Committee Hansard Thursday 13 November 1997 pages E88 and E89.
[62] Senate Economics Legislation Committee Hansard Thursday 13 November 1997 page E130

The question facing us is whether in targeting a relative few high loss trusts, that the many other trusts are unnecessarily attacked by this legislation. The Majority Report provides a good summary of the issues raised in evidence.

We have no way of knowing whether the ATO have underestimated the revenue effects of these measures. The ATO advise they expect to raise $550 million out of $5.2 billion trust losses, and out of 55 000 trusts. That represents about $10 000 additional revenue raised on average from each of those 55 000 trusts. It would have been helpful if industry representatives were able to quantify the expected financial impact on trusts. I suspect the legislation is too complex for them to do so.

**Recommendation 4**

The Australian Democrats will further consider amendments proposed to the Committee, particularly where the legislation places more onerous tax requirements on trusts than on companies. These are claimed to lessen some unnecessary consequences arising from legislation which appears to affect many more than those trusts targeted for trafficking in trust losses.

## 5. RETROSPECTIVITY

The Majority report correctly summarises the fact that the legislation before the Senate differs considerably from the original announcement of 9 May 1995, and differs considerably from the first versions of the bill. Submissions and witnesses to the Committee universally believe that the bills before us are far different in intent and consequence than as foreshadowed by the Treasurer on 9 May 1995. They felt that the bill was so materially different from the original announcement that people would be unfairly prejudiced if the legislation was effective retrospectively.

What is more, the complexity of this legislation seriously prejudices the interests of anyone attempting to govern their affairs according to the Treasurer's announcement of 9 May 1995. Submissions contend that these bills will affect large numbers of trusts who are not trust loss traffickers, who have operated entirely legally, who are taxpayers, and who will unfairly lose a tax benefit.

The ATO does not agree with these views.

The claimed consequences of this legislation are as complex as the legislation itself. Evidence was offered that the retrospective effects could extend back to the late 80's and forward for a number of years. It is claimed that losses legitimately incurred prior to 9 May 1995, that were not as a result of trafficking in trust losses, will be detrimentally affected by this legislation. Making the legislation retrospective from 9 May 1995 could mean many trusts are unable to claim a deduction for losses legitimately incurred during the years from 1995 onwards as well, when there was in fact no trafficking in these losses.

> **Mr Jones** Director Horvath Vic (Pty) Ltd -*It should be limited to trafficking and trafficking only. The fact is that the announcement on 9 May 1995 effectively ended*

> *trafficking on that day. Anybody who did it after that date would - in the vernacular - be a bloody fool, and I do not believe anybody has done that. What is the purpose of continuing with this legislation if the announcement achieved the primary design?*[63]

**Recommendation 5**

The Australian Democrats concur with the Majority Report that the Government should examine evidence to the Committee, and consider further amendments with respect to retrospectivity. While there is no case against retrospectivity to 9 May 1995 with regard to narrowly defined trafficking in trust losses, the Australian Democrats will explore alternatives for retrospectivity and transitional arrangements, with regard to those other legislative elements introduced subsequent to 9 May 1995.

## 6. OTHER ISSUES

Other issues raised in evidence include compliance costs, family definitions, family trust elections, interposed entity elections, the distribution test, the income injection test, the definition of benefit, the continuity of ownership test, and effects on joint unit trusts. Discontent was strongly expressed in terms of cost, complexity, unfairness, and bad policy.

With regard to unit trusts, evidence was led that with regard to the business test it was inequitable for publicly listed unit trusts to receive a tax concession not available to unlisted unit trusts. This has wide ramifications :

> **Mr Barbour** Member, Taxation Working Group, Investment Funds Association - *...there might be 300-odd thousand unit holders in listed trusts and probably about one and a half million non-superannuation unit holders in unlisted trusts.*[64]

The Government has apparently consulted widely on these matters, but the intensity of informed dissatisfaction expressed to the Committee may mean that it would be unwise for the government not to revisit these issues, before this legislation is debated in 1998.

**Recommendation 6**

The Australian Democrats recommend that the Government re-examine a number of these concerns expressed in submissions to the Committee, on grounds of fairness, simplicity, and efficiency.

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[63] Senate Economics Legislation Committee Hansard Thursday 13 November 1997 page E116
[64] Senate Economics Legislation Committee Hansard Thursday 13 November 1997 page E103

**Senator Andrew Murray**

Declaration: Senator Murray is a Trustee for a Family Trust

# Appendix 1

**List of Submissions**

| Submission | Name |
|---|---|
| 1. | Halperin & Co Pty Ltd |
| 2. | Stuart Glasgow |
| 3. | Boyd Partners Ltd |
| 3a. | Boyd Partners Ltd |
| 4. | Investment Funds Association Australia Ltd |
| 5. | Horwath S.A. Pty Ltd |
| 6. | Kelvin W. Boyd |
| 7. | Susan J. Prestneyt |
| 8. | Craig J. Van Wegen |
| 9. | James Jones |
| 10. | Lee Baines |
| 11. | Michael Dunn |
| 12. | Richard Owen |
| 13. | Anthony Dobbyn |
| 14. | Adrian Mancini |
| 15. | Bradley Reid |
| 16. | Julianne Moloney |

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17. Nicholas White
18. Alan Yildiz
19. Naree Brooks
20. Peter Sprekos
21. Anthony Carafa
22. Herc Koustas
23. Dani De Balsio
24. Chris Schreenan
25. Sarah Tovell
26. Chris Tanner
27. Brett Greig
28. Helen Cotter
29. Stephen Wolff
30. Judith Silvapulle
31. Brendan Farmer
32. Robyn Shaw
33. R.C. Melin - Horwath
34. Craig J. Stephens - Horwath
35. Briner & Associates
36. Horwath W.A. Pty Ltd
37. Horwath & Horwath
38. P. Sartori & Co Pty Ltd

39. Mann Judd Associates Pty Ltd

40. Metricon QLD Pty Ltd

41. Fobuxi Pty Ltd

42. Sydenham Developments Pty Ltd

43. BECTON Group of Co's

44. MAB Corp. Pty Ltd

45. Tony Stolarek - Arthur Andersen Co.

46. Law Council of Australia

47. A.S.C.P.A.'s

48. I.C.C.A.

49. Chaundy & Henry C.A.'s

50. William Buck Pty Ltd

51. Jerrard & Stuk

52. Shaddick & Spence

53. The Tax Advisers VOICE

54. Law Institute of Victoria

55. Coopers & Lybrand

56. Rose & Associates - Eli Goldfinger

57. Pitcher Partners - Neil Flavel

58. Gabrielle Pollard

59. Catherine Arnold

60. Kumi Sundanalingam

–

61. Scott Saunders
62. Christine Richardson
63. Taxation Institute of Australia
64. Family Business Council
65. C. & J. McHardy Pty Ltd
66. Freehill Hollingdale & Page
67. Butler & Mannix
68. Andrew Goldbager
69. Steve Hart

# Appendix 2

## Witnesses at hearing

### Canberra, 13 November 1997

| | Submission No. |
|---|---|
| **Law Council of Australia**<br>Mr Mark Leibler, AO, Arnold Bloch Leibler | **46** |
| **Law Institute of Vic**<br>Mr Tony Riordan, Chairman | **54** |
| **Australian Society of CPA's**<br>Mr Peter Riley | **47** |
| **Institute of Chartered Accountants**<br>Mr Geoff Wardle, Chartered Accountant | **48** |
| **Investment Funds Association**<br>Mr Richard Gilbert, Executive Director<br>Mr Michael Barbour, Senior Manager, Coopers & Lybrand | **4** |
| **National Tax & Accountants Association**<br>Mr Robert Warnock | **53** |
| **Trust Loss Amendment Campaign**<br>Mr Brian Patterson, Partner, Cooper & Lybrand<br>Mr Ian Kearney, Director, Hughes Fincher<br>Mr Steven Jones, Partner, Horwath & Horwath | **50** |
| **Senator the Hon Rod Kemp (Assistant Treasurer)**<br>Mr Tom Meredith<br>Mr Andrew England<br>Mr Mano Manoranjan | |