

Dissenting Report from Coalition Senators

Senators Alan Eggleston (Deputy Chair),
Barnaby Joyce and David Bushby

Overview

Schedule 1

To assist in the demutualisation of private health services, as wished for by private health insurers, the passage of Schedule 1 brings into effect a capital gains tax exemption to current policy holders for the one off gain.

The bill does this by expanding the definition of “members” under the current exemptions for tax in regard to demutualisations covered in Div 9AA and Schedule 2H of the *Income Tax Assessment Act 1936*.

In summary, there is an intended exemption in the act for demutualisation and this change brings current manifestations of demutualisation into the net of exemptions prescribed by the act.

Recommendation

It is the belief of the Coalition Senators that this situation is in need of remedy and the purpose of the act is to return the legislation to its original intent so should be supported.

Schedule 2

In brief, this schedule makes changes to lineal descendents laws for Family Trusts and changes to the variation of the Test Individual.

The current moves against changes to family trusts have little to do with closing loop holes and are far more, it appears, a move to transition trusts to entity taxation laws. The move to restrict the inter-generational nature of trusts works against the implicit nature of why we have trusts.

...a lot of trusts have a typical vesting period of around 80 years. In practice, they can typically cover four generations. The proposed amendment to limit the definition of family is out of line with the expected life span of trusts.¹

1 Mr Julian Cheng, Institute of Chartered Accountants, *Proof Committee Hansard*, 12 August 2008, p. 8.

The issue with the change to the test individual is that it starts to limit the lifespan of the trust and forces the trust to an event horizon where either the trust vests or the penalty tax is paid at 46.5 per cent. As that is at a premium to the corporate tax rate then the trust will become obsolete and companies will take their place. The benefit to the treasury is the long term removal of the tax advantage of discretionary trusts.

As discretionary trusts are one of the major ownership vehicles in family assets, especially rural land, then all current ownership structures will have to be reviewed, which has already started. For the discerning, majority non real property asset structures will be moved overseas, for the majority of trusts however they will, for no apparent reason, have the tax nature of their asset changed.

CHAIR—Are you aware of any groups of people who form family trusts—for example, in rural areas...

...I understand that there are in the area of the rural communities. It would mainly be in the farming sector, where the land may be held separately to the business...it might be because you want to segregate and control your assets in succession planning.²

These proposed changes effect a reversal of some of a suite of amendments made in this area by the previous Government under the *Tax Laws Amendment (2007 Measures No. 4) Act 2007*.

The rationale for reversing these amendments was stated in the Explanatory Memoranda as being a savings measure:

The trust loss measures 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 debts being transferred to persons who did not bear the economic loss or bad debt when it was incurred.³

This was reinforced by evidence received by Treasury:

When this measure was announced by the current government, it was announced as a savings measure.⁴

However, the methodology for calculating the quantum of savings was seen to be less than rigorous and, at least as far as it extended to the proposed amendment relating to lineal descendants, almost entirely absent:

The costing of this represents the reversal of the earlier measure, so it is based essentially on the earlier costing of the changes to family trusts and family trust elections... My recollection of the costing of this is that the

2 Mr Raphael Cicchini, Treasury, *Proof Committee Hansard*, 12 August 2008, p. 3.

3 *Explanatory Memorandum*, p. 33.

4 Mr Raphael Cicchini, Treasury, *Proof Committee Hansard*, 12 August 2008, p. 4.

lineal descendants, over the forward estimates period, is a very small part, probably around \$1 million.⁵

Evidence received from other witnesses (refer to comments by Mr Ali Noroozi below) suggests strongly that there will be no savings from the amendment relating to lineal descendants.

Given the lack of clear evidence that the amendment – particularly as it relates to the changes to lineal descendants – will save the government any money, the rationale for this change is questionable, given the clear evidence of the problems the 2007 amendment addressed and passing of the bill would reintroduce.

Despite the questionable calculations of savings, any savings that may be achieved as a result of the proposed changes will be well and truly lost by the cost that so many of the 400 to 500 thousand trusts will have to incur in order to re-adjust for the changes with no economic gain to the economy from this expenditure. In fact the forward figure itself, as proposed by the treasury, seems unlikely if the motivation for this law is, as stated, 'closing a loophole' and not the first step of much more encompassing change.

I do not believe that this is an integrity measure. As Treasury confirmed, it was seen as a savings measure...we doubt very much if it will save the government any money and, if it does, it will be very little and will be by way of almost a penalty tax...⁶

The fact that the test individual cannot be changed has serious implications where there is an unforeseen death, such as a car accident. The effect of the changes is that any new family trusts cannot nominate the deceased person as the test individual; therefore these trusts potentially cannot be included in the family group of the original test individual. Similarly, new companies owned by trusts may not be able to make interposed entity elections to be included in the family of the original test individual.

One of the things with the test individual is that...the families of today are smaller and, therefore, you may well find yourself in the position where you do not have any direct lineal descent.⁷

Whilst the Coalition was in government, the TLAB (4) 2007 allowed the test individual to be varied once, and for a good reason, to make better policy.

5 Mr Colin Brown, Treasury, *Proof Committee Hansard*, 12 August 2008, p. 5.

6 Mr Ali Noroozi, Institute of Chartered Accountants, *Proof Committee Hansard*, 12 August 2008, p. 8.

7 Mrs Genevieve Power, Family Business Australia, *Proof Committee Hansard*, 12 August 2008, p. 21.

Recommendation

Coalition Senators recommend that Schedule 2 be opposed as it is a change to the current structure and intent of trusts and a move which mitigates the effect of trusts - a widely used vehicle of asset ownership and protection, as well as being an essential element of an effective family tax structure.

Schedule 3

Technical amendments.

Recommendation

It is the belief of the Coalition Senators that this situation is in need of remedy and the purpose of the act is to return the legislation to its original intent so should be supported.

Senator Alan Eggleston

Deputy Chair

LP

Senator Barnaby Joyce

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Senator David Bushby

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