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Australian Taxation Office

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TO: , Acting General Manager, Tax Analysis Division

COPIES TO: TAX OFFICE: (Acting FAC),

TREASURY: (GM), Tax Design Division,

TREASURY REF: CQAU_0809_023 DATED 10 JUNE 2008

FROM: , Acting Assistant Commissioner

BUSINESS LINE: GOVERNANCE AND GOVERNMENT RELATIONS SECTION: REVENUE ANALYSIS BRANCH

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OTHER REFS: A. ATO MINUTE 431-2006 TO TREASURY DATED 19 JUNE 2006
B. ATO MINUTE 440-2006 TO TREASURY DATED 22 JUNE 2006

CATEGORY: ☒ Pre policy approval
☐ Legislative measures development
☐ General

ISSUE DATE: 26 June 2006 RESPONSE DATE:

SUBJECT: CHANGES TO TRUST CLONING – CGT EXCEPTIONS TO EVENTS E1 AND E2

1. Purpose

To provide an estimate of the revenue, departmental and compliance cost impacts of the proposal to remove the exceptions to capital gains tax (CGT) events E1 and E2.

2. Proposal

The first proposal is to remove the exceptions to CGT events E1 and E2. This will clarify and simplify the CGT implications that arise from trust cloning, and remove potential tax advantages that may arise as a result.

The second proposal is to remove the exceptions to CGT events E1 and E2, except where the trustee has made a family trust election (FTE). In this case, the identity of the appointor and specified individual must be the same for both trusts. This will also clarify and simplify the CGT implications that arise from trust cloning, and remove potential tax advantages that may arise as a result, while maintaining the trust cloning exemption for the legitimate non-tax purpose of succession planning or asset protection to preserve tax integrity.

3. Start Date

1 July 2008.

4. Background

Paragraphs 104-55(5)(b) and 104-60(5)(b) of the *Income Tax Assessment Act 1997* (ITAA 1997) provide an exception to CGT events E1 and E2, where a trust is created over an asset transferred from another trust or where an asset is transferred from one trust to another trust. In either situation the beneficiaries and terms of both trusts must be the same.

The Tax Office uses *Taxation Ruling 2006/4* (TR2006/4) to determine whether the trusts involved in trust cloning are the same, by using a strict definition both for meaning and effect. The only things that are allowed to alter under the ruling are the trustees, the commencement date, the establishment date, the settlors and the trust property.

Trust cloning is primarily used for succession planning and asset protection. Discretionary trusts are able to use cloning in succession planning to provide an effective transfer of control over individual assets without triggering a CGT taxing point. For example, a discretionary trust holds two properties, and has two beneficiaries who are individuals. By creating a cloned trust, with both individuals remaining beneficiaries of both, but with different corporate trustees controlled by each individual, control of the two properties is effectively split.

Asset protection is another reason for using trust cloning, to isolate passive investment assets from the risks associated with active business assets. For example, cloning may be used to isolate the shares and the rental property in a new trust so that they are not at risk of being taken by creditors to satisfy business debts.

It is also thought that trust cloning may be used to split trust assets between separate trusts so that each trust satisfies the maximum net asset value test and each can therefore access the CGT small business concessions. A further possibility is that trust cloning is also used to transfer assets between resident and non-resident trusts, resulting in any increase in the asset's value while in Australia escaping the Australian tax system.

5. Impact analysis – summary details

5.1 Revenue impact

Financial Year	2008-09	2009-10	2010-11	2011-12
	\$m	\$m	\$m	\$m
Proposal 1	-	*	*	*
Proposal 2	-	*	*	*

Key – '-' nil

'*' unquantifiable

The Tax Office believes that the revenue impact of both proposals is unquantifiable. Tax return data for the 2005-06 income year shows that approximately 80,000 new trusts lodged returns, of which around 50,000 were discretionary trusts. However, it is difficult to estimate how many of these trusts were established as a result of trust cloning.

If Proposal 1 were adopted it is expected that revenue collections would increase, though the extent of this increase is unknown, Proposal 1 offers some protection to the CGT revenue base. Also it is possible that if the exemptions are removed some trusts will instead seek other ways to transfer property without triggering a CGT taxing point.

If Proposal 2 were implemented it is expected to result in a lower revenue gain than Proposal 1, as it would allow trusts who make an FTE to be able to access the exceptions. It is thought that Proposal 2 may also result in an increase in the number of trusts making an FTE, as this would allow them access to the exceptions.

5.2 Compliance cost impact – (see Appendix 1)

Proposal 1

Overall impact summary

Based on the preliminary assessment, this proposal is expected to result in a low overall compliance cost impact, comprised of a low implementation impact and low decrease in ongoing compliance costs relative to the affected group.

Key issues

- Beneficiaries and trustees would need to become aware of the changes, and may need to evaluate what structure is now most appropriate for them.
- There could be a reduction in disputes and litigation
- Will reduce legislative complexity

Proposal 2

Overall impact summary

Based on the preliminary assessment, this proposal is expected to result in a low overall compliance cost impact, comprised of a low implementation impact and low increase in ongoing compliance costs relative to the affected group.

Key issues

- Beneficiaries and trustees would need to become aware of the changes, and may need to evaluate what structure is now most appropriate for them. There may be a need to re-evaluate their situation in the future.
- Some disputes and litigation, as well as requests for rulings will remain at the same level.

- Legislative complexity will be maintained for those trusts who choose to make a family trust election.

Section 22

**Acting Assistant Commissioner
Revenue Analysis Branch**

Appendix 1– Compliance cost impact

PROPOSAL 1 - PART 1: POTENTIAL COMPLIANCE COST IMPACTS

Step 1 DESCRIBE THE PROPOSAL

Proposal 1 is to remove the exceptions to CGT events E1 and E2.

Step 2: INDICATE TAX TYPES AFFECTED

Select tax type(s)	Income tax	PAYG / withholding	FBT	CGT	GST	Super	Excise
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Step 3: IDENTIFY AFFECTED GROUPS

Client Group	Characteristics and potential population
Individuals	<p>Key characteristics Individuals as beneficiaries of trusts that have used or could use trust cloning.</p> <p>Estimated number of taxpayers/clients or proportion of population Taxation Statistics 2005-06 reported that over 2.1 million individuals received income from a trust distribution in that income year. However, it is not known how many of these individuals are beneficiaries of trusts that have used or could use trust cloning.</p>
Businesses, superannuation funds and other entities	<p>Key characteristics Trusts that have used or could use trust cloning.</p> <p>Estimated number of taxpayers/clients or proportion of population Taxation Statistics 2005-06 reports that there were around 430,000 discretionary trusts in that income year, but it is not known how many trusts transferred assets using trust cloning.</p>
Tax practitioners	<p>Key characteristics Tax agents with trust clients.</p> <p>Estimated number of taxpayers/clients or proportion of population There are approximately 22,000 registered tax agents. The majority of these would be expected to have some trust clients that have used or could use trust cloning.</p>
Other intermediaries	<p>Key characteristics</p>
- Software developers	Estimated number of taxpayers/clients or proportion of population
- Bookkeepers	
- Financial Planners	

Step 4: IDENTIFY POTENTIAL BEHAVIOURAL RESPONSES THAT MIGHT AFFECT TAXPAYER COMPLIANCE COSTS

Taxpayer group(s)	Expected change(s)
Individuals Trustees	If this proposal were to go ahead it is expected that there may be a decrease in the use of trusts. This is because some of the purposes and resulting advantages for using trusts will be removed. However, this behavioural impact is not expected to be significant because taxpayers may have other motivations for setting up trusts.

Step 5: PROVIDE AN OVERVIEW OF THE POTENTIAL COMPLIANCE COST IMPACTS

The initial and ongoing compliance costs are expected to be low. The proposal will predominantly affect trustees that are considering transferring assets to another trust and avoid the CGT consequences through claiming the exception to a CGT event.

Step 6: provide A DETAILED description OF THE POTENTIAL implementation and ongoing COMPLIANCE COST IMPACTS

Implementation Impact	Magnitude	Explanation
Learning and education	Low	Beneficiaries, trustees and tax agents would need to be made aware of the changes. This would be expected to be done through the Tax Office website, updates to call centre scripts and publications being sent directly to tax agents. It is likely that individuals and other entities will rely on their tax agents to inform them of the changes.
Evaluation and planning	Low	Individuals and tax agents already use trust structures for various purposes. The changes contained in both proposals may result in individuals and tax agents evaluating whether their current trust structure is the most beneficial type for them.
Purchases – equipment/ software/supplies/advice	No Change	
Record keeping systems and procedures	No Change	There will not need to be any alteration of record keeping systems and procedures.
Forms and payments	No Change	
Rulings, audits, disputes and litigation	Low	Adopting this proposal may lead to less disputes and litigation because of the uncertainty involved in the current approach of the Tax Office under current law would be removed.
Associated (non-tax) compliance cost impacts	No Change	
Legislative complexity	Low	This proposal would slightly reduce legislative complexity.
Cash flow impact	No Change	
Start date capacity	No Change	
Overall rating	Low	Taxpayers and tax agents will need to become aware of the changes. They may also need to evaluate what the most beneficial trust structure is for their purposes.

Ongoing Impact	Magnitude	Explanation
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Learning and education	No Change	Once taxpayers are made aware of the changes there will be no further impact other than remedial.
Evaluation and planning	No Change	There is unlikely to be much change in trust planning in the long term, but it will likely reduce the use of trust cloning.
Purchases – equipment/ software/supplies/advice	No Change	
Record keeping systems and procedures	No Change	
Forms and payments	No Change	
Rulings, audits, disputes and litigation	Low Decrease	As per the Implementation costs above, adopting this proposal may lead to less disputes and litigation because of the uncertainty involved in the current approach of the Tax Office under current law would be removed.
Associated (non-tax) compliance cost impacts	No Change	
Legislative complexity	No Change	This proposal will result in a slight reduction in legislative complexity.
Cash flow impact	No Change	
Overall rating	Low Decrease	The potential reduction in disputes and litigation, combined with the slight decrease in legislative complexity, will decrease overall compliance costs.

Step 7: SUMMARISE THE POTENTIAL COMPLIANCE COST IMPACT OF THE PROPOSAL

Based on the preliminary assessment, this proposal is expected to result in a **Low** overall compliance cost impact, comprised of a **Low** implementation impact and a **Low Decrease** in ongoing compliance costs relative to the affected group.

Tax Compliance Cost Calculator Report

Executive Summary

Proposal 1: Changes to trust cloning – CGT exceptions to events E1 and E2

Problem: To be completed by Treasury

Objective : The intent of the first proposal is to clarify and simplify the CGT implications that arise from trust cloning, as well as remove potential tax advantages.

The intent of the second is the same as above, but maintains the trust cloning exemption for the 'legitimate non-tax purpose' of succession planning or asset protections. Special rules for trusts with family trust elections aim to protect tax integrity.

Implementation Options:

Option Name Changes to trust cloning – CGT exceptions to events E1 and E2

Quick scan result

Proposal 1 is to remove the exceptions to CGT events E1 and E2.

Low

Low

Compliance Cost Summary

Option Name: Changes to trust cloning – CGT exceptions to events E1 and E2

Taxpayers/Clients Affected: Beneficiaries and trustees of trusts who may currently use trust cloning.

Potential option costs	Potential cost per taxpayer/client	Total potential cost of regulation
<i>Start-up</i>	N/A	N/A
<i>Ongoing (p.a.)</i>	N/A	N/A

The above report contains a summary of potential direct compliance cost impacts only and is therefore a partial estimate of the potential compliance cost impact. An assessment of direct compliance costs does not indicate which policy option is the most effective and efficient. Rather, it provides information that needs to be considered alongside other relevant factors and issues when deciding between alternative policy options. The following section of this report includes a qualitative assessment of indirect compliance cost impacts, such as changes in legislative complexity, the timeframe for implementation and business cash flow.

The level of confidence of the compliance cost assessment

Supporting evidence is strong. Data is comprehensive and relevant	1. High	2. Medium	3. Low	Supporting evidence is weak. Firm data are not available requiring estimates to be made
<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	

Overall impact summary

Based on the preliminary assessment, this proposal is expected to result in a low overall compliance cost impact, comprised of a low implementation impact and low decrease in ongoing compliance costs relative to the affected group.

Key issues

- Beneficiaries and trustees would need to become aware of the changes, and may need to evaluate what structure is now most appropriate for them.
- There could be a reduction in disputes and litigation
- Will reduce legislative complexity

Data used in calculating suggested times (average hours) are informed by ATO expertise and information derived from the ATO-ATAX compliance cost survey; New Zealand SME survey; ATO time-box form data; and post-implementation reviews conducted by the Board of Taxation.

PROPOSAL 2 - PART 1: POTENTIAL COMPLIANCE COST IMPACTS

Step 1 DESCRIBE THE PROPOSAL

This proposal is to remove the exceptions to CGT events E1 and E2 except where the trustee has made a family trust election. The identity of the appointer and specified individual must also be the same for both trusts.

Step 2: INDICATE TAX TYPES AFFECTED

Select tax type(s)	Income tax	PAYG / withholding	FBT	CGT	GST	Super	Excise
	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Step 3: IDENTIFY AFFECTED GROUPS

Client Group	Characteristics and potential population
Individuals	<p>Key characteristics Individuals as beneficiaries of trusts that have used or could use trust cloning.</p> <p>Estimated number of taxpayers/clients or proportion of population Taxation Statistics 2005-06 reported that over 2.1 million individuals received income from a trust distribution in that income year. However, it is not known how many of these individuals are beneficiaries of trusts that have used or could use trust cloning.</p>
Businesses, superannuation funds and other entities	<p>Key characteristics Trusts that have used or could use trust cloning.</p> <p>Estimated number of taxpayers/clients or proportion of population Taxation Statistics 2005-06 reports that there were around 430,000 discretionary trusts in that income year, but it is not known how many trusts transferred assets using trust cloning.</p> <p>Trust tax return data shows that approximately 95,000 trusts who lodged a tax return in the 2005-06 income year had previously made a family trust election, that is, at some time between the 1997-98 and 2005-06 income year. However it is probable that this number may be higher, as completion of that part of the tax return is not compulsory. If proposal 2 were to go ahead then these trusts would receive the exception.</p>
Tax practitioners	<p>Key characteristics Tax agents with trust clients.</p> <p>Estimated number of taxpayers/clients or proportion of population There are approximately 22,000 registered tax agents. The majority of these would be expected to have some trust clients that have used or could use trust cloning.</p>
Other intermediaries	<p>Key characteristics</p> <p>Estimated number of taxpayers/clients or proportion of population</p> <ul style="list-style-type: none"> - Software developers - Bookkeepers - Financial Planners

Step 4: IDENTIFY POTENTIAL BEHAVIOURAL RESPONSES THAT MIGHT AFFECT TAXPAYER COMPLIANCE COSTS

Taxpayer group(s)	Expected change(s)
Individuals Trustees	If this proposal were to go ahead it is expected that there may be a decrease in the use of trusts. This is because some of the purposes and resulting advantages for using trusts will be removed. However, this behavioural impact is not expected to be significant because taxpayers may have other motivations for setting up trusts.

Step 5: PROVIDE AN OVERVIEW OF THE POTENTIAL COMPLIANCE COST IMPACTS

For this proposal the initial compliance costs are expected to be low and there are some aspects to the implementation costs that may be medium given the need to make a family trust election and undertake analysis of trust deeds.

Step 6: provide A DETAILED description OF THE POTENTIAL implementation and ongoing COMPLIANCE COST IMPACTS

Implementation Impact	Magnitude	Explanation
Learning and education	Low	For this proposal trustees, beneficiaries and tax agents would need to be made aware of the changes. This would be expected to be done through the Tax Office website, updates to call centre scripts and publications being sent directly to tax agents. It is likely that individuals and other entities will rely on their tax agents to inform them of the changes.
Evaluation and planning	Low	Individuals and tax agents already use trust structures for various purposes. The changes contained in both proposals may result in individuals and tax agents evaluating whether their current trust structure is the most beneficial type for them. The impacts and consequences of making a family trust election will need to be evaluated.
Purchases – equipment/ software/supplies/advice	No Change	
Record keeping systems and procedures	No Change	There will not need to be any alteration of record keeping systems and procedures.
Forms and payments	No Change	This proposal may require a family trust election to be made, minimal impacts are expected from having to do this.
Rulings, audits, disputes and litigation	Medium	Adopting this proposal would not remove the existing compliance costs as rulings may still be required and if anything the existing compliance burden would remain and may increase with the requirement that a family trust election be made.
Associated (non-tax) compliance cost impacts	No Change	

Legislative complexity	Low	This proposal would result in the existing complexity remaining for trusts who make family trust elections, and reduced complexity for other types of trusts.
Cash flow impact	No Change	
Start date capacity	No Change	
Overall rating	Low	Taxpayers and tax agents will need to become aware of the changes. They may also need to evaluate what the most beneficial trust structure is for their purposes. Overall this proposal would result in a low increase in compliance costs.

Ongoing Impact	Magnitude	Explanation
Learning and education	Low Increase	This proposal may require some further learning. For example, when making a family trust election.
Evaluation and planning	No Change	There is unlikely to be much change in trust planning in the long term, but it will likely reduce the use of trust cloning.
Purchases – equipment/ software/supplies/advice	No Change	
Record keeping systems and procedures	No Change	
Forms and payments	No Change	
Rulings, audits, disputes and litigation	Low Increase	Adopting this proposal would not remove the existing compliance costs as rulings may still be required and if anything the existing compliance burden would remain and may increase with the requirement that a family trust election be made.
Associated (non-tax) compliance cost impacts	No Change	
Legislative complexity	No Change	This proposal would result in the existing complexity remaining.
Cash flow impact	No Change	
Overall rating	Low Increase	Taxpayers may be required to be educated about making a family trust election in the future, and the compliance burden with making a family trust election is expected to remain the same. Rulings may also still be required.

Step 7: SUMMARISE THE POTENTIAL COMPLIANCE COST IMPACT OF THE PROPOSAL

Based on the preliminary assessment, this proposal is expected to result in a **Low** overall compliance cost impact, comprised of a **Low** implementation impact and a **Low Increase** in ongoing compliance costs relative to the affected group.

Tax Compliance Cost Calculator Report

Executive Summary

Proposal 2 - Changes to trust cloning – CGT exceptions to events E1 and E2

Problem: To be completed by Treasury

Objective : The intent of the first proposal is to clarify and simplify the CGT implications that arise from trust cloning, as well as remove potential tax advantages.

The intent of the second is the same as above, but maintains the trust cloning exemption for the 'legitimate non-tax purpose' of succession planning or asset protections. Special rules for trusts with family trust elections aim to protect tax integrity.

Implementation Options:

Option Name Changes to trust cloning – CGT exceptions to events E1 and E2

Quick scan result

Proposal 2 is to remove the above exceptions, except where the trust has made a family trust election. In this case the identity of the appointor and specified individual must be the same for both trusts.

Low

Low

Compliance Cost Summary




Option Name: Changes to trust cloning – CGT exceptions to events E1 and E2

Taxpayers/Clients Affected: Beneficiaries and trustees of trusts who may currently use trust cloning.

Potential option costs	Potential cost per taxpayer/client	Total potential cost of regulation
<i>Start-up</i>	N/A	N/A
<i>Ongoing (p.a.)</i>	N/A	N/A

The above report contains a summary of potential direct compliance cost impacts only and is therefore a partial estimate of the potential compliance cost impact. An assessment of direct compliance costs does not indicate which policy option is the most effective and efficient. Rather, it provides information that needs to be considered alongside other relevant factors and issues when deciding between alternative policy options. The following section of this report includes a qualitative assessment of indirect compliance cost impacts, such as changes in legislative complexity, the timeframe for implementation and business cash flow.

The level of confidence of the compliance cost assessment

Supporting evidence is strong. Data is comprehensive and relevant	1. High	2. Medium	3. Low	Supporting evidence is weak. Firm data are not available requiring estimates to be made
				

Overall impact summary

Based on the preliminary assessment, this proposal is expected to result in a low overall compliance cost impact, comprised of a low implementation impact and low increase in ongoing compliance costs relative to the affected group.

Key issues

- Beneficiaries and trustees would need to become aware of the changes, and may need to evaluate what structure is now most appropriate for them. There may be a need to re-evaluate their situation in the future.
- Some disputes and litigation, as well as requests for rulings will remain at the same level.
- Legislative complexity will be maintained for those trusts who choose to make a family trust election.

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