

# Document 9

## COSTING REQUEST

Our Ref No: CQAU\_0809\_023

**TITLE**      **Changes to trust cloning — CGT exemption**

### DETAILS

Requested by:		Phone No:	
Division:	Business Tax Division	Unit:	Capital Gains Tax Unit
Date of request:	10/06/2008	Date required by:	
Urgency: [routine, high, very high]	Routine	Sensitivity:	Medium

### DESCRIPTION:

#### Current Policy:

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

*Taxation Ruling* TR 2006/4 explains the current approach of the Tax Office for determining whether the trusts are the same. The approach takes a strict definition of the same, in meaning and effect. The only things that do not have to be the same are: the trustees; the commencement and establishment dates; the settlors; and, the trust property.

The Tax Office explains in ATO Minute 431/2006 why trust cloning might be used. Trust cloning is primarily used for succession planning and asset protection.

As a succession-planning tool, it can only be used by discretionary trusts. Cloning a discretionary trust but changing trustees allows an effective transfer of control over the individual assets without triggering a taxing point (provided the exemption test is met). For example, if two individuals are beneficiaries of a discretionary trust that holds two properties, one property could be transferred to a cloned trust. Both individuals remain beneficiaries of both trusts, but with different corporate trustees controlled by each individual — effectively splitting control of the two properties.

Trust cloning is used to isolate passive investment assets from the risks associated with active business assets. For example, a discretionary trust has a business with loans and other liabilities attached, plus shares and a rental property. Cloning may be used to isolate the shares and the rental property in a new trust so they do not run the risk of being taken by creditors to satisfy business debts.

There is also some suggestion of cloning being used to split trust assets between separate trusts so

each trust satisfies the maximum net asset value test and each can therefore access the CGT small business concessions. There have also been suggestions that it has been used to transfer assets between resident and non-resident trusts. If that happens, then any increase in the asset's value while it was in Australia escapes the Australian tax net permanently.

#### Proposal:

The first proposal is to remove the exceptions to CGT events E1 and E2.

The second 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 appointor and specified individual must be the same for both trusts.

In either case, the date of effect will be from the date of announcement. For the purpose of the costing, the date of effect will be from July 1 2008.

#### Intent of the measure:

The exception was originally inserted because it was thought that a change of trustee resulted in the creation of a new trust. It was therefore thought a provision was needed to ensure that the transfer of the trust assets to the 'new' trust did not trigger a CGT liability. However, subsequent opinion is that a change of trustee does not create a new trust, so arguably no exception is required.

The intent of the first proposal therefore 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 proposal is the same as for the first proposal, but maintains the trust cloning exemption for the 'legitimate non-tax purpose' of succession planning or asset protection. Specific tax rules for family trusts would arguably preserve tax integrity.

The pressure for this measure comes from the Tax Office for several reasons: difficulties in administering the current law; legislative gaps in the current law (such as the absence of roll-over rules despite the current practice of providing a roll-over); and, the potential for litigation to undermine the current approach of the Tax Office (including the strict interpretation of 'the same' and providing roll-over relief rather than the new trust acquiring a new cost base).

#### Additional analysis required:

No

#### Revenue impact:

According to ATO Minute 431/2006, a revenue gain is possible from the removal or reduction of exemptions to CGT events E1 and E2. The minute states that there is no data available to determine an estimate of the size of the revenue impact.

However, given the widespread concern from practitioners about the trust cloning rules, and in particular what is seen as an inflexible approach from the Tax Office, the potential revenue is significant.

**PREFERRED DATA AND ASSUMPTIONS:**

Data:

Assumptions:

**ATO Contact:**

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