Daniel Allison & Associates
Chartered Accountants and Tax Lawyers

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The General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir

Improving the Taxation of Trust Income
Submission to Discussion Paper

Daniel Allison & Associates Chartered Accountants and Tax Lawyers ("**DAA**") are advisors to many family business groups and high net wealth individuals. On behalf of our clients, we applaud and welcome the Government's initiatives to provide clarity in the operation of the trust income tax provisions in Division 6 of Part III of the *Income Tax Assessment Act 1936* ("**ITAA 1936**").

The operation of the current taxation of trust rules has been an area of much uncertainty since the Australian Taxation Office's ("**ATO**") attitudes and approaches in this regard had changed.[1] While the clarification of these provisions through legislative amendment will assist in resolving some of these uncertainties, we also raise some concerns to the approaches canvassed in the *Improving the Taxation of Trust Income* Discussion Paper.

1. Better Aligning the Concepts of Distributable Income and Taxable Income

Most of the current operative provisions of Division 6 of Part III of ITAA 1936 have been in existence since 1979.[2] In many regards, the issues highlighted in the Discussion Paper, in particular the interaction between the concepts of Distributable Income and Taxable Income (as they are defined in the Discussion Paper), are not new. Taxpayers and tax practitioners alike have had over three decades of experience and invested significant time and effort in coming to terms with these concepts. Over the decades, many of the difficulties highlighted in the Discussion Paper have been overcome through the use of specific provisions within the trust deed, such as widening a trustee's powers to determine the definition and composition of Distributable Income. For practical purposes, we believe that much of the problems highlighted in the Discussion Paper have been settled and are better left undisturbed.

For example, the problem highlighted in Example 1, in practice, is overcome through an income reclassification clause within the trust deed to enable the capital gain to be distributed as income o

[1] For example, compare the ATO's approaches in *Taxation Ruling* TR 1992/13 and *Law Administration Practice Statement (General Administration)* PS LA 2005/1 (GA) (withdrawn) with that in *Federal Commissioner of Taxation of T v Bamford & Ors* [2010] HCA 10 and *Law Administration Practice Statement* PS LA 2010/1.
[2] The current sections 95 and 97 of ITAA 1936 were first introduced by the *Income Tax Amendment Act 1979*.

f the trust estate. We also note that, in our experience, it is uncommon to have a trust deed that has separate income and capital beneficiaries, and therefore this scenario would only impact a small percentage of trusts.

We consider that abuse of income reclassification clauses to clearly manipulate tax liabilities, such as that demonstrated in Example 2, fall within the ambit of the general anti-avoidance provisions in Part IVA of ITAA 1936 which addresses schemes entered into with a dominant purpose of obtaining a tax benefit.

We therefore express caution in the Government's proposal in making legislative amendments to align the trust law concept of Distributable Income with the tax law concept of Taxable Income. In particular, we have concerns that the three approaches outlined in the Discussion Paper will introduce an additional layer of complexity and compliance costs for our clients without necessarily overcoming any problems that could not be addressed under the current law.

The first and second approaches of equating Distributable Income with "net income of a trust estate" and income determined in accordance with generally accepted accounting principles respectively is unsatisfactory. Both approaches are premised upon the trust deed definition of Distributable Income being able to be aligned, as a matter of trust law, with the legislative definition of Distributable Income. Where the trust deed does not provide for such an alignment, the first and second approaches will result in a mismatch between Distributable Income in accordance with the trust deed and Distributable Income in accordance with the legislative definition, which creates a further source of uncertainty.

On the other hand, where the trust deed contains an income equalisation clause and/or re-classification of income clause, as most modern trust deeds do, the first and second approaches do not produce a materially different or superior outcome than under the current method but simply adds to our clients' already substantial tax compliance burden. Under the first and second approaches, we anticipate significant changes would be necessary to the format of trust financial accounts, tax reconciliation statements and trust distribution minutes.

The third approach of defining Distributable Income to include capital gains also appears superfluous where the trust deed already provides a power to include capital gains made by the trust in its determination of Distributable Income.

We consider that redefining the concept of distributable income is a fundamental change to the taxation of trusts that will have far-reaching effects for each trust. We consider that this issue would be better addressed as part of the overall reassessment of Division 6 which we understand the Government is to commence later this year.

We absolutely reject any specific anti-avoidance provisions being introduced in relation to the taxation of trusts. Specific anti-avoidance provisions are invariably drafted widely and confer discretionary powers to the Federal Commissioner of Taxation.[3] The introduction of a specific anti-avoidance provision to the taxation of trusts will simply add greater uncertainty.

[3] Note for example section 45A, 45B and 45C of ITAA 1936, section 100A of ITAA 1936 and Division 204 of ITAA 1997.

2. Enabling the Streaming of Franked Distributions and Net Capital Gains

We welcome the amendment of current tax laws to enable the streaming of franked distributions and net capital gains to ensure that distributions of such amounts will retain their character in the hands of beneficiaries. However, we do not see any basis for limiting the ability for a trust to stream only franked distributions and capital gains but not any other classes or pools of income.

Trusts, and in particular, discretionary trusts are commonly used by family groups as a vehicle to accumulate wealth through a variety of investments and not limited to investments in Australian shares and other capital assets. A trust may derive other classes of income such as interest income, rental income, foreign income and trading income. It is common for trust deeds to include powers allowing trustees to distribute particular classes of income to particular beneficiaries. This may be for succession planning purposes or for other familial purposes.

We submit that the ability to stream income of a trust should be extended to apply to other classes of trust income and not be limited to only dividends and capital gains. Accordingly, we recommend that, in addition to amending Subdivision 207-B and Subdivision 115-C of ITAA 1997, provisions be introduced to Division 6 of Part III of ITAA 1936 to allow a general ability for trusts to stream other classes of trust income to beneficiaries. This could be possible, for instance, through legislative amendment of the word "share" of the net income of the trust estate in section 97 of ITAA 1936 to include "parts of" or "share of classes within" the net income of the trust estate.

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We thank you for the opportunity to make this submission.

Should you have any queries or require clarification, please do not hesitate to contact the writer.

Yours sincerely
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