Parliamentary Budget Office

Policy costing

Discretionary trust reform	
Party:	Australian Labor Party
Summary of proposal: • Implement a minimum tax rate of 30 per cent on discretionary trust distributions to mature beneficiaries (individuals over 18 years of age). – The minimum tax rate would be applied to the total trust distribution, rather than on a marginal basis. Non-trust income would continue to be taxed at marginal rates, with an individual's tax liability on this income assessed exclusive of discretionary trust income. – Trust distributions relating to primary production income would be exempt from the minimum tax rate. – Discretionary trust distributions to people undergoing serious hardship (for instance, those with a disability) would be exempt from the minimum tax rate at the discretion of the Commissioner of Taxation. – The minimum tax rate would not apply to distributions from discretionary charitable trusts, deceased estate trusts, or testamentary trusts. The proposal would take effect from 1 July 2019.	

Costing overview

Policy background

A trust is a structure in which a trustee is under an obligation to hold assets for the benefit of others (the beneficiaries). Discretionary trusts are widely used for estate planning and asset protection, while providing the trustee with discretion over the allocation of income and capital of the trust to its beneficiaries.

Under current policy, discretionary trust distributions to individuals aged 18 years and over are taxed at marginal tax rates. The proposal would tax these distributions at a minimum average rate of 30 per cent, with some exclusions.

This would primarily affect individuals receiving a trust distribution who have little other net income. Individuals facing a marginal tax rate above 30 per cent before receiving a trust distribution would typically not be affected, nor would those receiving sufficiently large trust distributions such that the average tax rate on the distribution already exceeds 30 per cent.

Under the proposal, individuals would continue to receive franking credits from trust distributions that include dividend income, and the minimum tax rate calculation would then apply to dividends and franking credits. Similarly, the capital gains tax discount would continue to apply when capital gains are realised within a trust and allocated to an individual, and the minimum tax rate calculation would apply to the discounted capital gain.

Financial impact

This proposal would be expected to increase the fiscal and underlying cash balances by $7,685 million over the 2019-20 Budget forward estimates period. This impact reflects an increase in revenue of $7,700 million, partially offset by an increase in departmental expenses of $15 million over this period.

Table 1: Financial implications ($m)[a][b]

	2019–20	2020–21	2021–22	2022–23	Total to 2022–23
Fiscal balance	1,085	2,200	2,200	2,300	**7,685**
Underlying cash balance	1,085	2,200	2,200	2,300	**7,685**

(a) A positive number represents an increase in the relevant budget balance; a negative number represents a decrease.
(b) Figures may not sum to totals due to rounding.

This proposal would be expected to have an ongoing impact that extends beyond the 2019-20 Budget forward estimates period. The financial implications of the proposal for the period to 2029-30 are included at Attachment A.

Uncertainties

This costing is subject to uncertainties surrounding the growth rate of capital income of discretionary trusts, as well as potential behavioural responses.[1] The degree to which individuals would choose to divert their investments away from discretionary trusts as a result of this change is highly uncertain, as many individuals hold discretionary trusts for significant reasons other than the potential tax benefits, such as estate planning, income and asset protection, and control over the size and timing of distributions. There would also be transaction costs and capital gains tax associated with moving assets out of a trust. These factors, and existing compliance work by the Australian Taxation Office (ATO), may limit the extent of any behavioural responses.

Key assumptions

The Parliamentary Budget Office has made the following assumptions in costing this proposal.

Behavioural responses

- Some affected individuals with a marginal tax rate below 30 per cent would bring forward trust distributions from 2019-20 to before the start date of 1 July 2019, however this would not have a material impact on the financial implications.

[1] There are inherent uncertainties in all policy costings, regardless of who produces them. For a more detailed discussion of the nature and sources of these uncertainties, see Parliamentary Budget Office information paper no. 01/2017, *Factors influencing the reliability of policy proposal costings.*

- Some individuals and trustees affected by the proposal would find ways to adjust their affairs in order to minimise the impact of the proposal.
  - Small businesses could choose to pay wages to working family members instead of using trust distributions.
  - Trustees could choose to allocate trust income to a company and distribute franked dividends to beneficiaries with low taxable incomes, on which the minimum tax rate would not apply.
  - Individuals may choose to wind up a discretionary trust to invest in alternative tax-effective investments, such as superannuation.
  - The impacts of these potential behavioural responses are significant and have been assessed in aggregate. They reduce the revenue impact by 25 per cent. The extent to which individuals would adjust their behaviour is limited by the other reasons individuals hold discretionary trusts and because there are transaction costs associated with changing arrangements. It would also be limited by the existing compliance work of the ATO relating to trusts, such as the 2013-14 Budget measure *Tax compliance – Australian Taxation Office trusts taskforce*.

Timing of tax collections

- The alternative minimum tax would be collected in the same financial year as the distribution for 50 per cent of all affected trust distributions, with the other 50 per cent collected in the year of assessment.
  - This is because the additional tax is expected to be factored into the existing withholding schedules for trust distributions.

Exemptions

- Allowing an exemption from the proposal for those undergoing serious hardship would not have a material impact on the financial implications.

Methodology

- The costing was estimated using a 2016-17 de-identified trust unit record file and a 16 per cent sample of de-identified personal income tax and superannuation returns for 2016-17 provided by the ATO.
  - The data were used to estimate the additional tax collected from each individual if a minimum tax rate of 30 per cent was applied on discretionary trust distributions (excluding from those trusts and distributions that are exempted from the proposal) to individuals aged over 18. This impact was projected over the period to 2029-30, taking into account proposed policy settings, income and population growth, and the behavioural responses outlined above.
  - The estimates were benchmarked to 100 per cent files of personal income tax and superannuation returns for a number of years to ensure a representative sample.
- This costing has taken account of the timing of tax collections.
- Departmental expenses include the costs of implementation.
- Estimates of revenue have been rounded to the nearest $100 million.
- Departmental expense estimates have been rounded to the nearest $1 million.

Data sources

The ATO provided:

- a 16 per cent sample of de-identified personal income tax and superannuation returns from the 2014-15, 2015-16 and 2016-17 tax years
- a 100 per cent file of de-identified personal income tax, trust and superannuation returns from the 2014-15, 2015-16 and 2016-17 tax years.

Australian Taxation Office, 2019. *Current issues with trusts and the tax system,* Canberra: Commonwealth of Australia.

Australian Bureau of Statistics, 2013. *Australian and New Zealand Standard Industrial Classification (ANZSIC) 2006*, Canberra: Commonwealth of Australia.

Commonwealth of Australia, 2013. *2013-14 Budget*, Canberra: Commonwealth of Australia.

Attachment A – Discretionary trust reform – financial implications

Table A1: Discretionary trust reform – Fiscal and underlying cash balances ($m)[(a)(b)]

	2019–20	2020–21	2021–22	2022–23	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29	2029–30	**Total to 2022–23**	**Total to 2029–30**
Revenue	*1,100*	*2,200*	*2,200*	*2,300*	*2,400*	*2,500*	*2,700*	*2,800*	*2,900*	*3,000*	*3,100*	***7,700***	***26,900***
Departmental – ATO	*-15*	-	-	-	-	-	-	-	-	-	-	***-15***	***-15***
Total	**1,085**	**2,200**	**2,200**	**2,300**	**2,400**	**2,500**	**2,700**	**2,800**	**2,900**	**3,000**	**3,100**	**7,685**	**26,885**

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms.
A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms.
A positive number for the underlying cash balance indicates an increase in receipts or a decrease in payments or net capital investment in cash terms.
A negative number for the underlying cash balance indicates a decrease in receipts or an increase in payments or net capital investment in cash terms.

(b) Figures may not sum to totals due to rounding.

\- Indicates nil.