CAs seek clarity around farm carve-out from Labor's 30% minimum trust distribution tax and ask: "Why no carve-out for active small businesses?"

4 September 2017

A few weeks back, I asked Chartered Accountants ANZ Tax News readers to comment on the ALP's proposal to deny the graduated personal rate scale to individual beneficiaries of discretionary trusts, imposing instead a *minimum* 30% tax on distributions to adult beneficiaries from 1 July 2019.

Here's the first instalment on what you had to say[1]. More of your feedback next week.

1. Active small businesses should be carved-out too, just like the farmers

Labor's decision to carve-out farm trusts prompted many CAs to write-in about their SME clients, particularly in light of Bill Shorten's interview with ABC News where he acknowledged that about 200,000 small businesses would be impacted.

CAs pointed out that, like farmers, they too had small business clients where family members work in the business, with some in the younger generation expected to follow in their parents' footsteps.

In some cases, these small business clients were analogous to farmers because they operated in industries which, like agriculture, were subject to variable conditions (e.g. building and construction) and found the start-up phase particularly tough.

From rural Australia in particular came examples of businesses dependent on rural activity (e.g. the businesses of rural contractors, produce merchants, farm equipment suppliers, agents).

Overall, there was a strong theme that Labor should provide a small business carve-out, perhaps by developing an "active business" family trust test.

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[1] Unless otherwise mentioned, all references to a "trust" refer to a discretionary trust, the only type of trust targeted by Labor's policy.

This test could be dovetailed with the active small business company issue which Revenue Minister Kelly O'Dwyer recently alluded to in response to questions about eligibility for the 27.5% small company tax rate.

In the absence of such equivalent treatment, CAs felt the farm trust carve-out would continue to be derided as politically motivated, designed to mute the powerful rural lobby, as distinct from other small businesses operating in disparate industries which struggle to speak with one voice.

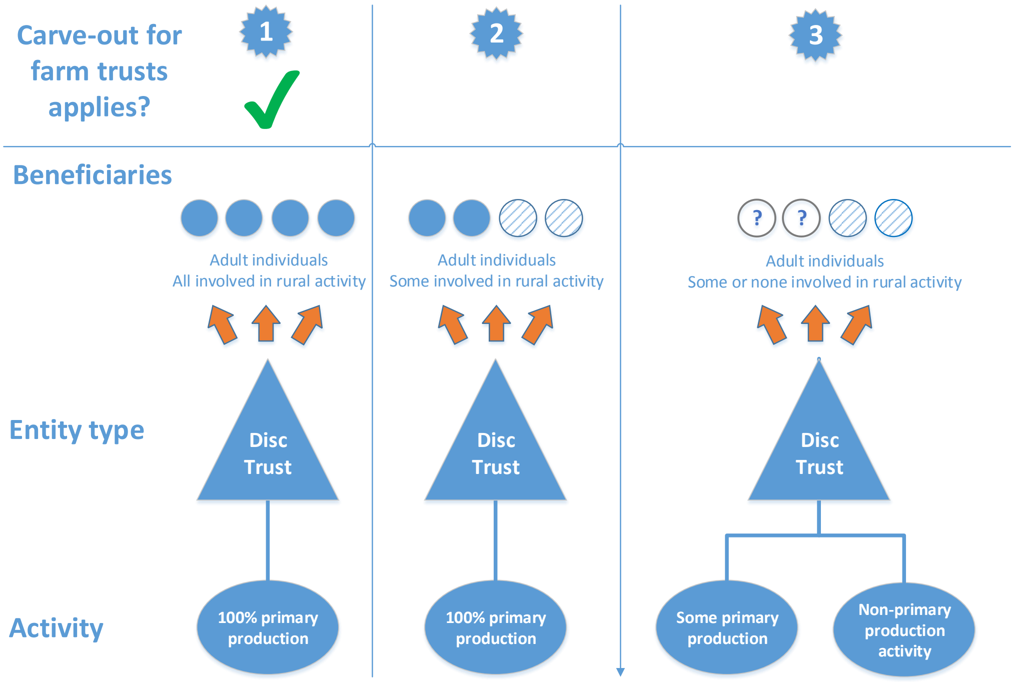
2. What's the scope of the farm trust carve-out?

CAs with farm trust clients wanted to know more from Labor about the scope of the carve-out.

They know all too well that the devil is always in the detail when it comes to tax announcements and are concerned about their clients' eligibility.

Various scenarios were put to CA ANZ for clarification with Labor. Here are some diagrams to help explain the concerns raised:

Scenarios 1, 2 & 3: The scope of the farm trust exclusion



Source: Chartered Accountants Australia and New Zealand

Scenario 1

This scenario depicts the most straightforward farm trust structure I could think of. The trust is solely engaged in primary production activity and all trust beneficiaries are associated with the rural activity.

There seems little doubt this simple structure would be carved out under Labor's model.

However, the structures rural CAs deal with are usually more complicated.

Scenario 2

Clearly, not all members of a farming family work the land. But those who pursue opportunities elsewhere may nonetheless be beneficiaries of the farm trust, as will other family members such as grandparents who may have retired.

There are also scenarios where no beneficiary has a substantial connection with the day-to-day farming activity conducted by the trust. For example, older readers will recall the expression “Pitt St farmer”, describing a successful city dweller who also runs a genuine farming business using the services of a farm manager and contract labour.

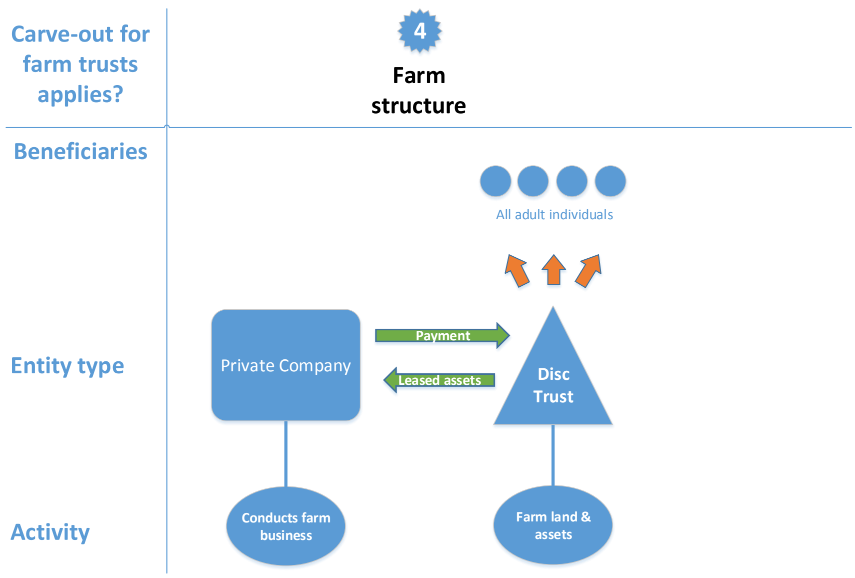
Scenario 3

Successful, astute farming families may have built up investments in the trust over several generations and the trust distribution therefore includes non-farm sources of trust income.

I’m not just talking cash reserves and investments here. For example:

- A farmer may conduct multiple businesses (e.g. by undertaking contract harvesting for other farms in the district)
- By leasing primary production land and\or equipment to others who actually undertake day-to-day rural activity: see Scenario 4.

Scenario 4: The scope of the farm trust exclusion – Trust supports active business



Source: Chartered Accountants Australia and New Zealand

Overall, the two questions from CAs boil-down to this:

- In view of the farm trust carve-out, why target non-farm, active small businesses?
- Tell us how you’ll define “farm trusts” to determine eligibility for the carve-out?