

This law creates a 70% tax rate

The follow is the same arrangement and how it is taxed before the DTMT and after the DTMT. The tax rate increases from 47% (which is correct as it is the highest marginal tax rate) to 70%.

A trust earning income, making a company presently entitled to that income and that company pays a dividend to a shareholder before the DTMT – 47% tax rate

- A trust makes \$100 in profits
- The trust makes a company presently entitled to the \$100
- The company includes \$100 in its assessable income.
- **The company pays \$30 in tax**
- The company pays a fully franked \$70 dividend to a shareholder
- The shareholder includes the \$70 dividend and the \$30 franking credit in their taxable income = \$100
- The taxpayer includes the \$100 in their tax return and potentially pays 47% (\$47) on that amount
- However, the taxpayer has \$30 of franking credits
- **The shareholder pays \$17** (\$47 - \$30)
- Total tax paid on the \$100 the trust earned: \$30 by company & \$17 by the shareholder = \$47 for a 47% tax rate

A trust earning income, making a company presently entitled, that pays a dividend to a shareholder under the DTMT – 70% tax rate

- A minimum tax trust makes \$100 in profits, all of which are minimum tax income
- **The trust pays \$30 in tax**
- The trust makes a company presently entitled to the \$100.
- While the company is owed \$100 from the trust, the trust only has \$70 after paying the tax so transfers the \$70 to the company
- The company includes the \$100 in its assessable income (it has to include the entire present entitlement)
- If the company has no other income or deductions in pays 30% (assume not a base rate entity) in tax on this \$100.
- **The company pays \$30 in tax**
- This \$30 in tax is paid from the \$70 it received, leaving the company with \$40.

\$100 of income was earned, \$60 was paid to the ATO leaving \$40 left. **The tax rate at this moment is 60%.** But it gets worse...

- The company pays the \$40 out as a fully franked dividend to a shareholder.
- The company can attach ~\$17 of franking credits
- The shareholder includes the \$40 and the \$17 in their assessable income - ~\$57.
- The shareholder potentially has tax payable at 47% on this ~\$57, being ~\$27.
- However, the shareholder has a ~\$17 franking credit so the ~\$27 of tax they owe is reduced to ~\$10
- **The shareholder pays \$10 in tax**
- The shareholder received \$40 and paid \$10 in tax so now has \$30.
- Total tax paid on the \$100 the trust earned: \$30 by trust, \$30 by the company & \$10 by the shareholder = \$70 for a 70% tax rate

The Discretionary Trust Minimum Tax was supposed to achieve a 30% minimum tax, but it this creates a 70% tax rate.

This is easily fixed and the Treasury are aware of this fix.

The Treasury have suggested the arrangement above should continue to be taxed at 70% as the fix discussed below would be more complex than what is currently in the Bill. This Bill offers some simplicity with a 70% tax rate and rejects some complexity with the appropriate tax rate of 47%. It is obvious that this is an inappropriate choice and the committee should recommend the fix below be added to the Bill.

Fixing the 70% tax rate

The company should be given a non-refundable offset for the amount of tax paid by the trust, as is the case for non-corporate beneficiaries. Therefore, the company would not pay 30% as the trust has already paid 30% on the amount

To ensure the company cannot then pay a dividend to a low taxed individual who can get the tax paid by the trust refunded, the company does not get a franking credit for the tax it did not pay due to using the offset.

However, the company records the amount of these non-refundable offsets it uses and can attach these non-refundable offsets to any unfranked dividends it pays, providing the shareholder with a non-refundable offset.

This simple solution would return the tax rate to 47%.

The Committee should recommend the Bill be amended to remove the 70% tax rate by implementing this simple and well know method.

Should you wish to discuss this further I am happy to be contacted on 0429 566 516 or ken@taxrambling.com.

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