

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Additional Estimates

13 – 14 February 2013

Question: AET 63

Topic: Taxing Trusts

Hansard Page: Page 103, 14 February 2013

Senator CAMERON asked:

Senator CAMERON: Just let me go through the other issue. Joe Hockey, the week before this article but I do not know exactly what day, in an address to accountants said:

The difference in tax rates between entities carrying on businesses as individuals, partnerships, trusts and companies according to the type of legal entity seems to have no basis in logic.

So the shadow Treasurer is saying this whole trust approach has no basis in logic. He then went on to say that the different tax treatment provides incentives to arrange business affairs to minimise tax rather than focus on business activity. Are you aware of those statements by the shadow Treasurer?

Mr Jordan: I am not aware of those specific statements, but it does raise the choice that taxpayers do have in terms of what vehicle they can use to carry on a business. They can be a sole trader and simply pay tax at their marginal rate. They can be a partnership, which does not have limited liability, and achieve income splitting through a partnership mechanism. They can have a trust or they can have a company.

Senator CAMERON: You can take this on notice. Can you provide me the logic between the different entities. I am not asking you to do it now, because I have a range of questions, but take it on notice and provide me the logic of that. It seems to me that the shadow Treasurer is saying there is no logic in it and John Passant from the faculty of law says it offends a basic tax principle. So I would like you to take those questions on notice and come back to me. Thanks for the questions on notice that you answered last time.

Answer:

In Australia, persons may carry on businesses through a number of different legal entities, including sole traders, general or limited partnerships, trusts, or companies (or a combination of these entities).

Each of these legal structures has advantages and disadvantages independent of tax. For example, they offer different levels of limited liability, asset protection, reporting obligations and operating costs (such as legal and accounting fees).

In terms of taxation, companies are taxed at 30 per cent with a credit flowing through to shareholders. Partnership and trusts are treated as flow through vehicles where income is attributed to individual partners or beneficiaries and taxed at their personal tax rates. In addition, limited liability partnerships and public trading trusts that operate as companies and provide limited liability are treated as companies by the Australian tax system and taxed accordingly.

You mention Mr Passant's public view that this differential tax treatment offends a basic tax principle that entities in similar tax situations should be taxed similarly (equity principle). This view raises the public policy trade-offs between the principles for a good tax system.

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It is arguable that this differential tax treatment amongst legal entities may lead to the substitution of one form of business structure for another and therefore breaches the equity principle, and in particular horizontal equity (taxpayers with the same economic power pay the same tax). However, in order to raise tax revenue, this equity principle can be traded-off against other tax principles such as efficiency (raise and redistribute revenue at the least possible cost to economic efficiency and with minimal administration and compliance costs) and sustainability (raise revenue to fund government programs).

Finally, the Australian tax system does try to reduce the distortion between choosing different business structures by integrating the tax treatment of these legal entities with progressive personal income tax rates.