



ATO trust crackdown – here's what you need to consider

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While tax experts continue to slam the ATO over its decision to "drive a stake into the heart of SMEs" by cracking down on discretionary trusts, entrepreneurs using trusts are trying to figure out what they need to do to prevent their tax bill getting out of control.

The crackdown focuses on a tax planning arrangement used by thousands of entrepreneurs – a trust distributes income to a corporate beneficiary, which then pays tax on that distribution at the corporate tax rate of 30%. But no cash actually moves between the trust and the corporate beneficiary – instead, the funds remain in the trust, where they can be used by the business owner as working capital to fund further growth. This is known as an unpaid present entitlement.

But the ATO wants to crack down on instances where the funds retained in the trust are used to purchase personal assets, such as cars or property.

It will do this by treating unpaid present entitlements as a deemed dividend paid by the corporate beneficiary, taxed at the highest marginal tax rate

Tax experts have warned the crackdown will cost hundreds of millions of dollars and could send some businesses to the wall if they are forced to restructure their operations and pay large tax bills.

Entrepreneurs who use this common structure are being told to get in contact with their tax advisor as quickly as possible to start working through the possible consequences of the ATO's rule changes.

Sue Prestney, principal at MGI Melbourne and SME spokesperson for the Institute of Chartered Accountants, says the size of the problem a business owner will face is likely to depend on how the transaction between the company and the trust has been described.

If it has been called a loan – something very common in many company accounts, according to Prestney – then the entrepreneur is likely to face a

problem, as the ATO will now treat this as a deemed dividend, taxable at the highest marginal tax rate.

The taxpayer will be able to avoid this loan being classed as a deemed dividend if they put a commercial, arms-length loan arrangement in place.

However, the loan will generally need to be repaid over seven years, and minimum repayments of the interest and principal will need to be made each year.

How the loan is used by the trust will also have an impact on the entrepreneur's tax bill. If the loan is invested in assets where tax is deductible (property would be a good example) then the entrepreneur may be able to avoid paying tax on the interest.

Prestney says entrepreneurs will also need to consider how distributions made by a trust to a corporate beneficiary in the 2010 tax year will be treated.

The distribution could simply be paid to a corporate beneficiary in cash. However, if an entrepreneur wants to reinvest this distribution into their business via the trust, they will need to go through the process of setting up a commercial loan agreement.

Marc Peskett, a partner of MPR Group, says business owners with a trust will also need to start talking to their adviser about long-term tax planning in light of the ATO's decision.

"You need to think about whether this is the right structure for you going forward. Is it still relevant to have a discretionary trust or will a company structure suit me better?"

Prestney says the ATO's ruling will have a "huge impact" on SMEs over the next few years and like many in the tax profession says the Government needs to legislate on the issue to clear up confusion and complexity.

"The tax profession really believes that in law this ruling is not correct."