



## Public advice and guidance compendium – TD 2019/13

### **1 Relying on this Compendium**

This Compendium of comments provides responses to comments received on draft Taxation Determination TD 2019/D8 *Income tax: what is an ‘employee share trust’?* It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO’s general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

### **Summary of issues raised and responses**

| <b>Issue number</b>     | <b>Issue raised</b>   | <b>ATO response</b>  |
|-------------------------|---|--|
| <b>General comments</b> |   |  |
| 1                       | We support the Commissioner’s intent to provide greater clarity in relation to the Commissioner’s approach to employee share trusts (ESTs).   | Noted.   |
| 2                       | <p>It would be useful if the final Determination could confirm that, for the purposes of the definition of an EST:</p> <ul style="list-style-type: none"><li>the reference to ‘shares’ includes a reference to stapled securities, as acquisition by employees of stapled securities in their employer are treated in the same way as acquisition of a share, provided that at least one of the ownership interests that are stapled is a share (see section 83A-335 of the <i>Income Tax Assessment Act 1997</i><sup>1</sup>), and</li><li>the reference to ‘employee’ includes a reference to an individual covered by column 1 of the table in section 83A-325 (being the extended definition of employee for the purposes of Division 83A).</li></ul> | Agreed. Section 130-97 provides that sections 83A-335 (about stapled securities) and 83A-325 (about relationships similar to employment) have effect for the purposes of Subdivision 130-D in the same way they do for Division 83A. We have included footnotes 4 and 5 in the final Determination to clarify the relationship between these provisions. |

<sup>1</sup> All legislative references in this compendium are to the *Income Tax Assessment Act 1997* unless otherwise indicated.

| Issue number                                 | Issue raised   | ATO response   |
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| <b>Trustee acting in multiple capacities</b> |  |  |
| 3  | We agree with the Commissioner's approach in paragraph 5 of the draft Determination.   | Noted.   |
| <b>Activities</b>                            |  |  |
| 4  | We support the Commissioner's view that the test requires an examination of the activities undertaken, and that the existence of a clause in the trust documents will not, of itself, cause a trust to fail the test.  | Noted.   |
| <b>Merely incidental</b>                     |  |  |
| <b>General comments</b>                      |  |  |
| 5  | We are in broad agreement with the views expressed in the draft Determination regarding the permissible activities of an EST. However, in our view, the meaning of 'merely incidental' is broader than that indicated by the examples in the draft Determination. A similar, but arguably broader, definition of the phrase 'merely incidental' can be ascertained from the body of case law considering the meaning of 'merely incidental' in the context of the activities of a charitable institution. In this context, activities have been held to be 'merely incidental' provided that they are 'something which tends to assist, or which naturally goes with, the achievement of the main object.' ( <i>Navy Health Limited v Deputy Commissioner of Taxation</i> [2007] FCA 931 at [65]). | <p>The Commissioner considers that the suggested test, in large parts, aligns with the views outlined in paragraphs 9 to 11 of the final Determination, to the extent that the activities must be a natural incident or consequence of the specified activities in paragraphs 130-85(4)(a) and (b).</p> <p>The context of the case law arising in respect of charitable institutions is significantly different to the context of the EST legislation. In considering whether a body is a 'charitable institution', the phrase 'merely incidental' has simply been used by the courts as a means of examining relevant objects of the body under consideration, as opposed to being a specific requirement in a relevant Act. Similarly, the courts in those cases are examining broad objects relating to a particular body, as opposed to links to specific, prescribed activities.</p> <p>The Government's intent with ESTs was that they were designed to be little more than bare trusts, to just acquire, hold and pass on shares/ employee share scheme (ESS) interests to employees.</p> <p>See also our response to Issue 8 of this Compendium.</p> |
| 6  | The foundations and basis for ruling that certain listed activities at paragraphs 11 and 12 of the draft Determination are considered to be/not to be merely incidental should be individually explained with the inclusion of detailed and sound reasoning supporting the positions taken. As currently drafted, there is little technical  | <p>The principles regarding whether an activity is merely incidental are outlined in paragraphs 9 to 11 of the final Determination. Paragraphs 12 and 13 of the final Determination (paragraphs 11 and 12 of the draft Determination) merely list examples of activities that do/do not satisfy these principles.</p> <p>However we have included additional explanation at paragraphs 32 to 40 of</p>   |

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|              | reasoning as to why certain activities are acceptable and others are not.   | the final Determination to more clearly show the connection between the activities listed and the legal principles.   |
| 7            | Paragraph 12 of the draft Determination provides a series of 'bright line' activity tests. However these activity tests appear to go beyond Parliament's intent in crafting legislation where the terms are applied to the particular facts in respect of each actual EST (and not in the abstract). In the same way that paragraph 6 of the draft Determination refers to the need to interrogate 'actual activities', activities that are not 'merely incidental' should be considered in the light of the particular facts and circumstances of the actual EST. Accordingly, we believe that paragraph 12 of the draft Determination should be qualified to say that consideration must be given to the activities and surrounding facts and circumstances in respect of each case. There is no hard and fast way to make this call in the abstract as purported by the draft Determination. | <p>Paragraph 13 of the final Determination (paragraph 12 of the draft Determination) does not set out tests, it merely lists some examples of activities that will not satisfy the general principles of what is 'merely incidental' as outlined in paragraphs 9 to 11 of the final Determination.</p> <p>Paragraph 6 of the final Determination refers to 'actual activities', because the test in subsection 130-85(4) refers to the trust's 'sole activities'. So we must look to what the trustee actually does rather than what it could do under the trust documents.</p> <p>However, 'merely incidental' is defined by reference to the two primary purposes outlined in paragraphs 130-85(4)(a) and (b):</p> <ul style="list-style-type: none"> <li>• obtaining shares or rights in a company, and</li> <li>• ensuring that ESS interests in the company are provided under the ESS to employees.</li> </ul> <p>That is, any other activities of the trust must be merely incidental to these two activities. Paragraphs 12 and 13 of the final Determination provide examples of activities that the Commissioner considers would and would not be merely incidental to those two primary activities, regardless of the type of trust or the particular facts and circumstances.</p> |
| 8            | A conjoint phrase like 'merely incidental' should be considered in its place in the broader drafting of the legislation and by how the words 'lean in' together. For example, taking their natural dictionary meaning into account and then reading them together, these words should be read more expansively to reference activities that are merely subordinate to the purpose of the EST, that is, providing a supportive role to the EST but not intending to achieve a separate outcome to that of the EST.   | <p>It is considered that the Commissioner's view, as outlined in paragraphs 9 to 11 of the final Determination, reflects a reading together of the words 'merely incidental' that is consistent with the legislative intent of the provision. The provision acts as an integrity measure to ensure that the relevant concessions are only available to a specific subset of trusts that meet the statutory definition of an EST.</p> <p>Paragraph 11 of the final Determination notes that an activity will be merely incidental if it is a natural incident or consequence of the trust obtaining, holding and providing shares or rights under an ESS. It also makes it clear that an activity will not be merely incidental if it is undertaken for, or follows from, some other purpose.</p>  |
| 9            | The ATO should consider providing advice on whether the   | Exercising voting rights and participating in rights issues are discussed in paragraphs 30 and 31 of the final Determination. Not acting, or abstaining   |

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|              | <p>following activities are merely incidental activities:</p> <ul style="list-style-type: none"> <li>• exercising voting rights</li> <li>• participating in rights issues</li> <li>• dealing with bonus shares</li> <li>• the trustee becoming party to, and complying with any obligations imposed on it by, a shareholder's agreement of the company</li> <li>• borrowing money – from the company group or elsewhere (and what expenses they can pay on such loans, for example, interest)</li> </ul> <p>purchasing derivatives – may be done to hedge against price increases without committing to the purchase of all the shares (allows them to manage price risk and capital going into the trust).</p> | <p>from acting, will not cause a breach of subsection 130-85(4). Voting or participating in a rights issue will not cause a breach of subsection 130-85(4) where it falls within paragraphs 130-85(4)(a), (b) or (c). It is expected that this would be satisfied in the majority of cases, however an example of where it would not be satisfied is where the activity was undertaken to further some other purpose. The same principle would apply to other activities undertaken as a shareholder.</p> <p>We have also clarified at paragraph 12 of the final Determination (see dot point 4) that borrowing money to purchase shares or rights in the employer company will be merely incidental, where no security is provided over trust assets and the interest payable is no more than arm's length commercial rates. Borrowing money for another purpose, where security is provided over the trust assets, or where the interest payable is more than arm's length commercial interest rates would not be merely incidental (see dot point 5 in paragraph 13 of the final Determination).</p> <p>Where a derivative is a right to acquire a share in the employer company (for example, a physically settled call option), it will fall within paragraph 130-85(4)(a). Given the broad variety of types of derivatives that exist, it is not feasible to consider and provide public guidance on all forms a derivative may take.</p> |
| 10           | <p>Many of the activities given as examples of 'merely incidental' would appear as 'necessary' or 'unavoidable' activities, rather than incidental. It is difficult to see how an EST would otherwise operate in the absence of those activities. Other activities that should constitute unavoidable activities would include, for example:</p> <ul style="list-style-type: none"> <li>• dealing with rights and bonus issues in respect of shares held</li> <li>• default winding up beneficiaries</li> </ul> <p>payments of dividend equivalents before rights to shares/shares vest or shares become unrestricted.</p>  | <p>The purpose of the inclusion of 'merely incidental' activities in paragraph 130-85(4)(c) is to ensure that the trust can undertake the activities that are necessary and incidental to acquiring shares in the employee company and passing on ESS interests to employees.</p> <p>Rights issues are discussed in our response to Issue 9 of this Compendium. Footnote 16 of the final Determination notes that a trust's failure to satisfy the requirements of an employee share trust on the transfer of trust income and capital to a default beneficiary on the winding up of the trust would have no practical implications, since the trust will cease at that time.</p> <p>Dividend equivalent payments are dealt with in dot point 6 in paragraph 12 and dot point 2 (together with footnote 15) in paragraph 13 of the final Determination. If the arrangement falls outside these parameters, it should be assessed against the general principles in paragraphs 9 to 11 of the final Determination and advice can be sought from the Commissioner if required.</p>  |

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| <b>Bank accounts</b>                 |  |  |
| 11                                   | It would be useful to understand when the operation of a bank account and the receipt of interest from bank accounts may become more than 'merely incidental' in light of the view that investing in assets other than shares or rights to shares is not considered merely incidental. This distinction may become important especially should cash reserves now increase as a result of the adverse taxation implications associated with the waiving of dividends. For example, would investing surplus cash in a term deposit be considered not to be merely incidental?  | Holding surplus cash in a bank account or similar bank deposit until it is applied to conduct activities falling within subsection 130-85(4) is considered to be a merely incidental activity (see dot points 1 and 5 in paragraph 12 of the final Determination). However, actively investing to generate additional income for the trust (for example, investing in bonds) would not be considered merely incidental.  |
| <b>Dividend equivalent payments</b>  |  |  |
| 12                                   | The draft Determination contains examples where certain dividend equivalent payments are considered merely incidental and not merely incidental. However what if such payments are made during the vesting period (that is, before it is known whether the relevant rights will vest)?   | This issue is beyond the scope of this Determination, as more information would be required on the nature of the arrangement.  |
| 13                                   | <p><i>Interaction with TD 2017/26 Income tax: employee share schemes – when a dividend equivalent payment is assessable to an employee as remuneration</i></p> <p>Example 2 in TD 2017/26 mentions a dividend equivalent payment paid as a result of a broad discretion the trustee has in the trust deed. There is no mention in the example that the trust would not be an EST if it acted in that manner, so it gives the impression that such a clause is acceptable for an EST.</p> <p>In Example 1 of the draft Determination, reference is made to an after-tax dividend equivalent payment for Megan, but no mention is made of the amount being assessable to her.</p> <p>It would be helpful to clarify the interaction between the two Determinations and, in particular, the examples.</p> | <p>TD 2017/26 does not refer to the trusts as being ESTs, and is silent on that question. To avoid potential confusion, we have amended footnote 3 in TD 2017/26 to state that the Determination does not deal with the question of whether such a trust is an EST and include reference to this final Determination. We have also inserted footnote 5A in Example 2 of TD 2017/26 to clarify that the trust in that example would not be an EST.</p> <p>Similarly, the focus of Example 1 of the draft Determination is on the activities of the trust. It does not deal with the tax treatment of the payment in the hands of the employee. To avoid potential confusion, we have inserted a footnote in Example 1 of the final Determination to clarify that the payment is assessable income in Megan's hands, with a cross-reference to TD 2017/26.</p> |
| <b>Dealing with forfeited shares</b> |  |  |
| 14                                   | We note that 'dealing with shares forfeited under an ESS' is stated as an example of a 'merely incidental' activity. It would be useful to   | As mentioned in dot point 7 in paragraph 12 of the final Determination, the trustee would be able to 'deal with' forfeited shares in a manner that would   |

| Issue number   | Issue raised   | ATO response   |
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|  | clarify the position and provide additional commentary on the various types of acceptable (or non-acceptable) incidental 'dealings' with forfeited shares.   | itself be a merely incidental activity. For example, the trustee may retain the share for its subsequent use in transferring to another employee in satisfaction of its obligations under the relevant rules of the ESS, or it may sell the share and use the proceeds to pay necessary and incidental costs of administering the trust.   |
| <b>Receiving and immediately distributing shares under a demerger, etc</b> |  |  |
| 15   | ATO ID 2010/108 <sup>2</sup> included <i>receiving and immediately distributing shares under a demerger</i> as a permitted activity falling within the 'merely incidental' safe harbour. The new updated list of 'merely incidental' activities now includes: <i>receiving and immediately distributing shares under a demerger or actions in order to participate in a takeover or restructure covered by section 83A-130</i> . This should make it easier to facilitate corporate transactions without jeopardising the status of the trust as an EST. | Noted.   |
| 16   | What constitutes 'immediately' for the purpose of the last dot point in paragraph 11 of the draft Determination which refers to receiving and immediately distributing shares under a demerger or actions in order to participate in a takeover or restructure covered by section 83A-130? Often the trustee may be unable to transfer or sell shares straight away, due to blackout periods etc. A potential solution is to just require the shares to be distributed/disposed of before the next dividend is declared or becomes payable.              | Where the trustee immediately (allowing for any relevant administrative processes) distributes the shares under a demerger/takeover/restructure, the activity will be a merely incidental activity.<br>The trustee should distribute the shares as quickly as possible. However, the Commissioner recognises that, in some circumstances, the trustee may be prevented from immediately distributing or disposing of shares under a demerger or other corporate actions. Whether the distribution or disposal of the shares will be considered merely incidental in those situations will depend on the facts and circumstances of the particular case, including the reasons why the trustee is unable to distribute the shares immediately, the expected timeframe for distribution/disposal and what may happen in relation to the share in the intervening period. |
| <b>Payments on winding up the trust</b>                                    |  |  |
| 17   | ATO ID 2010/108 included reference to when income and/or capital is transferred to default beneficiaries that are not necessarily the  | See footnote 16 of the final Determination.<br>The action of the trustee in making a payment or transfer of trust income and   |

<sup>2</sup> ATO Interpretative Decision ATO ID 2010/108 *Income Tax: Employee share trust that acquires shares to satisfy rights provided under an employee share scheme and engages in other incidental activities* (withdrawn).

| Issue number                        | Issue raised  | ATO response   |
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|                                     | employees of the company. That does not seem to be reflected in the draft Determination.  | capital to a default beneficiary on the winding up of the trust will breach the requirements of subsection 130-85(4). However it will have no practical implications, since the trust will cease at that time.   |
| 18                                  | If the trustee of an EST wanted to wind up an EST and transfer the assets from the original EST to a new 'clean skin' EST, how would the ATO treat the movement of shares between the two trusts?   | This question is beyond the scope of this Determination. The tax treatment will depend on the facts and circumstances of the particular case.  |
| <b><i>Payments to charities</i></b> |   |  |
| 19                                  | In our view, it is entirely consistent with the purpose of the EST, and incidental to its operation, that any distribution received in respect of unallocated shares could be paid or distributed to a charity (which is allowed under the relevant trust deed). As long as the number of securities held in the trust is reasonable compared to the number expected to vest, we think this should be considered incidental to the activity of the EST.   | The Commissioner does not agree that distributing income from unallocated shares to a charity is an activity that could be considered as merely incidental to obtaining shares in the employer company and ensuring ESS interests are provided to employees. See paragraph 11 and dot point 2 in paragraph 13 of the final Determination.  |
| 20                                  | We are aware of some ESSs involving contributions from employees to acquire shares where the EST may retain small cash amounts (for example, 'rounding' amounts where there is insufficient cash to acquire a whole share for the participant and the employee has subsequently left the scheme). In these circumstances, the trustee may (based on the employee's consent when agreeing to participate in the ESS), rather than return the amounts to the participant, donate the excess cash to a charitable beneficiary. Given the amounts involved are typically very small (in the context of the overall ESS), it would be helpful if the Determination could confirm the Commissioner's view on whether such donations in these circumstances would be considered 'merely incidental'. | If the money in the circumstances described is the employee's money and requires their consent to deal with, such that the funds are not part of the trust funds, the trustee is not acting in its capacity as trustee if it pays the leftover funds to a charity in accordance with the employee's consent/wishes.<br><br>However, if the money forms part of the trust funds generally available to the trust, it is expected that the trustee uses those funds for activities that satisfy paragraphs 130-85(4)(a), (b) or (c) (for example, to purchase additional shares for the ESS, pay relevant expenses etc). It would not be a merely incidental activity for the trustee to distribute its funds to a charity. See paragraph 35 of the final Determination. |
| <b><i>Dividend waivers</i></b>      |   |  |
| 21                                  | The ATO should allow the waiving of dividends on unallocated shares. The genuine commercial rationale for dividend waivers is to prevent the unnecessary build-up of cash and after-tax profits in a trust where unallocated shares are held in the trust.  | The Commissioner does not agree that the trustee waiving payment of dividends on unallocated shares is an activity that could be considered merely incidental to obtaining shares in the employer company and ensuring ESS interests are provided to employees, for the reasons outlined in  |

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|              | <p>In our view, dividend waivers should be allowed on the following alternative bases:</p> <ul style="list-style-type: none"> <li>• The agreement to waive a dividend is not an activity.</li> <li>• If it is an activity, it is part of 'obtaining shares in a company.'</li> <li>• If it is an activity, it is an activity that is merely incidental to those described in paragraphs 130-85(4)(a) and (b).</li> </ul> <p>A trustee should not properly take all the benefits of share ownership for shares held in respect of an ESS. For example, the Australian Securities and Investment Commission requires that, if the trustee is the listed body or an associate of the body, 'the trustee does not, at its own discretion, exercise any voting rights attaching to any of the underlying eligible products that it holds on trust' (ASIC Class Order [CO 14/1000]).</p> <p>Given the purpose of the EST acquiring and holding shares is to manage (and minimise) the cost of acquiring shares to satisfy ESS obligations, the receipt of dividends for unallocated shares is an unwanted side-effect and complication, potentially over-funding the trust. In disclaiming the dividends, the trustee is essentially seeking to ensure it more precisely meets its funding needs from time to time.</p> | <p>paragraph 36 of the final Determination.</p>  |
| 22           | <p>There is a general reluctance by private companies to utilise an EST, due to what is perceived to be a 'wastage' of dividends flowing to the trust. A key aim of implementing an employee share plan in a private company context is to ensure the profits of the company are shared among the employee owners. It is not the company's intention that a portion of the profits be quarantined in an EST for an extended period. The difficulties in establishing a simple mechanism to acquire a former employee's shares on cessation of employment is a significant barrier to private companies implementing employee equity plans. This challenge could be largely alleviated by either:</p> <ul style="list-style-type: none"> <li>• allowing an EST to waive or relinquish dividend entitlements, and/or</li> </ul>   | <p>The Commissioner does not agree that the trustee waiving payment of dividends on unallocated shares is an activity that could be considered merely incidental to obtaining shares in the employer company and ensuring ESS interests are provided to employees, for the reasons outlined in paragraph 36 of the final Determination.</p> <p>The application of Division 16K of the ITAA 1936 is beyond the scope of this Determination.</p> |

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|   | <ul style="list-style-type: none"> <li>providing more tailored guidance regarding the application of Division 16K of the <i>Income Tax Assessment Act 1936</i> (ITAA 1936) to an ESS buy-back.</li> </ul>  |   |
| 23  | <p>Paragraph 12 of the draft Determination states that ‘distributing mainly cash payments to participating employees rather than shares or ESS interests under the ESS’ will not be considered merely incidental.</p> <p>We do not believe that the extent of sales of securities should impact the outcome. We believe it is consistent with the sole activity test that in certain circumstances, securities may be sold. If the securities are acquired by the EST to deliver to employees, any sale of securities is incidental to the activity of acquiring shares for employees.</p> | We have provided further explanations on this issue at paragraphs 39 and 40 of the final Determination.   |
| <b>Breaching the requirements in subsection 130-85(4)</b> |  |   |
| 24  | Further elaboration on why a trust cannot regain its status as an EST is required.   | See our response to Issue 27 of this Compendium.  |
| 25  | What is the intended operation of the provision where multiple ESS for a single company are administered by a single trust with one trust deed covering all the ESS?   | <p>The Commissioner takes the view that the words ‘an employee share trust, for an employee share scheme’ in subsection 130-85(4) mean that you look at an ESS to identify the relevant trust to be tested, that is what the trust is for this ESS. Having then identified the trust to be tested, it is the trust’s activities in their entirety that must be tested against the activities in paragraphs 130-85(4)(a), (b) and (c), as the provision refers to ‘<i>the trust’s</i> sole activities’.</p> <p>It flows from this view that, where multiple ESS are administered by a single trust, if any of the trust’s activities do not fall within paragraphs 130-85(4)(a), (b) or (c) then the trust will fail to meet the requirements of an EST for all ESS arrangements as the relevant trust (see paragraph 7 and Example 3 of the final Determination).</p> |
| 26  | Does paragraph 13 of the draft Determination mean they are not an EST for just the particular grant that was in breach of the requirements, or is it punitive for all past, present and future grants within a plan?   | The trust will be an EST until it undertakes an activity that does not fall within paragraphs 130-85(4)(a), (b) or (c). Once it has breached the requirements of subsection 130-85, the trust will no longer be an EST for any plans. See our response to Issue 25 of this Compendium.  |

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| 27           | <p>The test in subsection 130-85(4) should be assessed on a year by year basis because the requirement as to whether a trust is an <i>employee share trust</i> links back to taxing provisions, that is it is relevant to calculating fringe benefits tax (FBT) liabilities (which are determined for an FBT year) and the application of the capital gains tax (CGT) provisions to particular points/events in time (referable to an income year).</p> <p>In addition, the word 'are' in the phrase 'whose sole activities are' is a reference to a point in time test. Any non-incident activity should mean no more than the EST fails for that year only, and the trust should be able to again qualify as an EST in later years where its activities can be properly confined to sole activities or incidental activities for those following years.</p> | <p>Whilst whether a trustee is an EST is only relevant at a point in time when specific events occur, that does not mean that the trust only needs to be an EST at that instant, or in that particular taxing period.</p> <p>The definition of an EST looks at the activities of the trust on an ongoing basis. The text of the legislation itself does not limit the examination of the trust's activities to a particular time or period. The limiting factor in the legislation is 'sole', and that prevents activities that happen in the past from being disregarded.</p> <p>It would not be a sensible drafting style to include that the activities 'are and always were...', as such additional words would be superfluous in the context of the use of the word 'sole'.</p> <p>The provisions have been drafted in a way that requires the trust to be restricting its activities to those described in subsection 130-85(4) on an ongoing basis, and to interpret the provision otherwise would be inconsistent with the context and purpose of the provision. See paragraph 14 of the final Determination.</p> |
| 28           | <p>We recommend a more practical approach be adopted such that the eligibility requirements for an EST be tested at or around the time that taxpayers wish to rely on a trust being an EST so as to not risk losing status as an EST once and for all after a particular breach (which in some cases may be quite minor or trivial) has occurred.</p>   | <p>See our response to Issue 27 of this Compendium.</p>   |
| 29           | <p>Given the severe implications of failing to qualify as an EST, we believe it is proper to provide for a <i>de minimis</i> application of the EST rules, for oversights or inadvertent mistakes in activity.</p>  | <p>A public ruling, such as a Determination, deals with how the Commissioner interprets the law. There is nothing in the law that provides for a <i>de minimis</i> exception.</p> <p>As a practical matter, the Commissioner always considers the most effective and efficient use of the ATO's resources when assessing risks and determining where the ATO will apply compliance resources.</p> <p>The Commissioner has outlined in Appendix 2 of the final Determination that compliance resources will not be applied to investigate whether activities a trustee may have undertaken prior to 1 January 2020 do not satisfy the requirements of subsection 130-85(4). See paragraphs 41 to 43 of the final Determination.</p>  |

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| 30                         | If the trustee has breached the requirements in subsection 130-85(4) (for example, waived dividends on unallocated shares) can the ESS continue under the same trust or will the ESS be required to start again under a new trust?   | <p>The ESS can continue under the same trust, however the trust will not be an EST from that point in time and therefore the concessions restricted to ESTs will not apply.</p> <p>However, see the compliance approach in paragraphs 41 to 43 of the final Determination in relation to activities undertaken by a trustee prior to 1 January 2020.</p> <p>Whether the ESS continues in the same trust or is transferred to a new trust is a decision for the relevant entities.</p>   |
| <b>Compliance approach</b> |  |   |
| 31                         | The compliance approach should be extended to all actions taken by the trustee, prior to 1 January 2020, which the Commissioner considers would not be merely incidental, therefore breaching subsection 130-85(4).  | The Commissioner has extended the compliance approach to all activities undertaken by the trustee prior to 1 January 2020. See paragraphs 41 to 43 of the final Determination.  |
| 32                         | <p>We suggest that a hard 'line in the sand' be drawn for trusts and activities before 1 January 2020 such that the Commissioner of Taxation accepts that those trusts are ESTs. Alternatively, the final Determination should state that an activity undertaken prior to 1 January 2020 will not impact a trust being considered an EST in the future so long as there is no activities undertaken after that date that are not merely incidental.</p> <p>On a go-forward basis, for those pre-existing trusts the following could be required:</p> <ul style="list-style-type: none"> <li>• an undertaking by the company/trustee to not apply provisions that permit not incidental activities. Of course, the not incidental activities will need to be clearly enumerated in the final Determination.</li> <li>• an annual declaration in the trust tax return that the EST has met the sole activities test, together with a statement that – if any additional activities – those activities are incidental. Again, sole activities and incidental activities will need to be clearly set out in the final Determination.</li> </ul> <p>If, on audit, the ATO finds that the undertaking was not complied</p> | <p>See paragraphs 41 to 43 of the final Determination on the Commissioner's compliance approach.</p> <p>As the compliance approach only applies to activities undertaken prior to 1 January 2020, it will not apply to trusts that come into existence on or after 1 January 2020.</p> <p>The Commissioner will not require an undertaking or annual declaration in the trust tax return. It is considered that the administrative penalty regime in Schedule 1 to the <i>Taxation Administration Act 1953</i> will apply appropriately if false or misleading statements are made to the Commissioner.</p> |

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|                        | <p>with or a statement is found to be false, then the trust as an EST will be invalidated and penalties in accordance with the tax laws may be applied.</p> <p>This one-off 'grandfathering' approach was applied by the ATO when dealing with 'novated' car lease arrangements in the 1990s. See Taxation Ruling TR 1999/15 <i>Income tax and fringe benefits tax: taxation consequences of certain motor vehicle lease novation arrangements</i>.</p> <p>Of course, for trusts set up after 1 January 2020, the requirements set out in the final Determination should be followed, perhaps together with an annual declaration as set out at the second bullet point above.</p> |   |
| 33                     | <p>We appreciate the inclusion of a compliance approach, however an increased transitional period (extended to 1 January 2021) should be provided to allow taxpayers sufficient time to attend to any necessary changes to their current arrangements. This may include multiple documentation changes, obtaining updated legal, taxation and accounting advice and communications with relevant employees and other stakeholders where required.</p>  | <p>It is the Commissioner's view that 1 January 2020 is an appropriate date. All that is required is the trustee to stop doing, or not to do again, any activities that are not considered merely incidental. It is considered that the period provided is sufficient for that to occur. The other actions mentioned, such as updating documents, seeking advice and communicating with relevant employees and stakeholders can occur after 1 January 2020 if necessary.</p>  |
| <b>Private rulings</b> |  |   |
| 34                     | <p>Will the Commissioner accept in the scheme description in private ruling requests that the trustee will not exercise certain clauses in the trust deed which might be seen as activities that would be considered not to be merely incidental?</p>  | <p>The Commissioner cannot accept a scheme description in a private ruling request that the trustee will not exercise clauses in the trust deed that would be seen as activities not considered to be merely incidental. The facts and description of the scheme cannot be inconsistent with the legal documents provided. Including such clauses in the trust deed signifies an intent for the trustee to be able to undertake such activities.</p> <p>The taxpayer can rely on paragraph 6 of the final Determination, that they will not be disqualified from being an EST merely because of the existence of those clauses in the trust deed.</p> |
| 35                     | <p>The proposed assumption in paragraph 36 of the draft Determination should be removed as it is not a practical outcome. In the event that a private ruling was made on an assumption as to the future that transpires to be not correct, the private ruling fails to</p>   | <p>See our response to Issue 34 of this Compendium.</p>   |

| Issue number | Issue raised  | ATO response   |
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|              | <p>apply by operation of the law, and there is no reason why a private ruling cannot be made based on applicable taxpayer statements of intent as to future activity that is outlined in the application for a private ruling. It is inappropriate for the Commissioner to fail to positively rule on those arrangements where, having regard to the current view of the Commissioner in the draft Determination, the applicant intends they would not exercise such a power given the adverse consequences.</p>  |  |
| 36           | <p>Will entities be required to conduct a self-audit going back years (up to 10 years in some cases) to determine if any breaches of the merely incidental requirement was made by a trustee prior to obtaining a new (refresh) private ruling?</p> <p>The ability to conduct a self-audit would be very difficult especially in circumstances where administrators have changed over the life of the ESS, given that companies will select administrators via tender processes.</p> <p>The Commissioner should draw a line in the sand in respect of past activities which could have occurred due to a mistake or receiving a positive private ruling, and allow entities to seek private rulings on a forward-looking basis.</p> | <p>Entities will not be required to review their activities prior to 1 January 2020. The compliance approach outlined in paragraphs 41 to 43 of the final Determination will enable entities to seek private rulings on a forward-looking basis.</p> |