



Taxpayer Alert

The Tax Office view on the arrangement is set out in Taxation Determination TD 2005/34.

FOI status: may be released

Taxpayer Alerts are intended to be an "early warning" of significant new and emerging higher risk tax planning issues or arrangements that the Tax Office has under risk assessment.

Taxpayer Alerts will provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform Tax officers of new and emerging higher risk tax planning issues. Not all potential tax planning issues that the Tax Office has under risk assessment will be subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the Tax Office.

Taxpayer Alerts will give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and will highlight the features which the Tax Office considers give rise to taxation issues. These issues will generally require more detailed analysis to provide a Tax Office view to taxpayers.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert can seek a formal determination of the Tax Office's position through a Private Ruling. (It should be noted that section 14ZAN of the Taxation Administration Act 1953 sets out circumstances where the Commissioner may decline to issue such a ruling). Such taxpayers might also contact the Tax officer named in the Alert and/or obtain their own advice.

This Taxpayer Alert is issued under the authority of the Commissioner.

TITLE: Profit washing scheme using a trust and loss entity.

This Taxpayer Alert describes an arrangement where the taxpayer seeks to minimise tax payable by seeking to use tax losses in an unrelated entity. The business of the taxpayer is restructured so that the income of the business passes through a chain of trusts and on to a loss company. The income, less an amount for promoter fees, remains effectively under the control of the taxpayer, or associates.

DESCRIPTION

This alert applies to arrangements that exhibit some or all of the following features:

Arrangement 1

1. A trading entity (the 'taxpayer') derives income from a business that it carries on. The business is restructured into a hybrid trust (the 'new trust') which then derives the income.
2. The new trust has a number of classes of units. Each class of units has different rights attached. The taxpayer or associates hold units with income, capital and voting rights in the new trust (class A units). Another trust (the promoter trust) holds units in the new trust with income rights only (class B units).
3. The trustee of the new trust has discretion as to the distribution of the income to class A or class B income unit holders.
4. All the units in the promoter trust are held by a company with carry forward losses (the 'loss company').
5. The new trust distributes a large proportion of the income to the class B unit holders. A smaller proportion may be distributed to the class A unit holders.
6. An amount, say 10% of the distribution to the class B unit holders, is paid in cash to the promoter trust. The balance of 90% is never paid and by agreement (usually verbal) between the parties is never intended to be paid.
7. The promoter trust then distributes all of the income distribution from the new trust to the loss company. The promoter claims that the loss company has carry forward losses that offset the distribution from the promoter trust.

Arrangement 2

8. In some arrangements a variation is used where the 90% balance of the distribution referred to in paragraph 6 above is paid but remains under the effective control of the taxpayer or associates through the use of a joint venture.
9. In these arrangements a joint venture is formed between the taxpayer or associates and the promoter trust.
10. By agreement the taxpayer or associates have effective control over the assets of the joint venture.
11. As described above in Arrangement 1 the new trust distributes the income to the promoter trust, however, pursuant to an agreement between the parties, the promoter trust then makes a capital contribution, say 90% of the distribution it receives from the new trust, to the joint venture thereby maintaining the effective control of the taxpayer or associates over those funds. In some cases the funds giving effect to the capital contribution by the promoter trust may be paid directly by the new trust to the joint venture.

FEATURES WHICH THE TAX OFFICE CONSIDERS GIVE RISE TO TAXATION ISSUES

The Tax Office considers that the arrangement outlined above gives rise to taxation issues that include whether:

- (a) Section 100A of the *Income Tax Assessment Act 1936* ('the ITAA 1936') applies to the trust distributions made in connection with or as a result of reimbursement agreements;
- (b) The loss company has available carry forward losses, and if so, whether those losses are deductible;
- (c) The general anti-avoidance provisions in *Part IVA* of the *ITAA 1936* have application as;
 - i) the arrangement seems artificial and lacks an ordinary business purpose in its design and execution; and
 - ii) it appears that the dominant purpose of entering into the arrangement is to obtain tax benefits;
- (d) the arrangement or crucial parts of it are a sham;
- (e) a CGT event or other tax consequences occur as a result of the restructure of the trading entity;

Note 1.

In appropriate cases possible sanctions under criminal law may apply.

The Australian Taxation Office is examining these arrangements.

subject references: *losses, hybrid trusts, trust distributions,*

related taxation rulings: *Taxation Ruling TR 1999/9*

legislative references: *Division 104 of the ITAA 1997*
Division 165 of the ITAA 1997
Section 100A of the ITAA 1936
Part IVA of the ITAA 1936

related taxpayer alerts:

related practice statements: PS LA 2008/15 - Taxpayer Alerts

related media releases: Media Release - Nat 05/25

file references:

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