



# Taxpayer Alert

TA 2008/19

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FOI status: may be released

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*Taxpayer Alerts are intended to be an 'early warning' of significant new and emerging higher risk tax planning issues or arrangements that the Australian Taxation Office has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed.*

*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 the 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. In these latter cases the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.*

*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 are of concern to the Tax Office. These issues will generally require more detailed analysis to provide the 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 (noting that 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 Taxpayer Alert and/or obtain their own advice.*

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

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<b>Title</b>	<b>Foreign residents attempting to avoid Australian capital gains tax by certain "staggered sell down" arrangements</b>
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This Taxpayer Alert describes certain 'staggered sell down' arrangements designed to result in disregarded capital gains tax where there is an indirect disposal of Australian real property under Division 855 of the *Income Tax Assessment Act 1997* (ITAA 1997).

## Description

The alert applies to arrangements having the following features:

1. A foreign resident vendor will typically have an existing membership interest of 10% or greater in a resident entity whose assets consist principally of Australian real property
2. The foreign resident vendor enters into an arrangement to dispose of part of its interest, retaining just less than 10% of that interest under a sale agreement

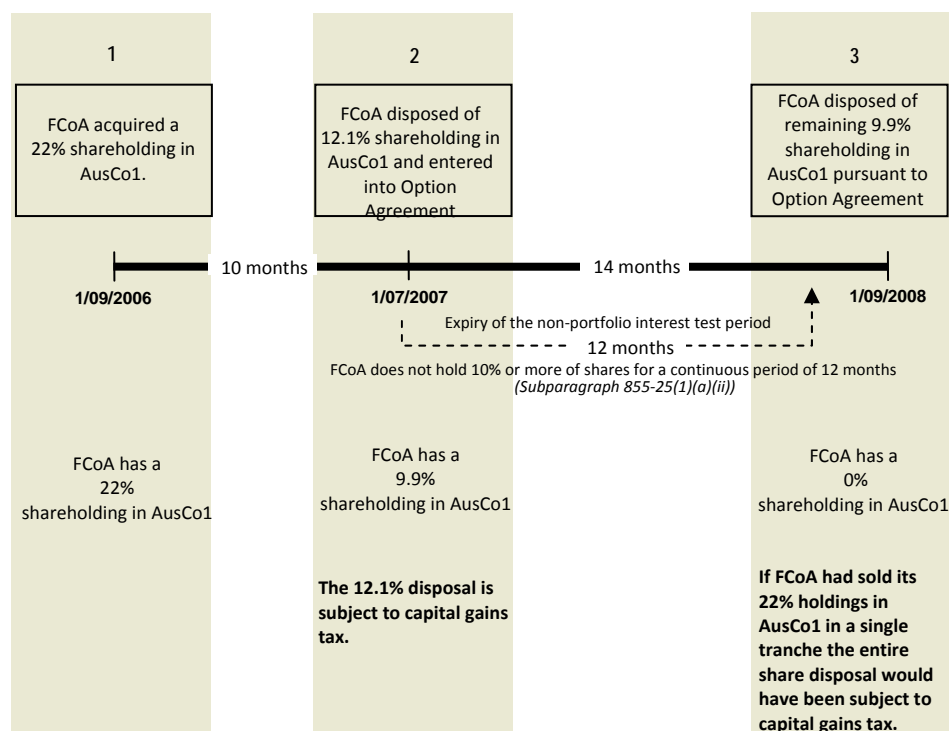
3. The foreign resident vendor concurrently enters into an option agreement to dispose of the remaining interest at a later time
4. This is intended to ensure that the foreign resident vendor can argue that they do not maintain a 10% or more membership interest at both:
  - (a) the time of the second disposal, and
  - (b) throughout a 12 month period that began no earlier than 24 months before that time and ends no later than that time.
5. Such structural planning may result in some capital gains tax being circumvented despite the fact that overall, a greater than 10% interest was held and eventually disposed of by the foreign resident vendor.

### Example

A foreign resident company 'FCoA' acquires a 22% holding in a resident entity whose assets consist principally of Australian real property 'AusCo1' on 1 September 2006.

On 1 July 2007, FCoA enters into an agreement to dispose of 12.1% of its shares in AusCo1 to FCoB, another foreign resident company. Any capital gain from this disposal can not be disregarded.

### Staggered sell down Scheme



At the same time, FCoA grants FCoB an option to acquire a further 9.9% of its shareholding in AusCo1, exercisable in 14 months from the date the option was granted.

The first share sell down occurs on 1 July 2007 and the subsequent sell down of shares, if the option is exercised, would occur on 1 September 2008.

If FCoA had disposed of its 22% holdings in AusCo1 in a single tranche the entire share disposal would have been subject to capital gains tax assuming the principal asset test is satisfied [i.e. if greater than 50% of the test entity's assets are taxable Australian real property (TARP) assets].

Structuring the subsequent sell down as an option that is exercisable just after the expiry of the relevant non-portfolio interest test period circumvents the operation of the non-portfolio test in paragraphs 855-25(1)(a)(i) and (ii) ITAA 1997 and results in the capital gain on the subsequent sell down being disregarded.

### Features which concern us

Depending upon the individual facts and circumstances, the Tax Office considers that staggered sell down arrangements, having the above mentioned features may give rise to taxation issues including whether:

- (a) the arrangement, or some transactions within it, may be a sham at general law
- (b) the amounts from the disposal must be included in the assessable income of the foreign resident vendor under section 6-10 of the ITAA 1997
- (c) any capital gain from the first disposal should be included in assessable income, as the foreign resident vendor would satisfy the non-portfolio interest test and the principal asset test
- (d) capital gains tax event D2 happens at the time the option is granted
- (e) any capital gain from the second disposal should not be disregarded, where the option agreement attempts to otherwise circumvent section 855-25 of the ITAA 1997
- (f) any transaction may be subject to the transfer pricing provisions contained in Division 13 of the *Income Tax Assessment Act 1936* (ITAA 1936)
- (g) any articles in applicable tax treaties between Australia and a relevant country may apply, especially:
  - (a) the income from real property article (where applicable),
  - (b) the business profits article (where applicable),
  - (c) the associated enterprises article (where applicable), or
  - (d) the alienation of property article (where applicable)
- (h) the general anti-avoidance rule contained in Part IVA of the ITAA 1936 may be applied to cancel any tax benefit under all, or some part, of the arrangement, and
- (i) any entity involved in the arrangement may be a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953).

*The Tax Office is currently reviewing these arrangements.*

**Note 1:** *If you have received a private ruling in respect of your arrangement, please check that the application of Part IVA of the Income Tax Assessment Act 1936 is considered in that ruling. The applicant may not have sought for us to rule on the application of Part IVA to the arrangement ruled upon, or to an associated or wider arrangement of which that arrangement is part. If you want us to rule on whether Part IVA applies to your arrangement, we will first need to obtain and consider all the relevant facts about the arrangement, including (if relevant) the manner in which it has actually been implemented.*

**Note 2:** *Base penalties of up to 50% of the tax avoided can apply where Part IVA is applied. Base penalties of up to 75% of the tax avoided can apply where you make a false and misleading statement to the Commissioner. Reductions in base penalty will be available if the taxpayer makes a voluntary disclosure to the Tax Office. If you have any information about the current arrangement, phone us on 1800 177 006. Tax agents wanting to provide information about people or companies who may be promoting arrangements covered by this alert should call the tax agent integrity service on 1800 639 745.*

**Note 3:** Penalties of up to 5,000 penalty units for individuals, 25,000 penalty units for bodies corporate or up to twice the amount of consideration received or receivable may apply to promoters of tax exploitation schemes under Division 290 of Schedule 1 to the Taxation Administration Act 1953. The Commissioner can also apply to the Federal Court of Australia for restraining and performance injunctions against promoters where prohibited conduct has occurred, is occurring or is proposed.

**Note 4:** Where appropriate, section 167 of the Income Tax Assessment Act 1936 (ITAA 1936) may be used to determine the amount of taxable income upon which the taxpayer should be assessed, see Law Administration Practice Statements, PSLA 2007/7 and PSLA 2007/24.

**Note 5:** A registered tax agent may have their registration cancelled or suspended by the Tax Agents' Board under section 251K of the Income Tax Assessment Act 1936 if they are guilty of misconduct as a tax agent or are not considered a fit and proper person to prepare income tax returns. A person under a sentence of imprisonment for a serious taxation offence is not a fit and proper person.

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**Subject References:**

Aggressive tax planning  
Part IVA  
Staggered sell downs  
Capital gains tax  
Arrangement  
Foreign resident vendor  
Australian real property  
Promoters

**Legislative References:**

Income Tax Assessment Act 1997  
[Division 855](#)  
Income Tax Assessment Act 1936  
[Part IVA](#)  
Taxation Administration Act 1953  
[Schedule 1 Div 290](#)

**Related Practice Statements:**

[PS LA 2008/15 - Taxpayer Alerts](#)

**Related ATO Interpretive Decisions:**

[ATO ID 2008/46](#).

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