



# Taxpayer Alert

TA 2015/4

## Accessing business profits through an interposed partnership with a private company partner

Alerts provide a summary of our concerns about new or emerging higher risk tax or superannuation arrangements or issues that we have under risk assessment.

While an Alert describes a type of arrangement, it is not possible to cover every potential variation of the arrangement. The absence of an Alert on an arrangement or a variation of an arrangement does not mean that we accept or endorse the arrangement or variation, or the underlying tax consequences.

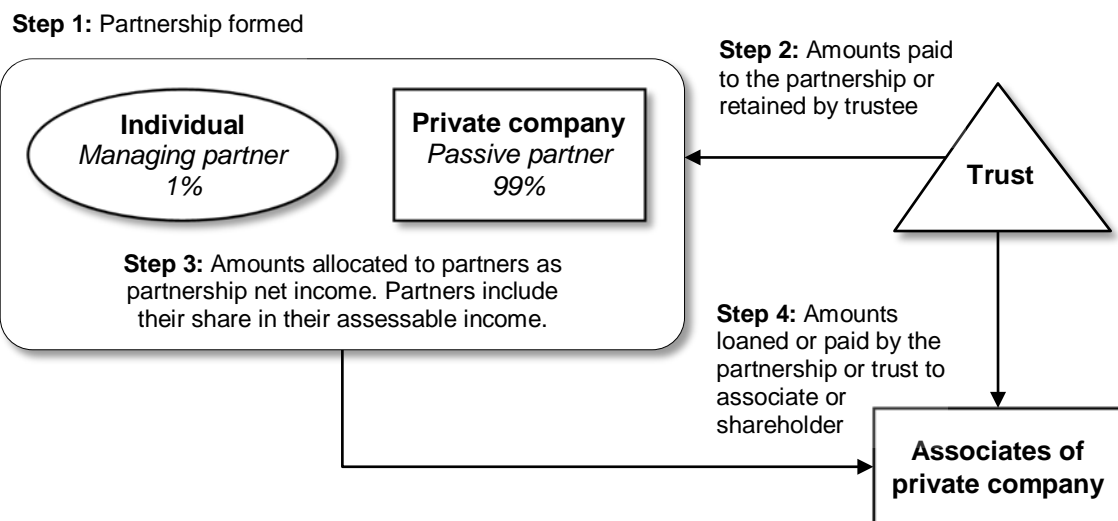
Refer to [PS LA 2008/15](#) for more about Alerts. See [Alerts](#) issued to date.

### Description

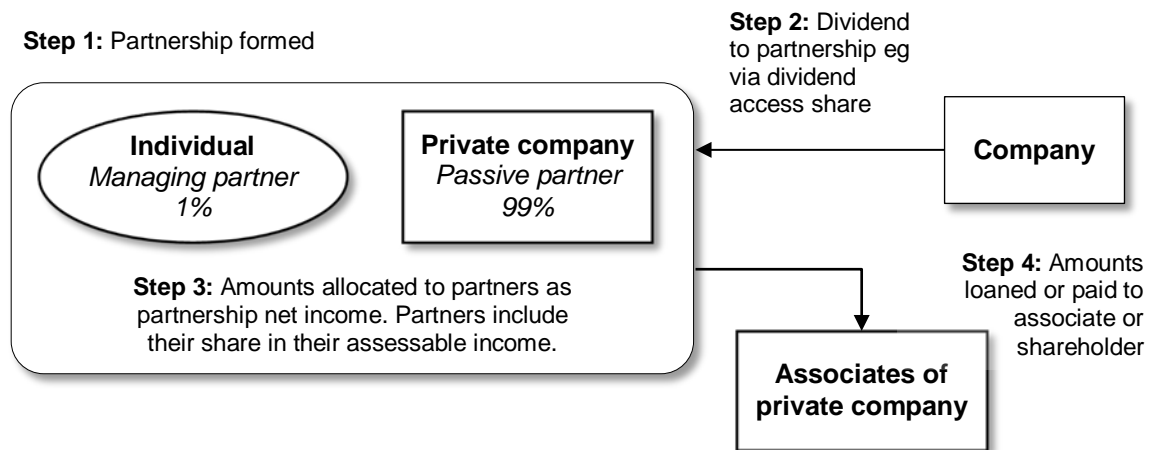
We are currently reviewing arrangements where profits are claimed to be directed through a purported partnership that has a private company as a partner. Most of the profits are taxed to the private company at the corporate tax rate, but are accessed by one or more individuals without paying additional tax reflecting their higher marginal tax rate.

These arrangements typically include all or most features of at least one of the following variations:

### Variation involving distributions from a trust



## Variation involving dividends from a company



The following describes these arrangements in further detail:

1. An individual and a private company, which is controlled by the individual or their associate, enter into a partnership.
2. The partnership has many of the following characteristics:
  - a. The private company contributes most of the capital, typically as much as 99%, with the individual contributing the remaining capital. The total amount of capital that is contributed frequently has only a nominal value, often as low as \$100, and the partners present themselves as sharing the income of the partnership in the same proportion as their capital contributions.
  - b. The individual (the **managing partner**) has control of the management, conduct and operation of the partnership. This control includes discretion over the application and distribution of the partnership's profits. The private company is a passive partner (the **passive partner**).
  - c. The source of the partnership's income is typically a related business, however the partnership may also receive income from other sources. The income is usually channelled to the partnership via a discretionary trust (the **trust**).
  - d. Income may also be channelled to the partnership via dividends from a private company eg through a 'dividend access share' or similar arrangement (see paragraph 4(c) of TD 2014/1).
  - e. The partnership may also purport to derive income directly from carrying on a business in its own right. However, its income from other sources greatly exceeds any income generated from its own business activities.
3. During an income year:
  - a. The trustee resolves to distribute a share of the net income of the trust to the partnership and either:
    - i. retains the money on sub-trust for the partnership
    - ii. purports to retain the money on sub-trust, but does not set aside the private company's share of the money for the sole benefit of the private company, or
    - iii. pays the money to the partnership.
  - b. The managing partner makes a resolution in favour of the partners according to their respective interests in the partnership.

- c. The partners include their share of the partnership profits in their assessable income. As much as 99% of the profits are typically assessed to the private company at the corporate tax rate.
- 4. In the same or a subsequent income year, the profits, including amounts taxed to the private company partner, are ultimately loaned or paid to a shareholder or associate of the managing partner.
  - a. Profits **retained** by the trustee are loaned or paid by the trustee to an associate of the managing partner, or applied within the business carried on by the trust.
  - b. Profits that were **paid** by the trustee to the partnership are:
    - i. loaned or paid to an associate of the managing partner or otherwise allocated
    - ii. loaned or paid back to the trust which loans or pays the amounts to an associate of the managing partner
    - iii. in some cases - paid to the private company partner which loans or pays the amounts to an associate of the managing partner, or
    - iv. applied by the trustee within the business carried on by the trust.
- 5. The managing partner's associates, to which the money is loaned or paid, do not include the amounts received in their assessable income. Minimal or no interest is paid on these amounts.
- 6. In many cases the arrangement is used to eliminate pre-2009 unpaid present entitlements (UPE) that could subsequently become subject to Division 7A of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936) due to the operation of sections 109XA and 109XI of the ITAA 1936.

### What are our concerns?

We are concerned that the arrangement is being used for the purpose of allowing individuals to access business and other profits at the corporate tax rate without paying additional 'top-up' tax reflecting their higher marginal tax rate.

From our initial consideration of cases involving these arrangements, we are concerned that:

- a) The partnership is not a 'partnership' at general law.
- b) The arrangement may be ineffective at law, or may have a different effect from that which has been presented, especially where there are inconsistencies in the implementation of transactions.
- c) It may be the partners, not the partnership, which are the beneficiaries of the trust.
- d) The passive partner may not have an interest in the income of the partnership, for the purposes of Division 5 of Part III of the ITAA 1936, due to the restrictions in the partnership deed.
- e) The passive partner may not be presently entitled to any part of the net income of the trust, due to the restrictions in the partnership deed, so that the trust distribution should not be included in the private company's assessable income under Division 6 of Part III of the ITAA 1936.
- f) In the event that the private company is presently entitled to any part of the net income of the trust:
  - i. The arrangement, or part of it, may constitute a 'reimbursement agreement', and as a result, the private company is deemed to not be presently entitled under section 100A of the ITAA 1936, and

- ii. The private company may have a sufficient interest in the funds for it to be taken to have made a loan or to have provided financial accommodation to the trustee under section 109D of the ITAA 1936.
- g) By making a loan, or providing financial accommodation, the private company may be taken to have paid an unfrankable dividend to the trustee, a shareholder or an associate under Division 7A of Part III of the ITAA 1936.
- h) Arrangements using a 'dividend access share' (see paragraph 2(d) above) may be debt interests, not equity interests, and unable to be franked.
- i) The arrangement may be a scheme by way of or in the nature of, or have substantially the same effect of, dividend stripping to which section 177E of the ITAA 1936 or section 207-145 of the *Income Tax Assessment Act 1997* (ITAA 1997) applies.
- j) The arrangement may be a scheme to which section 177D of the ITAA 1936 applies.

Accordingly, any entity involved in the promotion of this 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*.

Other arrangements involving the use of corporate limited partnerships (CLP) were used to avoid the operation of Division 7A of Part III of the ITAA 1936 in the past (see Taxpayer Alert TA 2007/5). These were addressed through legislative changes.

Those CLP arrangements were also recently considered by the Administrative Appeals Tribunal (AAT) in two cases, both favourable to the Commissioner: *D Marks Partnership & Ors v FC of T* [2015] AATA 651 and *NR Allsop Holdings Pty Ltd as General Partner of Q Uniform Partnership v FC of T* [2015] AATA 654. The AAT found that a number of specific provisions of the income tax law did not operate in the manner submitted by the taxpayers.

In particular the AAT decided that:

- a) the lack of business activities meant that there could be no general law partnership and thus could not constitute a CLP despite registration as such
- b) as the CLP was found not to exist the income was assessed directly to the 'partners'
- c) the 'dividend access share' arrangements were debt interests that were not able to be franked, and
- d) the applicants adopted a strained and unsustainable interpretation of relevant legislation.

The AAT did not consider the application of the general anti-avoidance rules in reaching its decision.

Although the AAT's decisions are currently being appealed, the Commissioner believes that the issues raised above have serious implications for the current managed partnership arrangements.

## **What are we doing?**

We are currently undertaking a pilot compliance program reviewing a number of cases involving arrangements of this type and we will be engaging with additional taxpayers over the coming months. A significant proportion of those taxpayers are actively pursuing settlement options with the Commissioner.

## **What should you do?**

If you have entered into, or are contemplating entering into, an arrangement of this type we

encourage you to:

- a) phone or email us at the [contact details](#) provided below
- b) ask us for our view through a [private ruling](#)
- c) seek independent professional advice, or
- d) make a [voluntary disclosure](#) to reduce penalties that may apply.

## Do you have information?

To provide information about this or another arrangement or a promoter of this or another arrangement:

- a) phone us on **1800 177 006** (after the initial messages, wait for the 'Taxpayer Alert' option then press 1), or
- b) complete the [ATO Tip-Off Form](#)

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## References

### Subject References:

borrowings & loans  
companies  
deemed dividends  
dividend stripping  
Division 7A  
partnerships  
payments  
present entitlement  
private companies  
reimbursement agreements  
trust stripping  
trusts  
undistributed profits  
unpaid present entitlement

### Legislative References:

*Income Tax Assessment Act 1936*

[Part III, Division 5](#)  
[Part III, Division 6](#)  
[Part III, Division 7A](#)  
[Part IVA](#)  
[Section 97](#)  
[Section 99A](#)  
[Section 100A](#)  
[Section 109C](#)  
[Section 109D](#)  
[Section 109N](#)  
[Section 109XA](#)  
[Section 109XB](#)  
[Section 109XI](#)  
[Section 177D](#)  
[Section 177E](#)  
[Section 318](#)

*Income Tax Assessment Act 1997*

[Section 202-45](#)

[Section 207-145](#)  
[Section 995-1](#)

*Taxation Administration Act 1953*  
[Schedule 1, Division 290](#)

**Case References:**

*D Marks Partnership & Ors v FC of T*  
[2015] AATA 651

*NR Allsop Holdings Pty Ltd as General Partner of Q Uniform Partnership v FC of T*  
[2015] AATA 654

**Related Practice Statement:**

[PS LA 2008/15](#)

**Related Rulings/Determinations:**

[TR 2010/3](#)  
[MT 2012/3](#)  
[TD 2014/1](#)

**Related Taxpayer Alert:**

[TA 2007/5](#)

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