


IT 2329 - Income tax : trust recoupment tax legislation

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TAXATION RULING NO. IT 2329

INCOME TAX : TRUST RECOUPMENT TAX LEGISLATION

F.O.I. EMBARGO: May be released

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PREAMBLE

The trust recoupment tax legislation seeks to recoup income tax sought to be avoided under certain trust stripping arrangements entered into on or after 12 May 1982. The legislation came into operation on 5 April 1985 and comprises the following Acts:-

- . Trust Recoupment Tax Assessment Act 1985
- . Trust Recoupment Tax Act 1985
- . Trust Recoupment Tax (Consequential Amendments) Act 1985

2. The legislation covers the so-called new generation charitable trust schemes which sought to exploit sub-section 95A(2) of the Income Tax Assessment Act. Under that sub-section, a beneficiary who has a vested and indefeasible interest in the income of a trust estate, but who is not presently entitled to that income, is deemed for assessment purposes to be presently entitled.

3. In its simplest form, this scheme provided for the income of a family trust to be allocated for tax purposes to a charity which was exempt from income tax. The charity, although given a vested and indefeasible interest in that income was, however, not entitled to payment until a much later vesting date, usually 80 years hence. Thus, the trust income was made to appear for tax purposes as income of an exempt body, while effective enjoyment of that income was retained for the benefit of the family members.

4. The blatant tax avoidance nature of such schemes can be demonstrated by the fact that, in reality, the charity derived virtually no benefit from the income allocated to it. As ultimate payment would not take place for some 80 years, the present value of that amount was negligible. For example, the present value of \$100,000 payable in 80 years time is equivalent to less than \$50 payable today. Therefore, by conferring on the charity a benefit worth less than \$50, the taxpayers concerned

sought to avoid tax up to \$60,000.

RULING Primary Taxable Amounts

5. The trust recoupment tax legislation applies to schemes of the type described above entered into on or after 12 May 1982 provided the present value of the expected benefit is less than 50% of the amount allocated to the exempt beneficiary. The trustee of a trust making an allocation of trust income for the purposes of the scheme is liable to recoupment tax on an amount equal to the stripped income at the rate of 60%. Where, as part of the scheme, there are successive allocations of income through a number of trusts, the taxable amounts in respect of each sub-trust is reduced by so much of that amount as is attributable to the relevant head trust income. In other words, the taxable amount applicable to a trustee of a sub-trust is transferred to the trustee of the head trust.

6. However, a right of election is available to persons (other than persons in the capacity of trustee) who, but for the scheme, could reasonably be expected to have benefited from a distribution from the trust. Those beneficiaries are able to elect to be assessed on amounts equal in aggregate to income stripped from the trust.

7. In circumstances where an election is made, provided the Commissioner is satisfied that the allocation of the trust income between the electors is reasonable and that the tax payable on the amounts to be included in their assessable income will be paid, the liability of the trustee is eliminated.

Secondary Taxable Amounts

8. Liability for trust recoupment tax may be traced from the stripped trust to persons who benefited from the stripped income in the following three situations:-

- (a) the stripped trust no longer exists;
- (b) the stripped trust now has different beneficiaries as a consequence of sales of beneficial interests;
or
- (c) it is unlikely that the trustee will pay its trust recoupment tax liabilities and the relevant persons behind the trust have not elected to be assessed on the stripped income.

9. Once the need to trace liability from a stripped trust has been established, a joint and several liability for the tax is placed on all persons in the eligible beneficiaries class. Generally, that class includes all persons who have directly or indirectly derived a benefit attributable to the stripped trust income. However, the class does not include third parties who derived a benefit as a result of arm's length transactions nor does it include the charity that was the nominal beneficiary under a particular scheme.

10. As the liability of an eligible beneficiaries class for trust recoupment tax is joint and several, it could occur that one, or more, of the members of the class is obliged to pay the tax that is the responsibility also of other members of that class. In those circumstances, section 10 of the Trust Recoupment Tax Assessment Act gives that member, or members, a right of contribution against other members of the class in respect of trust recoupment tax that the member has paid. This right is to be exercised in a court of competent jurisdiction, which may order such sharing of the tax as appears to the court to be just and equitable. Under the same section of the Act, the member who is sued by the Commissioner for unpaid trust recoupment tax may have other members of the class joined as co-defendants to the recovery suit. It is then up to the court to decide how much of the unpaid amount the person sued, and each of the persons joined, should be liable to pay.

Penalty Tax

11. The legislation also provides for the imposition of penalty tax in respect of new generation trust stripping schemes entered into after 28 April 1983 (the date of a Government announcement on these schemes). The penalty tax is imposed irrespective of whether the tax sought to be avoided is to be recovered as trust recoupment tax or as income tax payable as a result of an election made by the beneficiaries. The penalty tax imposed by the legislation is subject to a general power of remission of the Commissioner.

12. Where trust recoupment tax or income tax is assessed in relation to a scheme entered into after 28 April 1983 and before 5 April 1985 (commencement of the trust recoupment tax legislation), the penalty tax is based on an indexation formula to ensure that the real value of the tax sought to be avoided is collected. It is considered that remission in such cases would be very rare and should not be made without reference to the National Office.

13. In relation to a scheme entered into on or after 5 April 1985, the penalty tax is equal to 200% of the tax sought to be avoided. Normal remission guidelines relating to Part VII of the Income Tax Assessment Act apply, as appropriate, to such a scheme (see Taxation Rulings Nos. IT 2012, 2028, 2043 and 2206).

14. There are many similarities with the Taxation (Unpaid Company Tax) Assessment Act 1982. For example, by virtue of section 4 of the Trust Recoupment Tax Assessment Act, machinery provisions of the income tax law are adapted and applied for the purposes of the trust recoupment tax legislation. The application of those provisions to trust recoupment tax means for example, that a person has the same rights of objection and appeal against an assessment of trust recoupment tax as are available to a taxpayer who is dissatisfied with an income tax assessment.

15. Section 13 operates to render void as against the

Commissioner arrangements entered into on or after 28 April 1983 which have the dominant purpose and the effect of directly or indirectly defeating, evading or avoiding a person's liability to pay trust recoupment tax or income tax payable under the trust recoupment tax legislation.

COMMISSIONER OF TAXATION
18 June 1986