IT 2466 - Income tax : trust distributions of group interest to non-resident beneficiaries : determination of objections

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There is an Addendum notice for this document.

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TAXATION RULING NO. IT 2466

INCOME TAX : TRUST DISTRIBUTIONS OF GROUP INTEREST TO NON-RESIDENT BENEFICIARIES : DETERMINATION OF OBJECTIONS

F.O.I. EMBARGO: May be released

REF N.O. REF: 86/5015-2 DATE OF EFFECT: Immediate

B.O. REF: Hob J32/1/5
Syd 27/B13/AF.4064/1/1
Parr A.48/5/12
ACT 01/AC 75
Melb VJ 192/100
Bris 5/IT/COR.67W
Adel M.336/1/5 Pt.2
Perth J.36/255

DATE ORIG. MEMO ISSUED: 26 July 1983

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1010568	INCOME TAX AVOIDANCE	PART III . DIVISION 6
	TRUSTS WITH NON-RESIDENT BENEFICIARIES	. DIVISION 11A PART IVA PART VII
	INTEREST WITHHOLDING TAX	

OTHER RULINGS ON THIS TOPIC IT 2344

PREAMBLE This ruling provides guidelines for arrangements designed to provide a non-resident beneficiary with entitlement to interest income derived by a resident trust estate from associated entities. If the arrangements are effective, Australian tax payable on the entitlement is limited to the 10 per cent withholding tax on interest paid to non-residents.

2. Under the arrangements a deduction is claimed by the borrower in the group for the amount of interest paid to the associated trust. The interest income is then distributed to the non-resident beneficiary and 10 per cent interest withholding tax is paid by the trustee. The arrangement is based on the premise that the interest payment to the trust retains the character of interest when it passes into the hands of the beneficiary.

3. A common feature in many of these cases is that the amount applied for the benefit of the non-resident is not paid to the beneficiary but is retained by the trust, being shown in its accounts as owing to the beneficiary or, although paid to the beneficiary, is returned to the trustee, a resident beneficiary or to an associate.

RULING 4. A trustee may, where the trust deed allows, distribute income by type to particular beneficiaries. The trustee may,

for example, choose to distribute interest income to a non-resident beneficiary and the accounts may separately identify the income to reflect this. The non-resident beneficiary, if presently entitled to interest income, is deemed, in terms of sub-section 128 A(3) of the Income Tax Assessment Act, to have derived such interest income for the purposes of Division 11A. If this is the position, it must be accepted that the arrangement is effective for income tax purposes and Australian tax in respect of the trust distribution is therefore limited to the rate applicable to withholding tax on interest payments to non-residents.

5. However, cases have been encountered where the arrangements designed to pass group interest to non-resident beneficiaries have the hallmarks of challengeable tax avoidance schemes and bring into question both the deductibility of the interest payments by group borrowers and the status and entitlement of the non-resident beneficiary in relation to trust interest income. These scheme cases have generally fallen into one of two categories:

NEW INCOME FLOW

(i) In the first category, the scheme transactions give rise to the flow of interest income. Interest-bearing loans are made between associated entities in the group to create the background for a purported interest payment to a trust estate with a non-resident beneficiary. Where these intra-group loans and interest payments appear to be sham transactions or, on the objective facts, transactions entered into for the purpose of avoiding tax, a deduction claimed by the associate for the interest payment should be disallowed on the basis that the arrangement is a sham, that the payment is not incurred for the purposes described in sub-section 51(1) or that section 260 or Part IVA, where appropriate, applies to defeat the arrangement.

Such approaches should be considered in cases where there is no documentation to support the loan and interest transactions, where the transactions were part of an artificial round robin not supported by real funds or where there is no significant commercial justification for the transactions (other than the avoidance of tax). Even if the interest payment to the trust with the non-resident beneficiary is not regarded as a sham and is not caught by section 260 or Part IVA, the purported distribution by the trustee to the non-resident beneficiary may still give rise to the application of section 100A or Taxation Ruling No. IT 2344 which deals with purported distributions to non-resident beneficiaries who, if they exist, are never intended to receive the benefit of the purported

distributions. Where the beneficiaries do not appear to have had a genuine entitlement, assessments should be made in accordance with paragraph 5 of IT 2344. Of course, where section 100A applies assessments should be made under section 99A.

EXISTING INCOME FLOW

(ii) In the second category, the interest flow existed in the previous year and in the scheme year it is diverted to the trust with the non-resident beneficiary. The deduction claimed by the borrower for interest paid should be allowed in these cases if it was previously allowable under normal assessing guidelines. However, in these cases also the purported distribution to the non-resident beneficiary should be considered in accordance with Taxation Ruling No. IT 2344. Where after such consideration, the non-resident beneficiaries do not appear to have had a genuine entitlement, the whole of the arrangements under which the interest income was diverted within the taxpayer group should be reviewed in the light of Part IVA. In appropriate cases, Part IVA may possibly apply to include the interest receipt in the assessable income of the party who would have received it if the diversion arrangement had not been entered into. Reports on Part IVA cases should be referred to National Office. Other non-genuine cases should be assessed in accordance with paragraph 5 of IT 2344. In cases where present entitlement appears to exist, section 100A should be considered before it is accepted the arrangements are effective for tax purposes.

PENALTY

6. Penalty should be imposed and remitted in accordance with Taxation Rulings No's IT 2012, 2028, 2043, 2141, 2206 and 2312, as appropriate.

DETERMINATION OF OBJECTIONS

7. Where, after consideration of all relevant factors, it is not possible to be satisfied that the requirements of section 51 are met, objections against the disallowance of deductions for interest paid to the group trust should be disallowed. Cases relying on the application of sections 100A, 260 or Part IVA should be cleared with National Office before determination. Objections against the assessments raised on the basis that the trust distributions to non-residents are not genuine should be determined in accordance with Taxation Ruling No. IT 2344.

WITHHOLDING TAX PAID

8. In scheme cases assessed in accordance with this ruling, it will be necessary to refund or credit the amount of withholding tax paid on interest under the scheme arrangement in any case where it is established that no liability for the withholding tax existed. Action to refund or credit withholding tax to a taxpayer should not be taken until any disputes about that taxpayer's assessments arising from the disallowance of the scheme have been finally settled.

RECOVERY

9. Normal recovery action can be instituted on assessments that disallow the interest claim of the associated borrower. Recovery action in respect of assessments raised on the basis that the purported distributions to non-resident beneficiaries are not genuine should be taken in accordance with Taxation Ruling No. IT 2344.

COMMISSIONER OF TAXATION
18 February 1988