BTR/Section20 -

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20

AUSTRALIANS INVESTING OFFSHORE

Recognising foreign source income under imputation

Recommendation

20.1 Imputation credits for foreign DWT

That imputation credits of up to 15 per cent of repatriated dividends be provided for foreign dividend withholding tax (DWT) paid, including for DWT paid on repatriated exempt dividends.

This proposal is discussed in *A Platform for Consultation* (pages 672-673).

The current imputation arrangements provide a credit to resident individual shareholders for company tax paid on Australian source income (resulting in franked dividends) but levy a layer of domestic tax on distributed foreign source income. Hence foreign taxes are ignored when personal income tax is levied on dividends paid by resident companies out of foreign source income.

While there is only one layer of Australian tax levied on distributed dividends, foreign tax has the potential to discourage offshore investment relative to domestic investment. This may be contrary to Australia's best interests given the increased opportunities for Australian entities to invest profitably overseas.

A growing number of large public companies in Australia derive an increasing proportion of their income from overseas. In many cases they have outgrown the Australian market place and have expanded offshore.

Providing an imputation credit for foreign DWT (up to a maximum of 15 per cent of the dividend) will:

- partially remove the current imputation system's bias that discourages foreign investment over domestic investment, including where the underlying risk-adjusted rates of return are identical;
- provide a benefit to resident shareholders of companies deriving significant foreign source income — irrespective of the number of foreign shareholders — by converting some unfranked dividends into franked dividends;
- reduce the extent to which foreign dividend withholding taxes can discourage the repatriation of profits from offshore;
- achieve comparability with investments made directly by Australians in foreign companies (currently Australian individuals can claim a foreign tax credit for DWT if they invest in a foreign company either directly or via a resident trust, whereas Australian-based multinational companies are unable to pass on a credit for DWT to their Australian shareholders); and

- maintain this flow-through effect for foreign DWT under the proposed entity tax regime for investment offshore by Australian individuals via resident trusts — be they trusts taxed like companies or collective investment vehicles (CIVs).

The benefit to shareholders of providing an imputation credit for DWT is shown in Table 20.1.

Table 20.1 Impact of allowing imputation credits for foreign dividend withholding tax

	Direct investment in foreign entity or via CIVs $	Current company treatment $		Allowing an imputation credit for foreign dividend withholding tax $	
Foreign dividend	100	100		100	
Foreign DWT	-15	-15		-15	
Net dividend Paid to Australia	85	85		85	
Australian entity tax (at 30%, after credits allowed, under FTCS; or dividend repatriation exemption)		-15 (FTCS)	0 (Exempt)	-15 (FTCS)	0 (Exempt)
Distribution to resident investor	85	70	85	70	85
Impact of personal tax at 30% (after credits allowed)	-15[a]	-10.5[b]	-25.5[c]	0	-15[a]
Return to investor	70	59.5	59.5	70	70

(a) Personal tax of $30 on $100 foreign dividend less a foreign tax credit of $15.
(b) Personal tax of $25.50 on $85 dividend paid by the Australian entity, less imputation credit of $15 for the tax paid by the Australian entity.
(c) Personal tax of $25.50 on $85 dividend paid by the Australian entity.

Some submissions to the Review supported the provision of imputation credits for foreign tax in excess of DWT — that is, providing a credit for some or all foreign underlying tax. Providing imputation credits to this extent would have the following undesirable consequences.

- There would be a greater revenue cost. While some imputation credits could be made non-refundable to offset the extra cost, limiting credits to foreign DWT actually paid (up to 15 per cent) allows those credits to be refundable in the same way as other imputation credits. This reduces complexity, administration and compliance costs.
- There would be a revenue risk from dividends being repatriated to Australia to gain the imputation credit and then sent back offshore. Consequently, rules would be required to prevent such arrangements.
- Foreign investments via an entity would be favoured over direct investment in foreign entities (which would attract a foreign tax credit only for DWT paid, unless this credit were also increased).
- There would be a greater need to consider imputation credits for other foreign taxes paid by foreign branches of resident entities to avoid

providing markedly different treatment to branches and subsidiaries. It would be difficult to verify the amount of tax actually paid by foreign branches, since branch profits are generally not subject to tax on repatriation in the foreign country and are generally exempt in Australia under the current branch profit exemption arrangements.

Recommendation

20.2 No streaming of foreign source dividends

That foreign source dividends not be allowed to be streamed to foreign shareholders (and therefore franked dividends not be able to be streamed to Australian shareholders).

The extra layer of tax on foreign source dividends paid to Australian shareholders could be addressed by also allowing streaming of unfranked dividends out of foreign source income to foreign shareholders. Currently all dividends must be distributed proportionately to all shareholders.

Allowing streaming of foreign source dividends to foreign shareholders, as suggested by some submissions, would provide an additional benefit to Australian entities which have Australian and foreign shareholders and which also have both Australian and foreign source income — and as a result pay franked dividends (from taxed Australian source income) and unfranked dividends (from taxed foreign source income which is exempt from Australian entity tax). Streaming would effectively allow franked Australian source dividends to be paid to Australian shareholders (and unfranked dividends to foreign shareholders) while maintaining the same total dividend payment to all shareholders. Imputation credits (from taxing Australian source income) that would otherwise be 'wasted' on the foreign shareholder proportion could be channelled to Australian shareholders. In contrast, providing an imputation credit for foreign DWT paid only partially converts unfranked dividends out of foreign source income into franked dividends.

Streaming becomes more beneficial as the proportion of franked dividends increases relative to the proportion of Australian shareholders (since more franked dividends could be directed to Australian shareholders). If there is only a low proportion of franked dividends relative to the proportion of Australian shareholders, providing both imputation credits for foreign DWT (to boost the level of franking) and allowing streaming (to direct them to Australian shareholders) is beneficial.

As noted above, either providing an imputation credit for foreign DWT or allowing streaming of unfranked dividends to foreign shareholders would address the potential disincentive for offshore investment relative to domestic investment. However, streaming is estimated to have a greater revenue cost than providing imputation credits for DWT of up to 15 per cent. Furthermore, providing an imputation credit will benefit a wider range of

entities — not only those with some franked income and some foreign shareholders. All entities will have an equal incentive to expand offshore into profitable ventures. If only streaming were allowed, entities with no foreign shareholders or franked income would receive no incentive.

Allowing streaming of foreign dividends to foreign shareholders would not improve the returns to foreign shareholders. This is because Australian tax is not currently levied on most foreign source dividends paid to foreign shareholders (through the effect of the foreign dividend account arrangements). This is illustrated in Table 20.2.

Table 20.2 Effect of streaming on resident and non-resident shareholders

	Current approach (requires dividends to be equally franked) $	Streaming $
Exempt foreign source dividend received in Australia from comparable tax country (after foreign company tax at 30% and DWT at 15%)	100	100
Australian source income distributed franked (after company tax at 30%)	100	100
After-tax return to resident shareholders (50% of total shareholders) after imputation credits and personal income tax at 30%		
Australian source income	50	100
foreign source income	50×0.7= 35	0
total	85	100
After-tax return to foreign shareholders		
Australian source income	50	0
foreign source income	50	100
total	100	100

Allowing streaming would provide an incentive to match the proportion of Australian shareholders to the proportion of franked dividends. That would maximise the franking benefits received by Australian shareholders. If the proportion of unfranked dividends increased (reflecting further expansion offshore), there would be pressure to reduce the proportion of Australian shareholders relative to foreign shareholders (by, for example, issuing more share capital offshore) to ensure the dividends received by resident shareholders remain fully franked.

Streaming would provide a benefit to resident shareholders and increase the attractiveness to them of holding shares because of increased franking. However, if the proportion of foreign source income and the level of foreign shareholding in an Australian entity increased markedly over time such that resident shareholders are in the minority, the Australian entity could face pressure from the foreign shareholder majority to re-locate offshore (to improve the foreign shareholders' after-tax return on income sourced in their home country).

Recommendation

20.3 'Stapled stock' arrangements

That 'stapled stock' arrangements continue to be allowed with the current franking account adjustment.

Offshore 'stapled stock' arrangements broadly involve Australian entities establishing a foreign company that pays dividends to foreign shareholders while Australian shareholders receive a comparable franked dividend from the Australian entity. Under current treatment, the franking account of an Australian entity is debited for the imputation credits diverted to its Australian shareholders because dividends to foreign shareholders of the Australian entity's foreign company are directly paid from foreign source income of that company. If these arrangements were allowed without an adjustment to the franking account, they would provide the same benefits to resident shareholders as streaming by the Australian entity — that is, a higher proportion of franked dividends.

Stapled stock arrangements can provide an additional benefit for foreign shareholders without further reducing the Australian revenue if the foreign shareholders are located in the same country as the source of the 'foreign source' income. In this case foreign DWT can be avoided and any imputation credits provided by the foreign country for foreign tax may be preserved for the foreign shareholders.

Currently, foreign dividends paid to foreign shareholders under stapled stock arrangements incur a debit to the franking account for the imputation credits diverted to Australian shareholders. This debit removes the potential benefit to Australian shareholders of the stapling arrangement, while preserving the benefits for foreign shareholders outlined above.

Since streaming is not recommended, it would be inconsistent to allow stapling arrangements to achieve similar tax outcomes for resident shareholders. For this reason, the debit to the franking account will remain. As at present, companies could still use stapled stock arrangements to benefit foreign shareholders.

Consistent treatment of resident entities deriving foreign source income

Recommendation

20.4 Relief from double taxation for resident trusts

That resident trusts subject to entity taxation be allowed:

(i) credits for foreign 'underlying tax' in respect of dividends derived from direct investments in foreign companies or other entities taxed as companies;

(ii) the exemption for foreign dividends paid from comparably taxed company profits; and

(iii) the foreign branch profits exemption available to resident companies.

These proposals are discussed in A Platform for Consultation (pages 670-671).

In line with relief from double taxation for resident companies, resident trusts taxed as entities will be provided with:

- 'underlying tax' credit relief for tax imposed on profits from which dividends are derived from direct interests in foreign companies;
- an exemption for dividends from direct interests in foreign companies where the dividends are paid from profits likely to have been taxed without concession in a listed comparable tax country; and
- an exemption from Australian tax on foreign source income derived through a branch in a listed comparable tax country if the income is taxed without concession in the listed country.

Recommendation

20.5 Relief from double taxation for foreign trust distributions

That resident entities subject to entity taxation receiving distributions from direct interests in foreign trusts:

(i) not be allowed the dividend exemption for distributions from foreign trusts; but

(ii) be allowed a foreign tax credit for foreign 'underlying tax'.

These issues are discussed in *A Platform for Consultation* (page 670).

The dividend exemption is intended to be available only for dividends paid from profits that are likely to have been taxed in a listed comparable tax country. Trusts, however, are taxed as flow-through entities in many listed comparable tax countries and amounts derived through trusts located in these countries may not be subject to a comparable level of tax. Accordingly, the exemption will not be available for distributions from foreign trusts because they could be used, for instance, to stream low-taxed income from a third country to Australian beneficiaries without those amounts being subject to

comparable tax. Rules in the controlled foreign company measures that safeguard the dividend exemption would not apply to foreign trusts. Moreover, the foreign investment fund (FIF) measures may not provide protection because FIF income is generally reduced for exempt dividends paid by a FIF.

Since the dividend exemption would not be available, the foreign tax credit system would apply. By allowing resident entities (companies and trusts) a foreign 'underlying tax' credit for distributions from a direct interest in a foreign trust, companies and trusts subject to the entity tax regime will be treated consistently. For this purpose, fixed beneficial interests of at least 10 per cent in the profits of a foreign trust could be treated as direct interests.

Recognising imputation credits that initially flow offshore

Recommendation

20.6 Flow of franking credits through trans-Tasman companies

That the Australian Government propose to the New Zealand Government that discussions be held with a view to introducing a mechanism to allow franking credits to flow through trans-Tasman companies on a pro-rata basis to Australian and New Zealand investors.

Australian investors in New Zealand companies that are deriving Australian source income do not receive credit for Australian tax paid on that income. Likewise, New Zealand investors in Australian companies that are deriving New Zealand source income do not receive credit for New Zealand tax paid on that income.

This so-called 'triangular case' has been raised by business in the context of the Closer Economic Relations agreement with New Zealand (CER) and has been a long-standing subject of discussion between the Australian and New Zealand governments. Joint work on the issue has been undertaken between officials but further consideration deferred until after the outcome of this Review.

The issue was discussed in *A Platform for Consultation* (pages 660-661). Although it is a systemic problem, the only submissions arguing for the pursuit of a solution were made on behalf of a number of companies with substantial trans-Tasman investments and shareholders. Shareholders of these companies are significantly disadvantaged by the loss of franking credits. While reform could be implemented unilaterally, there will be advantages in negotiating a reciprocal agreement under the framework of CER.

A major risk with implementing a unilateral solution — one that could apply beyond New Zealand to any non-resident company with Australian shareholders that derive income through an Australian resident company — is that it could promote the shifting of headquarters overseas, for example to tax havens, to avoid features of Australia's tax regime. A relocated headquarters company, for example, could earn foreign source income through a tax haven while receiving fully taxed profits from its Australian operations and paying them to Australian shareholders by way of franked dividends, just as it could if its headquarters were in Australia.

Simplifying and strengthening the rules for foreign trusts

Recommendation

20.7 Foreign source income rules

That some limited changes be made to the foreign source income rules for foreign trusts pending a comprehensive review of the rules (Recommendation 23.1).

The foreign source income rules for foreign trusts are very complex. That complexity arises partly because the four regimes covering foreign trusts were not introduced concurrently. The main regimes that apply to foreign trusts are the transferor trust measures, the FIF measures and the deemed present entitlement rules in the general trust provisions. There are also rules that apply to foreign trusts in the controlled foreign company measures.

Broadly, the transferor trust measures tax residents, who have transferred value to a foreign trust, on the undistributed profits of the trust (called 'attributable income'). An exemption applies for transfers to family trusts and for amounts that have been comparably taxed. Another component of the transferor trust measures is an interest charge on foreign trust distributions to resident beneficiaries. The charge applies to distributions of profits not previously taxed in Australia or in a closely comparable tax country.

The FIF measures and deemed present entitlement rules apply to interests held by resident beneficiaries in foreign trusts. The FIF measures operate to tax resident beneficiaries on their share of the undistributed profits of a foreign trust. The deemed present entitlement rules apply to controlled foreign trusts and other foreign trusts that are exempt from the FIF measures. The rules treat resident beneficiaries as presently entitled to a share of profits accumulated in a foreign trust based on their rights to receive distributions from the trust.

A comprehensive review of the foreign source income rules has been recommended (Recommendation 23.1). There is, however, an opportunity before that review to make the foreign source income rules for foreign trusts less complex and to reduce compliance costs (Recommendations 20.8 and 20.9). Submissions on *A Platform for Consultation* have supported these changes. Changes to the transferor trust measures are also recommended to minimise tax avoidance through the use of foreign trusts (Recommendations 20.10 to 20.12).

Recommendation

20.8 Deemed present entitlement rules for foreign trusts

Removal of rules

(a) That the deemed present entitlement rules in relation to foreign trusts be removed.

Expanded application of FIF measures

(b) That certain interests currently taxed under these rules — fixed interests in closely held trusts and in trusts subject to the transferor trust measures — be subject to the FIF measures.

This proposal is discussed in *A Platform for Consultation* (page 676).

Currently, fixed beneficial interests in foreign trusts that are exempt from the FIF measures may be subject to the deemed present entitlement rules in the general trust provisions. The deemed present entitlement rules were intended to also apply to contingent and other non-fixed interests in foreign trusts but have only been effective when dealing with fixed interests. These fixed interests can be handled more equitably under the FIF measures which contain comprehensive rules for preventing double taxation. The deemed present entitlement rules cannot be made to operate appropriately for non-fixed interests and are therefore largely redundant.

Overlap will be avoided by removing the deemed present entitlement rules and taxing fixed interests in foreign trusts subject to those rules under the FIF measures. The scope of the FIF measures would be extended by removing exemptions for interests in closely held trusts and trusts subject to the transferor trust measures. Taxpayers will not be disadvantaged by extending the scope of the FIF measures in this way because only taxpayers currently subject to the deemed present entitlement rules would be affected.

Consistent with current treatment, interests in closely held fixed trusts will be subject to the calculation method for determining FIF income and an unmodified net income calculation will apply. These changes will not increase the compliance burden for beneficiaries of closely held fixed trusts because the

beneficiaries are currently required to make the more precise net income calculation under the deemed present entitlement rules.

To avoid double taxation, the amount on which a transferor is taxed under the transferor trust measures will be reduced to the extent the amount is taxed in the hands of resident beneficiaries under the FIF measures. This is consistent with the reduction that currently applies for amounts taxed under the deemed present entitlement rules.

Recommendation

20.9 Foreign fixed trusts

FIF measures the default regime

(a) That the FIF measures be the only attribution regime for foreign fixed trusts unless there are foreign beneficiaries.

Treatment in presence of foreign beneficiaries

(b) That where there are foreign beneficiaries:

(i) the FIF measures apply to resident beneficiaries; and

(ii) the transferor trust measures apply to resident transferors on amounts not taxed under the FIF measures.

These proposals are discussed in *A Platform for Consultation* (pages 678 and 688-689).

The FIF measures provide adequate protection from tax deferral for interests held by resident beneficiaries in fixed trusts offshore. Transfers to fixed trusts can therefore be excluded from the transferor trust measures where the trusts have only resident beneficiaries. These trusts would be subject only to the FIF measures and their distributions exempt from the interest charge that can currently apply to claw back the benefits from tax deferral.

For fixed trusts offshore with foreign beneficiaries, the FIF measures will apply to resident beneficiaries and resident transferors will be subject to the transferor trust measures on amounts not taxed under the FIF measures. Only the transferor trust measures provide effective protection from tax deferral where a resident has made a transfer to an offshore trust with foreign beneficiaries. A trust, for instance, could be only one component in a broader scheme that involves distributing trust profits to foreign beneficiaries who then provide gifts or other benefits to the transferor or associates of the transferor. The FIF measures provide little protection from arrangements of this kind because the measures apply only to interests held by resident beneficiaries.

Table 20.3 Foreign source income rules for fixed trusts offshore

Links with Australia		
Case 1 **No resident transferor**	**Case 2** **Resident transferor and all beneficiaries are residents**	**Case 3** **Resident transferor and some foreign beneficiaries**
Current treatment		
Resident beneficiaries subject to the FIF measures unless a foreign trust is closely held. Deemed present entitlement rules in the general trust provisions apply to interests of resident beneficiaries in closely held trusts. An interest charge applies to distributions from accumulated amounts not previously taxed to resident beneficiaries (exemptions apply for comparably taxed amounts, deceased estates and non-controlled public unit trusts).	Beneficiaries generally subject to the deemed present entitlement rules in the general trust provisions. The transferor is subject to the transferor trust measures (the amount attributed is reduced for amounts taxed under the general trust provisions). As in Case 1, an interest charge applies.	Same as Case 2 but only resident beneficiaries are subject to the deemed present entitlement rules.
Implications of current treatment		
The transferor trust measures cannot be applied.	The sole operation of either the FIF or transferor trust measures could provide effective protection from tax deferral.	As discussed in the rationale for Recommendation 20.9, only the transferor trust measures are considered to provide effective protection from tax deferral where there are non-resident beneficiaries.
Proposed treatment		
Resident beneficiaries subject to the FIF measures.	Resident beneficiaries subject to the FIF measures. The transferor trust measures will not apply if transferors can show that all beneficiaries are residents.	Resident beneficiaries subject to the FIF measures. Transferor subject to the transferor trust measures (the amount attributed will be reduced for amounts taxed under the FIF measures).
Information requirements in addition to current requirements		
None	None for the transferor or for resident beneficiaries. The transferor is currently required to ascertain the extent to which resident beneficiaries are taxed under the general trust provisions.	Same as Case 2

Reducing the overlap in the foreign source income rules, by providing an exemption from the FIF measures for fixed or hybrid trusts subject to the transferor trust measures, has not been recommended. (Hybrid trusts are discretionary trusts that have some fixed beneficial interests.) In part, that is because, to claim an exemption, resident beneficiaries would need to ascertain whether there is a resident transferor to whom the transferor trust measures apply. Another disadvantage of applying only the transferor trust measures is that a transferor may be taxed on amounts that can be shown to be accumulating for the benefit of resident beneficiaries and hence should be taxed in their hands.

The impact of the proposals in Recommendations 20.8 and 20.9 on the foreign source income rules for fixed trusts is summarised in Table 20.3.

Recommendation

20.10 Transferor trust measures

Application to pre-commencement and pre-residence transfers

(a) That the transferor trust measures generally apply to income derived from the 2000-01 income year in respect of transfers to foreign discretionary trusts made prior to:

(i) the operation of the transferor trust measures ('pre-commencement transfers'); and

(ii) a transferor becoming a resident ('pre-residence transfers').

Exclusion for certain transfers

(b) That paragraph (a) not apply:

(i) for four years after a transferor becomes a resident — if the transfer was made more than four years prior to the transferor becoming a resident; nor

(ii) to temporary visitors who stay no longer than four years in Australia.

Exemption from identification of family trust beneficiaries

(c) That the requirement for primary beneficiaries of family trusts to be identified by name not apply for foreign trusts created:

(i) before the commencement of the transferor trust measures; or

(ii) before a transferor first becomes a resident.

Reduced attribution where sufficient foreign tax paid

(d) That attributable income under the transferor trust measures be reduced by the amount of trust income distributed to foreign beneficiaries where foreign tax paid on the distribution is at least 20 per cent of the amount distributed.

Reduced attribution where no benefit for residents

(e) That attributable income for foreign trusts affected by paragraph (a) be reduced to the extent the Commissioner of Taxation is satisfied residents will not benefit from such trusts.

The application of the transferor trust measures to pre-commencement and pre-residence transfers is discussed in *A Platform for Consultation* (pages 678 and 690-691).

Application

Transfers made before the operation of the transferor trust measures are currently not covered by the measures unless the transfer was to a discretionary trust and it can be shown that the transferor or an associate is in a position to control the trust. Given the anti-avoidance rationale for the measures, the current restriction relating to control should be removed because:

- discretionary trusts are commonly used to avoid tax by hiding interests residents have in profits accumulating offshore;
- it is difficult to show in practice that a foreign trust is controlled (even though the term has a wide meaning for the purposes of the transferor trust measures) because information that can be obtained by the Australian Taxation Office (ATO) on offshore arrangements and on agreements between related parties is often informal and in the hands of parties in tax havens that have laws against disclosure of information; and
- the income accruing in these trusts has not been taxed since the transferor trust measures commenced in 1990, which represents relief well beyond normal transitional relief.

Prospective residents are allowed by the current treatment to transfer assets to a foreign trust immediately before becoming a resident. Australian tax is thereby deferred or avoided unless it can be shown that the foreign trust is controlled by the prospective resident. Again, this is not appropriate because transferors are then not taxed on income that accrues after they become resident in Australia and are enjoying the benefits of publicly provided services.

The recommended measure will only apply to income of affected trusts from the 2000-01 income year.

Exclusions

Attributable income under the transferor trust measures will be reduced by trust income distributed to foreign beneficiaries where foreign tax paid on the distribution is at least 20 per cent of the amount distributed. The risk that these foreign beneficiaries would be used to pass on tax-preferred or exempt benefits to Australian residents is low because comparable foreign tax has been paid on the distributed amounts.

The transferor trust measures will not initially apply to transfers made more than four years before a transferor becomes a resident. These transfers are unlikely to have been made to avoid or defer Australian tax. However, the measures will apply to such transfers four years after a transferor becomes a resident. This will allow transferors time to reorganise their affairs but also ensure that they are not treated more favourably than other residents on an ongoing basis.

In addition, not applying the transferor trust measures to temporary visitors to Australia whose stay is no longer than four years would be consistent with the temporary visitor exemption in the FIF measures.

Exemptions

The operation of the definition of family trusts will be improved by removing the requirement for primary beneficiaries to be identified by name in the trust deed for trusts created:

- before the commencement of the transferor trust measures; or
- before a transferor first became a resident.

Broadly, the transferor trust measures do not apply to family trusts where the only beneficiaries are non-residents in necessitous circumstances who are close relatives of the transferor. These trusts are unlikely to be used for the purpose of avoiding Australian tax. The requirement for beneficiaries of family trusts to be identified by name is overly restrictive for trusts created before the conditions of the exemption were known.

Reductions

Other foreign discretionary trusts affected by the wider application of the transferor trust measures may not have been set up for the purpose of avoiding Australian tax. The attributable income of these trusts will be reduced to the extent the Commissioner is satisfied residents will not benefit directly or indirectly from the trusts. To qualify for the reduction a transferor will need to estimate the extent to which residents will benefit from a foreign trust and to furnish information requested by the Commissioner for making a determination. Tax not paid because of the Commissioner's determination

will become payable with interest if the transferor underestimates the extent to which residents actually benefit. A moderately high interest rate will need to apply to discourage transferors from understating the estimate.

Recommendation

20.11 Winding up of pre-commencement or pre-residence trusts

Provision of amnesty

(a) That an amnesty be provided to allow foreign trusts to be wound up where they are affected by the wider application of the transferor trust measures (Recommendation 20.10), with:

(i) trust distributions to Australian residents made under the amnesty to be taxed at 10 per cent; and

(ii) an indemnity to ensure trust distributions made under the amnesty do not lead to an investigation by the ATO of a taxpayer's domestic affairs, or international dealings, relating to a foreign trust wound up under the amnesty.

Qualifying conditions for amnesty

(b) That the amnesty only be available where a taxpayer satisfies the Commissioner that:

(i) a foreign trust has been wound up;

(ii) a full distribution has been made of all property of the trust;

(iii) that property includes the balance remaining:

- **of all amounts transferred to the trust prior to the commencement of the transferor trust measurers or prior to a transferor becoming a resident; or**
- **of all income derived by the trust from those transferred amounts or from the reinvestment of such income; and**

(iv) if the full distribution was not made to Australian residents, no Australian resident has any direct or indirect interest in that part of the property distributed to non-Australian residents.

Exclusion from amnesty

(c) That the amnesty not be available if after the commencement of the transferor trust measures:

(i) a resident made a transfer, or caused a transfer to be made, to a foreign trust;

(ii) a foreign trust has been identified by the ATO as having been controlled by a resident transferor (for instance, where the transferor trust measures have previously been applied to a foreign trust because the trust was controlled); or

(iii) there has been a notification that the ATO is undertaking, or will undertake, an investigation of a transferor's taxation affairs.

This proposal was not discussed in *A Platform for Consultation* but is being recommended to allow foreign trusts to be wound up where they are affected by the wider application of the transferor trust measures in Recommendation 20.10.

A rebate was provided when the transferor trust measures were first introduced to encourage residents to wind up their foreign trusts. The rebate operated to limit the tax payable on trust distributions to a rate of 10 per cent and applied where foreign trusts were completely wound up before 30 June 1991. Few amounts were distributed from foreign trusts under these arrangements because further tax liabilities could arise if the Commissioner were to investigate the circumstances that gave rise to the distributed amounts.

The Review recommends that residents with foreign trusts affected by the wider application of the transferor trust measures for pre-commencement and pre-residence transfers to foreign trusts be given a final opportunity to normalise their tax affairs by providing an amnesty for the winding up of those trusts.

Tax payable on trust distributions made under the amnesty will be limited to 10 per cent of the distributed amount and will apply to distributions of both accumulated income and contributed capital. No distinction would be made between arrangements involving tax avoidance or tax evasion. An indemnity would also apply to ensure trust distributions made under the amnesty do not lead to an investigation by the ATO of a taxpayer's domestic affairs, or international dealings, relating to a foreign trust wound up under the amnesty. The ATO will be permitted to verify that the requirements for the amnesty had been satisfied but information gathered would not be permitted to be used by the ATO for other purposes. The indemnity will make the option of taking advantage of the amnesty more attractive.

While there are sensitivities in relation to taxpayer equity and compliance enforcement attached to this recommendation, the Review also recognises the pragmatic benefits from normalising complex offshore trust arrangements.

Recommendation

20.12 Amendment of assessments under the transferor trust measures

That the Commissioner be able to apply for a court order to amend assessments for the purposes of the transferor trust measures where the normal amendment period has expired.

Wider amendment powers for the transferor trust measures are discussed in *A Platform for Consultation* (pages 678-679 and 692).

In many cases it is not practical to establish within the normal four year amendment period whether the transferor trust measures should apply. It is difficult, for instance, to use return form questions to identify cases deserving close attention where taxpayers rely on fine points of law to take favourable positions when responding. It can also be difficult to obtain information on offshore arrangements in a timely fashion where those arrangements are purposely structured to make detection or verification difficult. Often arrangements only become visible when Australian residents ultimately benefit from a foreign trust — which may not be for many years after the expiry of the normal amendment period.

The Commissioner will therefore be allowed to amend assessments for the purposes of the transferor trust measures after the expiry of the normal four year amendment period where, for instance, a court is satisfied that:

- a transferor's response to a questionnaire or return form question on matters material to the application of the transferor trust measures was incorrect or misleading; or
- information requested from a transferor on matters relating to the transferor trust measures was not provided or was incomplete; or
- a transferor or other party otherwise takes action which obstructs the ATO in the application of the transferor trust measures.