TA 2003/3 - Avoidance of Capital Gains Tax Utilising a Trust Structure

Taxpayer Alert

TA 2003/3

The Tax Office considers that this arrangement is a variation of the reduction arrangements discussed in Taxation Determination TD 2003/03 and the discussion of the application of Part IVA in that Determination applies equally.

FOI status: may be released

Taxpayer Alerts are intended to be an "early warning" of significant new and emerging higher risk tax planning issues or arrangements that the ATO has under risk assessment.

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 ATO officers of new and emerging higher risk tax planning issues. Not all potential tax planning issues that the ATO has under risk assessment will be 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 ATO.

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 the ATO considers give rise to taxation issues. These issues will generally require more detailed analysis to provide an ATO 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 ATO's position through a Private Ruling. Such taxpayers might also contact the ATO officer named in the Alert and/or obtain their own advice.

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

TITLE: Avoidance of Capital Gains Tax Utilising a Trust Structure

This Taxpayer Alert describes an arrangement involving the sale of capital gains tax (CGT) assets. The arrangement seeks to ensure that on the sale of the CGT assets to an arm's length party the taxable capital gains are streamed to a tax preferred entity, such as a charity, whilst the original owners of the assets receive the sale proceeds free of any CGT liability.

DESCRIPTION

The alert applies to arrangements having the following features:

1. Assets owned by an individual or under a partnership or trust structure are disposed of to a special purpose company (‘SPC’). Roll-over relief is claimed under Division 122 of the *Income Tax Assessment Act* 1997 (‘ITAA 1997’).

2. A “bare” trust (First Trust) is created over the SPC assets with the sole beneficiary of the trust being the SPC. The trust deed allows further beneficiaries to be appointed with the consent of the original beneficiary. First Trust is a discretionary trust but is referred to as a hybrid or convertible trust.

3. SPC consents to the trustee appointing new beneficiaries of the First Trust which are trustees of other trusts and may be associates of the promoter of the arrangement.

4. A second trust is created (Second Trust) of which the beneficiaries are the original owner/s of the assets. The assets are then sold to this Second Trust for a nominal amount. However, the promoter argues that this sale for CGT purposes is deemed to have occurred at market value. This means that the First Trust has a deemed capital gain and the Second Trust acquires the assets with a market value cost base.

5. The Second Trust sells the assets for market value to a third party purchaser.

6. The Second Trust claims to have no taxable capital gain and distributes the sale proceeds (after deducting the promoter's fees) to the original owners in an arguably tax free manner, for example, as a loan or capital distribution.

7. The First Trust returns the deemed assessable capital gain and distributes this to the newly appointed beneficiaries, which in turn distribute this income to a beneficiary which has significant capital losses or is tax exempt such as a charity. No funds are actually received by the charity or other beneficiary.

FEATURES WHICH THE ATO CONSIDERS GIVE RISE TO TAXATION ISSUES

The ATO considers that the arrangement outlined above gives rise to taxation issues which include:

(a) Whether the initial disposal to SPC is an effective rollover under Division 122 to defer the making of a capital gain;

(b) Whether the declaration of trust over the SPC assets is a CGT event under Division 104 of the ITAA 1997;

(c) Whether the appointment of new beneficiaries to the First Trust results in a new trust being created;

(d) Whether the amounts received on the disposal by the Second Trust are assessable as ordinary income under section 6-5 of the ITAA 1997;

(e) Whether the entity which ultimately derives the deemed capital gain is exempt from tax or has deductible losses;

(f) Whether Part IVA of the ITAA 1936 applies as:

i. the arrangement seems artificial and lacks an ordinary business purpose in its design and execution; and

ii. it appears the dominant purpose of entering the arrangement is to provide tax relief to the original owners of the asset. The owners avoid an assessable capital gain upon subsequent sale to an arm's length third party.

The Australian Taxation Office is examining these arrangements.

subject references:	CGT; Partnerships; Rollover; Trusts.
legislative references:	ITAA 1997 Section 6-5 ITAA 1997 Division 104 ITAA 1997 Division 122 ITAA 1936 Part IVA
related tax guidelines:	Creation of a new trust – Statement of Principles August 2001 (withdrawn)
related practice statements:	PS LA 2008/15
related media releases:	
file references:	

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