

TA 2008/15 - Profit washing scheme using a trust and a loss entity

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⚠ This document has changed over time. This version was published on *25 June 2008*



Taxpayer Alert

TA 2008/15

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 Australian Taxation Office has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed.

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 tax officers of new and emerging higher risk tax planning issues. Not all potential tax planning issues that the Tax Office has under risk assessment will be the 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 Tax Office. In these latter cases the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.

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 are of concern to the Tax Office. These issues will generally require more detailed analysis to provide the Tax Office 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 Tax Office's position through a private ruling (noting that the Taxation Administration Act 1953 sets out circumstances where the Commissioner may decline to issue such a ruling). Such taxpayers might also contact the tax officer named in the Taxpayer Alert and/or obtain their own advice.

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

TITLE: Profit washing scheme using a trust and a loss entity

This Taxpayer Alert describes arrangements where a taxpayer attempts to minimise tax liability by using tax losses in an unrelated entity. The business of the taxpayer is restructured so that the income of the business passes through a chain of trusts and on to a loss company. The income, less an amount for promoter fees, remains effectively under the control of the taxpayer, or associates. This Alert covers substantially the same arrangement as described in TA 2005/1 as well as highlighting additional features of concern. In TA 2005/1 we formed the view that arrangements of this type are not likely to be effective.

DESCRIPTION

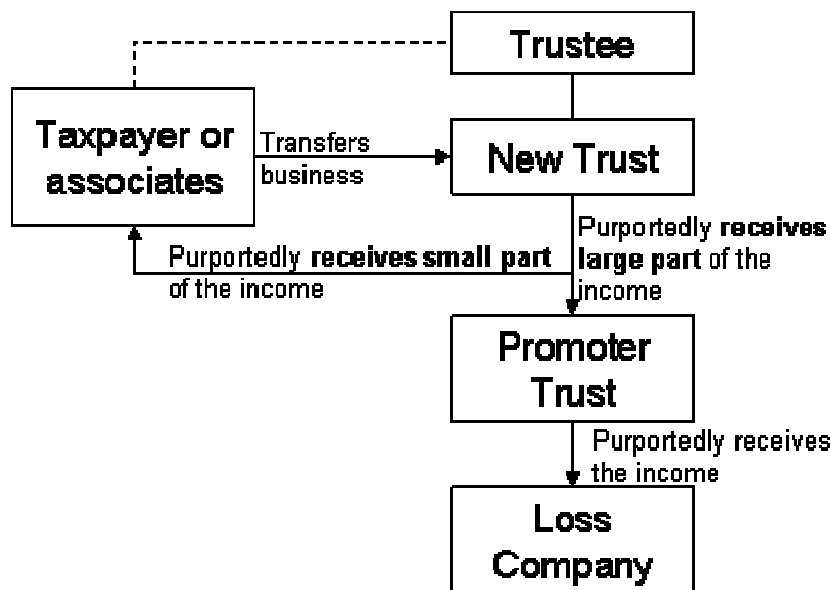
The alert applies to arrangements having some or all of the following features:

Arrangement 1

1. A trading entity (the 'taxpayer') derives income from a business that it carries on. The business is restructured into a hybrid trust (the 'new trust') which then derives the income.
2. The new trust has a number of classes of units. Each class of units has different rights attached. The taxpayer or associates hold units with income, capital and voting rights in the new trust (class A units). Another trust (the promoter trust) holds units in the new trust with income rights only (class B units).
3. The trustee of the new trust has discretion as to the distribution of the income to class A or class B income unit holders.
4. All the units in the promoter trust are held by a company with carry forward losses (the 'loss company').
5. The new trust distributes a large proportion of the income to the class B unit holders. A smaller proportion may be distributed to the class A unit holders.
6. An amount, say 10% of the distribution to the class B unit holders, is paid in cash to the promoter trust. The balance of 90% is never paid and by agreement (usually verbal) between the parties is never intended to be paid.
7. The promoter trust then distributes all of the income distribution from the new trust to the loss company. The promoter claims that the loss company has carry forward losses that offset the distribution from the promoter trust.

Arrangement 2

8. In some arrangements a variation is used where the 90% balance of the distribution referred to in paragraph 6 above is actually paid but remains under the effective control of the taxpayer or associates through the use of a joint venture.
9. In these arrangements a joint venture is formed between the taxpayer or associates and the promoter trust.
10. By agreement the taxpayer or associates have effective control over the assets of the joint venture.
11. As described above in Arrangement 1 the new trust distributes the income to the promoter trust, however, pursuant to an agreement between the parties, the promoter trust then makes a capital contribution, say 90% of the distribution it receives from the new trust, to the joint venture thereby maintaining the effective control of the taxpayer or associates over those funds. In some cases the funds giving effect to the capital contribution by the promoter trust may be paid directly by the new trust to the joint venture.
12. The basic features of these arrangements can be summarised diagrammatically as follows:



FEATURES WHICH CONCERN US

The Tax Office considers that an arrangement of the type described above gives rise to taxation issues that include whether:

- a. such an arrangement or certain steps within it are a sham;
- b. the right entities have been assessed in respect of any ordinary or statutory income;
- c. section 100A of the *Income Tax Assessment Act 1936* (ITAA 1936) applies to the trust distributions made in connection with or as a result of reimbursement agreements;
- d. the loss company has available carry forward losses, and if so, whether those losses are deductible;
- e. any steps within the arrangement may give rise to capital gains assessable to the taxpayer under Part 3 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- f. the arrangement may constitute a scheme to which the general anti avoidance rules in Part IVA of the ITAA 1936 apply; and
- g. any entity involved in the arrangement is a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953).

The Tax Office view on the above arrangements is outlined in Taxation Determination TD 2005/34, which applies to assess the trustee of the new trust on the purported distribution.

Note 1: *Base penalties of up to 50% of the tax avoided may be imposed where Part IVA applies. Base penalties for intentional disregard of the tax law are imposed at 75% of the tax avoided. Reductions in base penalty will be available if the taxpayer makes a voluntary disclosure to the Tax Office. If you have any information about the current arrangement, phone us on 1800 177 006. Tax agents wanting to provide information about people or companies who may be promoting arrangements covered by this Taxpayer Alert should call the tax agent integrity service on 1800 639 745.*

Note 2: *In appropriate cases possible sanctions under criminal law may also apply. Where a taxpayer makes a voluntary disclosure and that disclosure indicates possible criminal offences, the Commonwealth Director of Public Prosecutions has indicated that favourable consideration will be given to granting an indemnity from criminal prosecution in relation to the taxpayer's involvement in the scheme where:*

- the case does not exhibit a significant degree of criminality by the taxpayer
- the taxpayer provides information about how the arrangements worked, including the role and identity of the promoter, and
- the taxpayer co-operates with the investigation and consequential proceedings.

Note 3: Penalties of up to 5,000 penalty units for individuals, 25,000 penalty units for bodies corporate or up to twice the amount of consideration received or receivable may apply to promoters of tax exploitation schemes under Division 290 of Schedule 1 to the Taxation Administration Act 1953. The Commissioner can also apply to the Federal Court of Australia for restraining and performance injunctions against promoters where prohibited conduct has occurred, is occurring or is proposed.

Note 4: A registered tax agent may have their registration cancelled or suspended by the Tax Agents' Board under section 251K of the Income Tax Assessment Act 1936 if they are guilty of misconduct as a tax agent or are not considered a fit and proper person to prepare income tax returns. A person under a sentence of imprisonment for a serious taxation offence is not a fit and proper person.

Subject references

Losses
Hybrid trusts
Trust distributions
Liquidation

Legislative References

Income Tax Assessment Act 1936
Section 100A
Part IVA
Section 251K
Section 251BC
Income Tax Assessment Act 1997
Part 3
Division 165
Taxation Administration Act 1953
Division 290 of Schedule 1

Related Taxpayer Alerts

TA 2005/1

Related Rulings/Determinations

TD 2005/34

Related Practice Statements:

[PS LA 2005/13](#)

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