TA 2008/18 - Arrangements to shift foreign business losses into Australian branches or resident entities

Australian Government
Australian Taxation Office

Taxpayer Alert TA 2008/18

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 In these latter cases the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.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 **Arrangements to shift foreign business losses into Australian branches or resident entities**

This Taxpayer Alert describes arrangements within multi-national companies operating through branches, or operating through transactions with foreign associates, which seek to shift deductions for losses from foreign operations into their Australian businesses. Such arrangements are intended to result in the Australian resident entity or branch reporting a lower taxable income than would have been the case without the arrangement.

Description

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

Arrangement 1

1. A foreign resident entity has a branch in Australia which has assessable income for the relevant income year.

2. The foreign resident entity has:

    a. accumulated losses,

    b. assets with embedded, but not yet realised, losses ("loss assets", for example, a book of [bad] debts), or

    c. a liability to pay a third party (the "third party liability").

3. The foreign resident entity arranges to inappropriately attribute to the Australian branch:

    a. some or all of the losses from foreign operations,

    b. loss assets at an inflated price (i.e. by not properly accounting for the decrease in value arising from the embedded losses when it is attributed to the Australian branch), or

    c. the third party liability without attributing to the branch adequate compensation for the value of the liability assumed by the branch.

    Note: This is likely to involve either an international agreement between related parties that are not dealing at arm's length or profits and circumstances that would not reasonably be expected if the branch were a distinct and separate entity dealing at arm's length with the entity.

4. As a result of the arrangements, greater deductions for losses are sought in Australia by the Australian branch or subsidiary.

5. Similar tax outcomes may be sought by an Australian resident entity with a foreign branch failing to properly attribute to that branch relevant losses, loss assets or third party liabilities.

Arrangement 2

6. A foreign resident entity has an Australian resident associate (including a subsidiary member of a multiple entry consolidated group) with assessable income for the relevant income year.

7. The foreign resident entity has:

    a. assets with embedded, but not yet realised, losses ("loss assets", for example, a book of [bad] debts), or

    b. a liability to pay a third party (the "third party liability").

8. The foreign resident entity and the Australian resident associate arrange to inappropriately transfer:

    a. loss assets to the Australian resident entity at an inflated price (i.e. by not properly accounting for the decrease in value arising from the embedded losses), or

b. the third party liability to the Australian resident entity without receiving proper compensation for the value of the liability assumed.

Note: This is likely to involve either an international agreement between related parties that are not dealing at arm's length.

9. As a result of the arrangements, greater deductions for losses are sought in Australia by the Australian resident entity.

Features which concern us

The Tax Office considers that arrangements of this type give rise to the following taxation issues, including whether:

1. any amount expended by the Australian resident entity would be deductible under section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997), including the extent to which such an amount was incurred in the gaining or producing of non-assessable non-exempt income
2. any amounts would be reduced by the commercial debt forgiveness provisions in Division 245 of the ITAA 1936
3. any amounts of bad debts would be deductible under section 25-35 of the ITAA 1997
4. any losses would be affected by the participation exemption provisions in Division 768-G of the ITAA 1997
5. any company's tax losses or deductions may be affected by the provisions in Division 175 of the ITAA 1997
6. any transaction may be subject to the transfer pricing provisions contained in Division 13 of the *Income Tax Assessment Act 1936* (ITAA 1936)
7. any articles in applicable tax treaties between Australian and a relevant country may apply, especially:
    a. the associated enterprises article (where applicable), or
    b. the business profits article (where applicable)
8. the general anti-avoidance rule contained in Part IVA of the ITAA 1936 may be applied to cancel any tax benefit under all, or some part, of the arrangement, and
9. any entity involved in the arrangement may be 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 is currently reviewing these arrangements.

***Note 1**: If you have received a private ruling in respect of your arrangement, please check that the application of Part IVA of the Income Tax Assessment Act 1936 is considered in that ruling. The applicant may not have sought for us to rule on the application of Part IVA to the arrangement ruled upon, or to an associated or wider arrangement of which that arrangement is part. If you want us to rule on whether Part IVA applies to your arrangement, we will first need to obtain and consider all the relevant facts about the arrangement, including (if relevant) the manner in which it has actually been implemented.*

***Note 2**: Base penalties of up to 50% of the tax avoided can apply where Part IVA is applied. Base penalties of up to 75% of the tax avoided can apply where you make a false and misleading statement to the Commissioner. 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 060 062. Tax agents wanting to provide information about people or companies who may be promoting arrangements covered by this alert should call the tax agent integrity service on 1800 639 745.*

***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**: Where appropriate, section 167 of the Income Tax Assessment Act 1936 (ITAA 1936) may be used to determine the amount of taxable income upon which the taxpayer should be assessed, see Law Administration Practice Statements, PSLA 2007/7 and PSLA 2007/24.*

Amendment history

Date	Comment
19 January 2024	Updated ATO tip-off hotline number

Subject references:
Transfer pricing
Double tax agreements
International tax
Losses
Consolidation
Bad debts
Debt forgiveness
Participation exemption
General anti-avoidance rule
Promoter penalties

Legislative references:
Income Tax Assessment Act 1997
Section 8-1
Section 25-35
Division 175
Division 768-G

Income Tax Assessment Act 1936
Division 13
Part IVA
Division 245

Taxation Administration Act 1953
Division 290

Related taxpayer alerts:
PS LA 2005/13 - Taxpayer Alerts
PS LA 2007/24 - Making default assessments: section 167 of the Income Tax Assessment Act 1936 and other similar provisions

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