




TA 2010/8 - Gift deductions for donation of pharmaceuticals to charities operating overseas

 This cover sheet is provided for information only. It does not form part of *TA 2010/8 - Gift deductions for donation of pharmaceuticals to charities operating overseas*

 An arrangement of the type described in this Taxpayer Alert has been investigated by the ATO. The features of the arrangement and the tax consequences for participants are described in Charity donation schemes

 This document has changed over time. This version was published on 6 December 2010



Taxpayer Alert

TA 2010/08

FOI status: May be released

TITLE: Gift deductions for donation of pharmaceuticals to charities operating overseas

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 (ATO) has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed.

Taxpayer Alerts 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 ATO 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 ATO. In these latter cases, the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.

Taxpayer Alerts give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and highlight the features which are of concern to the ATO. These issues will generally require more detailed analysis to provide the 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 (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.

Overview

This Taxpayer Alert describes an arrangement where a taxpayer claims a gift deduction for pharmaceuticals and other items ('pharmaceuticals') to a charity for use overseas. The taxpayer provides cash for a vendor to purchase the pharmaceuticals from a low cost overseas supplier. They are then valued for gifting purposes at a much higher cost. The difference in these amounts is balanced by what appears to be an unsecured, long term, low interest loan facilitated by the promoter of the arrangement and purportedly funded by the vendor. The pharmaceuticals are apparently made available to the charity through an overseas bonded warehouse.

Under this arrangement, the taxpayer claims a deduction for a donation and related costs that is much greater than the actual amount outlaid, e.g. for a cash outlay of \$2,100 the taxpayer claims a gift deduction purportedly valued at \$20,000.

Context for the arrangement

Division 30 of the *Income Tax Assessment Act 1997* (Cth) (ITAA 1997) and section 78A of the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936) deal with deductible gifts or contributions.

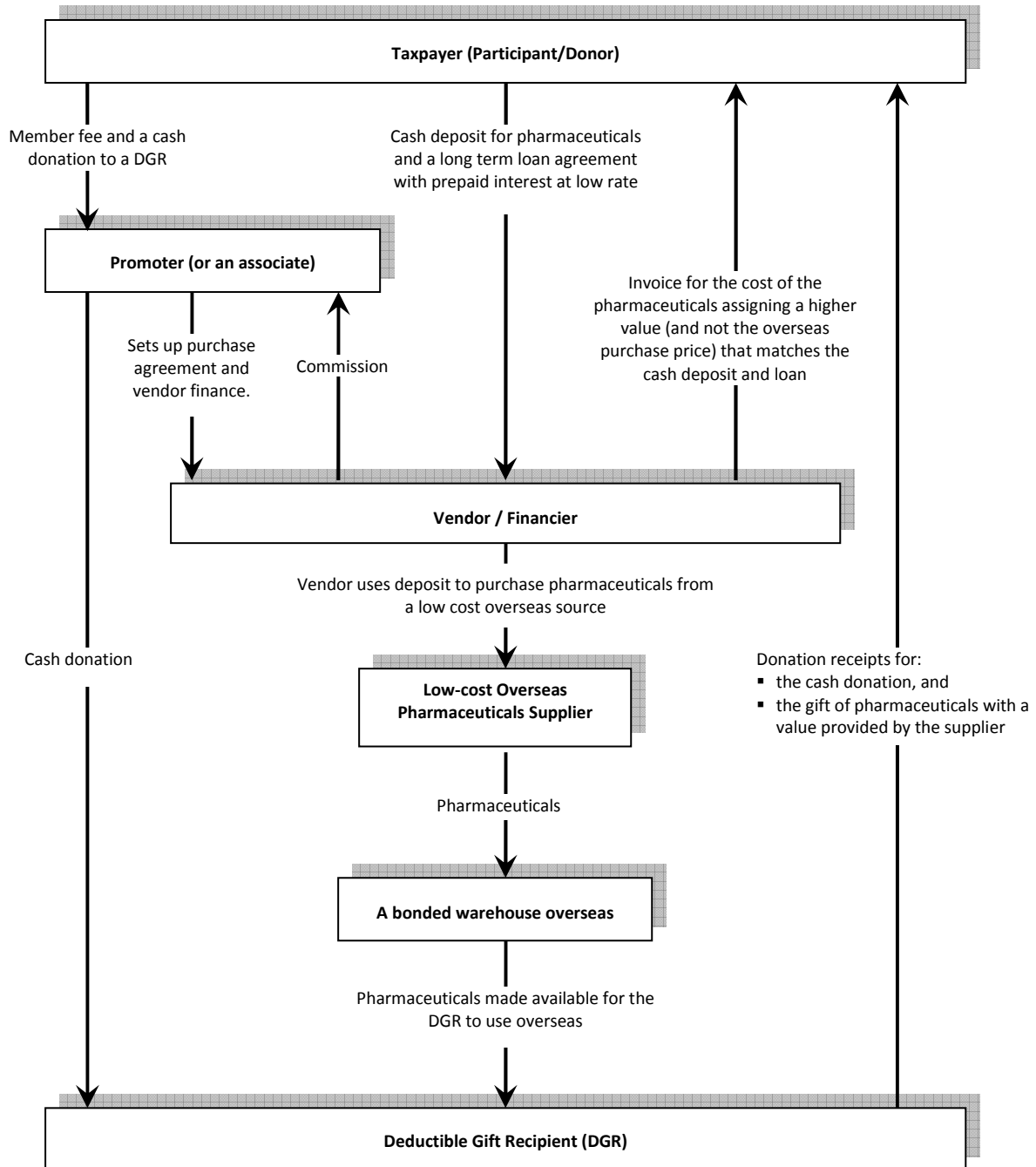
Description

The alert applies to arrangements with features substantially equivalent to the following:

1. An Australian taxpayer (the 'participant') enters an agreement ('the agreement') to purchase pharmaceuticals for donation to a Deductible Gift Recipient (DGR).
2. Under the agreement, the participant makes a cash payment of an amount comprising:
 - a) a payment to become a member of a facilitating entity (the promoter or an associated entity);
 - b) a cash donation to the nominated DGR;
 - c) an interest prepayment in respect of a purported long term, low interest loan alleged to fund the payment of pharmaceuticals; and
 - d) a deposit (generally of 7.5% or less) of the nominated amount to be paid for the pharmaceuticals.
3. The agreement relies upon a loan that does not appear to be on normal commercial terms, because:
 - a) the period of the loan for the pharmaceuticals is unusually long, in some cases up to 50 years,
 - b) the rates of interest are unusually low (generally less than 1% per annum), even though this interest is allegedly prepaid,
 - c) there is no security offered in respect of the principal amount, which may be a significant sum, and
 - d) payment will not be required in certain circumstances (such as death of the participant), meaning that there is no certainty of repayment – especially considering the unusually long term of the loan.
4. Under the agreement, the promoter or facilitating entity deals exclusively with the vendor and any pharmaceuticals are purchased from a low-cost overseas supplier and alleged to be delivered to the DGR entirely outside Australia.
5. Under the agreement, the participant receives:
 - a) a supply note from the DGR describing the pharmaceuticals
 - b) an invoice from the vendor for the pharmaceuticals assigning a domestic value rather than the cash amount actually paid to the overseas supplier, to match the cash deposit and the amount of the loan, and
 - c) a receipt from the DGR for any cash donation component.
6. On the basis of the agreement, the participant:
 - a) claims a tax deduction for the gift of the pharmaceuticals to the DGR, for the purported value of the pharmaceuticals (i.e. the amount nominated by the vendor) at the date of the agreement, and

- b) purportedly receives a reduction in tax payable that significantly exceeds the total cash amount actually outlaid under the agreement.

Example of typical arrangement



Features which concern us

The ATO considers that arrangements of this type give rise to the following issues relevant to taxation laws, including whether:

- a. the arrangement or any part of it may be a sham at general law;
- b. there may be any deductible gift of property under Division 30 of the ITAA 1997, including considering:
 - i. the question of whether the pharmaceuticals actually exist
 - ii. the market value of the pharmaceuticals at relevant times, if they do exist
 - iii. who has custody and control of the pharmaceuticals at relevant times, if they do exist, and
 - iv. the effect of the long-term low-interest unsecured loan on the arrangement;
- c. the anti-avoidance provisions of section 78A of the ITAA 1936 may operate to limit the availability of deductions claimed;
- d. any amounts may be allowable deductions under section 8-1 of the ITAA 1997, such as any amounts:
 - i. paid in cash for the cost of purchasing the pharmaceuticals
 - ii. borrowed for the cost of purchasing property, and/or
 - iii. associated with such a loan or with deferral of payment of the cost such as interest.
- e. any amounts may be allowable as deductions for borrowing expenses under section 25-25 of the ITAA 1997
- f. any of the transactions may be subject to the transfer pricing provisions in Division 13 of Part III of the ITAA 1936;
- g. the general anti-avoidance rule contained in Part IVA of the ITAA 1936 may allow the cancellation of a tax benefit under all, or some part, of the arrangement
- h. private rulings may be denied to participants under section 359-35 and/or section 357-110 of *Taxation Administration Act 1953* (TAA 1953);
- i. any fee, commission or other amount received by the promoter of this arrangement may be assessable income for any income year
- j. 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 TAA 1953,
- k. any taxation statements made in relation to the arrangement may be false or misleading; and
- l. any criminal offences may have been committed regarding the arrangement.

The ATO is currently reviewing these arrangements, but our initial view is that they are not effective at law.

Note 1: You may have already sought advice from the ATO in respect of your arrangement by way of a private ruling or class ruling. If you have received a private ruling or class ruling in respect of your arrangement, you can rely on that ruling.

A private or class ruling is legally binding against the Commissioner who will be bound to act in the way set out in the ruling, even if the ruling is later found to be incorrect. However, a private ruling only applies to a particular entity identified and the particular scheme described in the ruling, for the period the ruling specifies or if no period is specified for the period from when it is made to the end of the accounting period in which it is made. Similarly, a class ruling only applies to a specified class of entities and the particular scheme described in the ruling.

If there is a material difference between the scheme described in the ruling, and the scheme that was actually implemented, the ruling will not be legally binding on the Commissioner. Also, other entities cannot rely on a private ruling issued in respect of a different entity or on a class ruling in respect of a class of entities in which they are not included.

The ATO is advised that some of these arrangements have been and are being marketed as the subject of a private ruling. Whether a private ruling relates to a scheme which is materially different to that being marketed, and whether that private ruling was given to the participants to whom these arrangements are marketed, are questions for you.

Note 2: 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 asked 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 3: 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 ATO. 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 alert should call Tax Agent Infoline - **13 72 86** Fast Key Code **3 4**.

Note 4: 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 current value of a penalty unit is \$110. 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 5: 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 6: Where appropriate, section 167 of the ITAA 1936 may be used to determine the amount of taxable income upon which the taxpayer should be assessed, see Law Administration Practice Statements, PS LA 2007/7 and PS LA 2007/24.

Note 7: The Commissioner may amend an assessment at any time where he is of the opinion there has been fraud or evasion. See Law Administration Practice Statement PSLA 2008/6.

References

Subject references:

borrowings & loans
 deductible gift recipients
 deductions & expenses
 gifts and donations
 gifts to organisations
 interest expenses
 material benefits derived from gifts
 scheme promoters
 schemes & shams

Legislative references:

Income Tax Assessment Act 1936 Part IVA
Income Tax Assessment Act 1936 Section 78A
Income Tax Assessment Act 1997 Section 8-1
Income Tax Assessment Act 1997 Division 30
Taxation Administration Act 1953 Division 290 of Schedule 1

Case references:

AAT Case 12,314 Re Hodges v. FC of T 97 ATC 2158; (1997) 37 ATR 1091
Fletcher v. Federal Commissioner of Taxation (1991) 173 CLR 1; 91 ATC 4950; (1991) 22 ATR 613
Leary v. FC of T 80 ATC 4438 (1980) 11 ATR 145 (1980) 32 ALR 221
Milroy v. Lord (1862) 45 ER 1185 4 De G F & J 264 [1861-73] All ER Rep 783
Re Rose (dec'd); Rose v. Inland Revenue Commissioners [1952] 1 All ER 1217

Related Practice Statements:

PS LA 2005/24 - Application of General Anti-Avoidance Rules
 PS LA 2008/15 - Taxpayer Alerts

Rulings & Determinations:

TR 2005/13

Date issued:	6 December 2010
Authorised by:	Tim Dyce Deputy Commissioner Aggressive Tax Planning (ATP)
Contact Officer:	Stefan Kovic Assistant Commissioner Aggressive Tax Planning (ATP)
Business Line:	Aggressive Tax Planning (ATP)
Section:	Technical Leadership
Phone:	02 6216 6434
