TA 2013/1 - Arrangements to exploit mismatches between trust and taxable income

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Australian Government
Australian Taxation Office

Taxpayer Alert

TA 2013/1

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TITLE: Arrangements to exploit mismatches between trust and taxable income

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 In these latter cases the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.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

Where a Taxpayer Alert provides guidance that a particular arrangement is or will be ineffective and that guidance is subsequently found to be incorrect and the taxpayer had relied on that guidance, the taxpayer is protected from paying a shortfall penalty and any interest charge that would otherwise be payable under the law.

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

Overview

This Taxpayer Alert describes an artificial arrangement where a deliberate mismatch is created between the amounts beneficiaries are entitled to receive from a trust and the amounts they are taxed on.

Context for the arrangement

The arrangement concerns a situation where a trust has generated a small amount of income and a large capital gain during the year. The trust distributions are made in such a way that one beneficiary receives the funds generated from the capital gain, tax free, whilst another beneficiary (a new incorporated company) receives the tax liability attached to that capital gain. The newly incorporated company receives no funds from the capital gain to pay this tax liability, and winding-up proceedings are commenced. This process is designed to avoid the payment of tax on the large taxable capital gain.

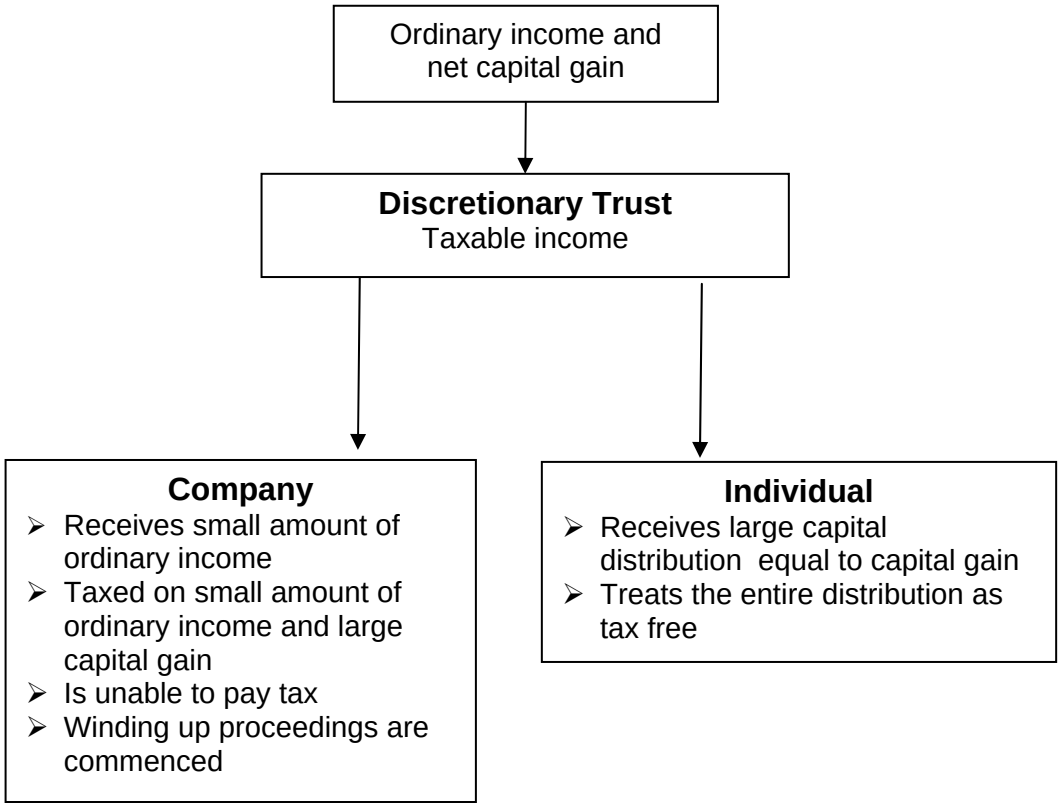
Description

The Taxpayer Alert applies to artificial arrangements with features substantially equivalent, but not limited to the following:

1. The trust is a discretionary trust. The beneficiaries are members of a family group. One family member controls the trust.
2. Trust income is defined in the trust deed to be equal to the trust's taxable income, unless the trustee determines otherwise.
3. During the year, the trustee sells a capital asset, which results in a capital gain. The trust also derives a small amount of ordinary income.
4. A newly incorporated company, controlled by a family member, is made a beneficiary of the trust.
5. The trustee exercises its power under the trust deed to:
   (i) determine that the capital gain is excluded from trust income; and
   (ii) distribute all of the trust income remaining to the new company beneficiary.
6. The result is that whilst the company is only entitled to receive the small amount determined to be trust income, it is assessed on the trust's entire taxable income (comprising both the net capital gain and the ordinary income).
7. In the following income year, the trustee makes a capital distribution of an amount equal to the capital gain to an individual family member.
8. There is no prospect of the company paying its tax liability, as its only material asset is an entitlement to the small amount of trust income.
9. A liquidator is appointed to wind up the company.
10. There is no evidence of any commercial, familial, or charitable reason for carrying out this arrangement.
11. The net effect of the arrangement is that all parties avoid the payment of tax on the capital gain.

Diagram of arrangement

The diagram below demonstrates the arrangement. The company is taxed on the ordinary income and capital gain, however the company is unable to pay the tax as it has insufficient funds. Most of the funds are received by the individual in the form of a capital distribution which is treated as tax free.



Features which concern us

The ATO considers that arrangements substantially of this type give rise to taxation issues that include whether:

(a) the arrangement, or steps within it, may be a sham;

(b) income may be assessable to any entity involved in the arrangement and their associates under section 100A of Division 6 of the *Income Tax Assessment Act 1936* (ITAA 1936);

(c) the arrangement may constitute a scheme to which the general anti-avoidance rules in Part IVA of the ITAA 1936 may apply;

(d) 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);

(e) any entity involved in the arrangement that is a tax practitioner may be referred to the Tax Practitioners Board under the *Tax Agent Services Act 2009* regarding matters relevant to the Code of Professional Conduct; and

(f) any civil or criminal offences have been committed by any entity involved in the arrangement (where the ATO becomes aware of such offences, the matter may be referred to the appropriate authority).

The ATO is currently reviewing these arrangements.

If you have any information about arrangements substantially equivalent to that described in this Taxpayer Alert, 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 the Tax Agent Infoline – 13 72 86 Fast Key Code 3 4.

Notes:

Note 1: *You may have already sought advice from the ATO in respect of your arrangement by way of a private ruling. If you have received a private ruling in respect of your arrangement, you can rely on that private ruling. A private ruling is legally binding on the Commissioner who will be bound to act in the way set out in the ruling, even if the private ruling is later found to be incorrect. However, a private ruling only applies to the particular entity identified and the particular scheme described in the ruling for the years identified in the ruling. If there is a material difference between the scheme described in the ruling, and the scheme that was actually implemented, the private 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.*

Note 2: *If you have received a private ruling in respect of your arrangement, please check that the application of Part IVA of the ITAA 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 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 Tax Office.*

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 TAA. 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: *A registered tax agent may have their registration cancelled or suspended by the Tax Practitioners' Board under the Tax Agent Services Act 2009 for breach of a condition of registration, including being penalised for being a promoter of a tax exploitation scheme.*

***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 PS LA 2008/6.*

References

Subject references:

- general anti-avoidance rule
- trust
- trust distributions

Legislative references:

Income Tax Assessment Act 1936

- Division 6
- Section 100A
- Part IVA

Taxation Administration Act 1953

- Division 290 of Schedule 1

Related Practice Statements:

- PS LA 2005/24
- PS LA 2008/6
- PS LA 2008/15

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