

***TD 2010/10 - Income tax: can Part IVA of the Income Tax Assessment Act 1936 apply to an employee savings plan as described in Taxpayer Alert TA 2008/13?***

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## Taxation Determination

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### Income tax: can Part IVA of the *Income Tax Assessment Act 1936* apply to an employee savings plan as described in Taxpayer Alert TA 2008/13?

**📌 This publication provides you with the following level of protection:**

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

#### Ruling

1. Yes. The application of Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936)<sup>1</sup> to any particular arrangement depends on a careful weighing of all the relevant circumstances of the arrangement and the relative weight that should be attached to each of those circumstances. Therefore, in the absence of all relevant information, it is not possible to state definitively whether Part IVA will apply to a particular scheme. However, it is the Commissioner's view that Part IVA is likely to apply to the employee savings plan arrangement as described in paragraph 5 of this Determination.

2. The Commissioner is likely to exercise his powers under subsection 177F(1) of the ITAA 1936 to cancel the tax benefit obtained by the employee and determine that the whole or part of the amounts contributed by the employer to the employee benefits trust was derived by the employee under section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997) as salary or wages or bonus income in the income year in which they were contributed.

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<sup>1</sup> All subsequent legislative references are to the ITAA 1936 unless otherwise indicated.

3. Where the Commissioner has determined that the contributed amounts were derived by the employee at the contribution time he may, if in his opinion it is fair and reasonable, make another determination under subsection 177F(3) adjusting the taxation situation of the employee. This determination is known as a 'compensating adjustment'. Whether a compensating adjustment will be made in respect of an employee savings plan arrangement needs to be considered on the facts of each case, and the requirements of subsection 177F(3) must be satisfied. The Commissioner will only be in a position to determine whether it is fair and reasonable that such an adjustment be made when the application of Part IVA is established.

4. Taxpayer Alert TA 2008/13 issued on 25 June 2008. It describes an employee savings plan remuneration arrangement entered into by an employee and employer whereby the employer agrees to contribute what would otherwise be salary or wages or bonus income of the employee to an employee benefits trust. The employee later receives bonus units from the trustee at the request of the employer. The bonus units have a value approximately equal to the amount contributed by the employer to the employee benefits trust in respect of the employee.

5. The arrangement exhibits the following features:

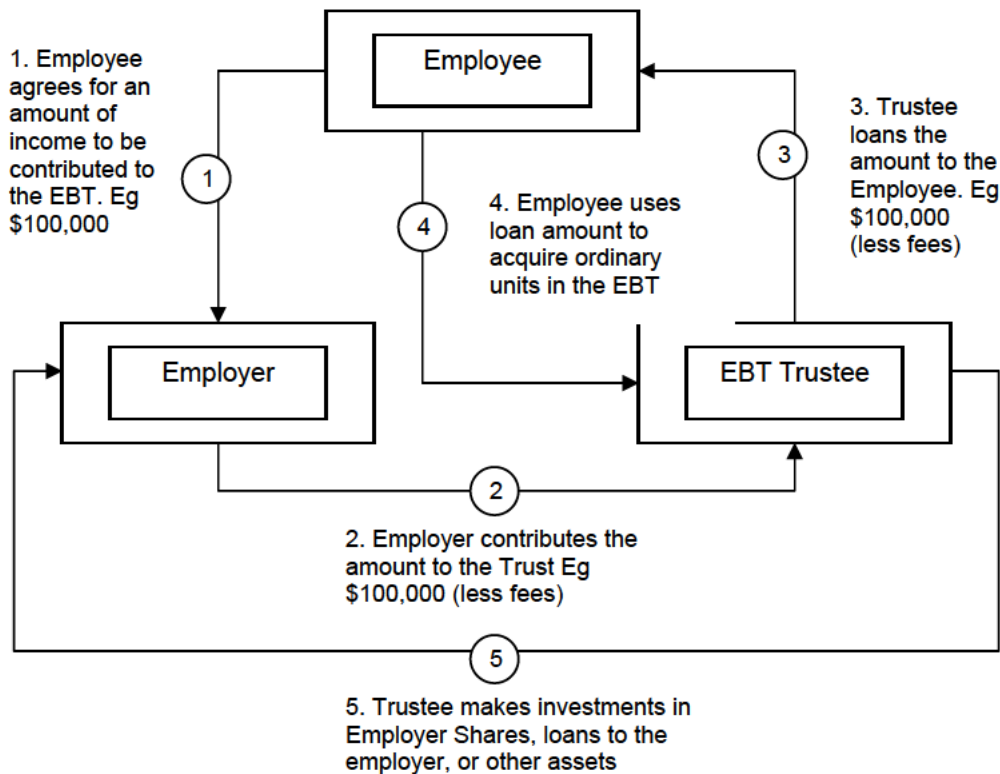
- an employee benefits trust (the trust) is established for or by the employer and administered by the trustee for the purpose of rewarding employees of the employer;
- under an agreement between the employer and an employee, an amount representing future salary or wages or bonus income of the employee is paid by the employer as a contribution to the trust (the agreement);
- the amount contributed to the trust in respect of the employee is held by the trustee as unallocated trust capital;
- on receipt of the contribution or shortly thereafter, the trustee of the trust makes a loan to the employee. The loan amount is typically equal to or slightly less than the amount previously contributed to the trust (the difference being made up by the administration fees payable to the trustee). The loan is ordinarily interest-free and of a limited recourse nature. The loan can only be used by the employee to purchase ordinary units in the trust itself. The repayment of the loan is linked to, and funded from, the redemption of the employee's ordinary units and any bonus units that the trustee may issue to the employee;
- the employee uses the loan monies to purchase ordinary units in the trust. Amounts paid by the employee for the purchase of ordinary units are treated in the trust accounts as further accretions to trust capital (as the employee's share of the trust capital);
- an ordinary unit does not give the unit holder an interest in the assets of the trust. Subject to the trustee's discretion, an ordinary unit gives the unit holder an entitlement to a redemption/cancellation amount payable to the unit holder on the redemption/cancellation of the unit;
- an ordinary unit holder may receive a share of the income of the trust at the trustee's discretion;

- the trustee uses the monies paid by the employee for ordinary units to purchase assets to be held on trust for the trust beneficiaries generally. Although assets may be notionally allocated to a particular beneficiary's ordinary units, the trustee has a discretion to re-allocate those assets to any other beneficiary's ordinary units. Whilst the value of a unit is determined by reference to this allocated asset, re-allocation of such assets will affect this value;
- as an ordinary unit holder in the trust, the employee may be issued bonus units at the trustee's discretion;
- bonus units are issued to ordinary unit holders at the request of the employer and at the discretion of the trustee. Bonus units may be issued to all or any of the ordinary unit holders in any number, regardless of the number of ordinary units held. There is no direct relationship between the number of ordinary units held and the number of bonus units that can be issued;
- the trust deed may specify that the 'issue price' in relation to a bonus unit means 'Nil';
- the trust deed typically specifies that bonus units are issued in respect of a unit holder's ordinary units and that bonus units may only be cancelled when the corresponding ordinary units are also cancelled;
- bonus units are used by the employer and the trustee to deliver the unallocated trust capital represented by the employer contributions to the employee. The value of the bonus units is directly linked to the unallocated trust capital represented by the employer contributions;
- the issue of bonus units typically coincides with the time when an employee can redeem their ordinary units. The employee may have to satisfy minimum ordinary unit holding periods and/or employment related performance hurdles before their ordinary and bonus units can be redeemed. Ordinarily, the minimum holding period for such units is 12 months;
- the cancellation entitlement for an employee's ordinary unit is typically the amount paid by the employee for the acquisition of the ordinary unit or a proportionate share of the value of the trust assets allocated to the employee's ordinary units. The cancellation entitlement of a bonus unit is typically a cash amount specified in the trust deed as the cancellation entitlement;
- when the holding period has expired and the performance hurdles are met, the employee may ask the trustee to redeem their ordinary and any corresponding bonus units that have issued. In practice, although the trustee has the discretion not to redeem the units, the trustee honours the request for redemption. Upon redemption, the trustee will:
  - (i) determine the value of the ordinary and bonus units issued to the employee;
  - (ii) offset the employee's outstanding loan balance against the value of the employee's ordinary and bonus units; and
  - (iii) pay to the employee the balance of the proceeds;

- the cancellation entitlement for the employee's bonus units will usually equal the employee's outstanding loan balance and will be offset against, and therefore extinguish, the loan.

6. Whether assessable income is derived by the employee when the employer makes a contribution to the trust depends on the operation of the particular arrangement. If assessable income is not derived when a contribution is made, there is a tax benefit for the purposes of Part IVA. This Determination does not consider whether Part IVA can apply to an effective salary sacrifice arrangement as described in Taxation Ruling TR 2001/10.

7. The flow of funds is as follows:



### Date of effect

8. This Determination applies to years of income commencing both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10).

## Appendix 1 – Explanation

**ⓘ** *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

### Explanation

9. Part IVA gives the Commissioner the discretion to cancel all or part of a tax benefit that has been obtained, or would, but for section 177F, be obtained, by a taxpayer in connection with a scheme to which Part IVA applies. Part IVA applies if:

- a tax benefit, as identified in section 177C, was or would, but for subsection 177F(1), have been obtained;
- the tax benefit was or would have been obtained in connection with a scheme as defined in section 177A; and
- having regard to section 177D, the scheme is one to which Part IVA applies.

10. The scheme under section 177A would consist of the steps taken to establish and conduct the employee savings plan. It is considered that the scheme would give rise to a tax benefit under paragraph 177C(1)(a). The objective circumstances of the scheme indicate that if the scheme had not been entered into it might reasonably be expected that the contributed sums would have been received by the employee as salary or wages or bonus income during the income year in which the employer contributed them to the employee benefits trust. The tax benefit is the amount of salary or wages or bonus income not included in the assessable income of the employee in the income year in which the contributions were made.

11. Section 177D provides that Part IVA applies to a scheme in connection with which the taxpayer has obtained a tax benefit if, after having regard to eight specified matters, it would be concluded that a person who entered into or carried out the scheme, or any part of it, did so for the purpose of enabling the taxpayer to obtain the tax benefit.

12. Whether the section 177D purpose test is satisfied depends on all the facts and circumstances. However it would be reasonable to conclude, having regard to the matters set out in section 177D, that the sole or dominant purpose of the employee (and/or the promoter and/or the employer) in entering into or carrying out the scheme was for the employee to obtain a tax benefit. In this context the following general observations can be made:

- the manner in which the scheme was entered into or carried out includes a number of contrived elements. In particular there is no commercial explanation for the employee agreeing to have future income paid as a contribution to a trust whereby, pursuant to the terms of the trust deed which make the delivery of benefits subject to the trustee's discretion, neither the employee nor any associate of the employee may obtain any benefit commensurate with the income deferred. Additionally there is no commercial rationale for delivery of employment related benefits to an employee by way of the issue of bonus units. The bonus units are simply the mechanism whereby the economic benefit of the employer contribution to the employee benefits trust is delivered to the employee in a purportedly tax preferred manner (subparagraph 177D(b)(i));

- the form of the scheme is to provide a mechanism for the employee to save and invest part of their income, and to receive the income when the employee meets minimum service periods and performance hurdles. The substance of the scheme is that the employee directs that part of their future salary or wages or bonus income be paid to a discretionary trust, to be utilised to acquire investments which are to be held for a minimum period. The employee gets the benefit of the contribution amounts initially through loans and subsequently through the receipt of bonus units (subparagraph 177D(b)(ii));
- the scheme has been set up to ensure, ordinarily, that there is a one year minimum holding period required before cancellation or redemption of units can occur. This one year period appears to co-incide with the 12 month holding period rule required to access the provisions dealing with discount capital gains (subparagraph 177D(b)(iii));
- but for the operation of Part IVA of the ITAA 1936, contributions to the trust are not assessable to the employee as salary or wages or bonus income. Furthermore, the employee is generally of the view that the issue of bonus units is not ordinary income for the purposes of section 6-5 of the ITAA 1997 or section 15-2 of the ITAA 1997 and is taxable as a capital gain (subparagraph 177D(b)(iv) of the ITAA 1936);
- the employee forgoes disposable income to acquire units in the trust via a limited recourse loan. The arrangement is implemented on the understanding that the amounts contributed to the trust are accessible by way of a loan and later through the issue and redemption of both the bonus units and the ordinary units. This in effect, cancels the loan at no cost to the employee and the employee exchanges a right to income for a benefit, putting them in the same effective financial position had they not participated in the scheme (subparagraph 177D(b)(v));
- generally, there are no other related parties who stand to benefit from the scheme as participation is limited to participating employees. However, this depends on the facts of the arrangement. The employer benefits from the scheme by claiming a deduction for the contributions made to the trust. If investments are made by the trustee in the employer or an associate of the employer, the financial position of the employer is the same as if the contributions were not made (subparagraph 177D(b)(vi));
- no other consequence for the relevant parties is identified (subparagraph 177D(b)(vii));
- the relevant taxpayer is an employee of the employer (subparagraph 177D(b)(viii)).

13. The Commissioner is therefore likely in these circumstances to exercise his powers under subsection 177F(1) of the ITAA 1936 to cancel the tax benefit and determine that the whole or part of the contributed amounts was derived by the employee under section 6-5 of the ITAA 1997 as salary or wages or bonus income during the income year in which they were contributed.

**Compensating adjustment**

14. Where payments received by the employee on the redemption of bonus units received by the employee are assessable as:

- ordinary income derived by the employee under section 6-5 of the ITAA 1997
- compensation, benefits or bonuses under section 15-2 of the ITAA 1997, or
- amounts included in assessable income by Part IVA of the ITAA 1936,

the Commissioner acknowledges that the same income will be taxed twice where Part IVA of the ITAA 1936 applies to the employee at the contribution time.

15. Where Part IVA applies as described in paragraphs 9 to 13 of this Determination, the Commissioner may make a determination under paragraph 177F(1)(a) in relation to the contributed amounts so that they are assessable to the employee.

16. Where such a determination is made, the following consequences arise:

- the Commissioner is authorised to take such action as considered necessary to give effect to that determination, for example to make or amend an assessment in accordance with that determination (subsection 177F(1)); and
- the Commissioner may make a determination for a compensating adjustment and take such action as considered necessary to give effect to that determination (subsection 177F(3)).

17. A determination for a compensating adjustment can be made where, in the opinion of the Commissioner, had the scheme not been entered into or carried out, an amount would not have been or would not be included in assessable income. The Commissioner must also be of the opinion that it is fair and reasonable that the compensating adjustment be made.

18. The existence of a tax benefit to which Part IVA applies entitles the Commissioner to make a Part IVA determination, to make a compensating adjustment, and to take action to give effect to either. It does not disturb the application of the income tax law unless, and only to the extent that, the Commissioner makes a Part IVA determination, and acts to give effect to it, or to give effect to a compensating adjustment that the Commissioner may also have made. The scheme of the anti-avoidance provisions is that in the absence of a determination by the Commissioner the law continues to apply on the basis that the scheme has been carried out, and not as if it were not carried out.

19. Whether a compensating adjustment will be made in respect of the inclusion of the redemption proceeds for the bonus units in the assessable income of the employee needs to be considered on the facts of each case, and the requirements of subsection 177F(3) must be satisfied. In general terms, where Part IVA applies to assess an employee on an amount contributed to an employee benefits trust in a particular year of income and where that amount also constitutes assessable income of the employee of a later year of income, the Commissioner would ordinarily conclude that it would be fair and reasonable to determine that the amount should not be included in the assessable income of the employee in the later year of income. This would also cover a case where an employee has included the redemption proceeds in assessable income in a later year of income as part of a net capital gain.

## References

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*Previous draft:*

TD 2009/D5

*Related Rulings/Determinations:*

TR 2001/10; TR 2006/10

*Subject references:*

- anti avoidance
- arrangement
- bonus units
- employee bonuses
- fringe benefits tax
- Part IVA
- salary & wages income
- salary sacrifice
- unit trusts

- ITAA 1936 177C
- ITAA 1936 177C(1)(a)
- ITAA 1936 177D
- ITAA 1936 177D(b)(i)
- ITAA 1936 177D(b)(ii)
- ITAA 1936 177D(b)(iii)
- ITAA 1936 177D(b)(iv)
- ITAA 1936 177D(b)(v)
- ITAA 1936 177D(b)(vi)
- ITAA 1936 177D(b)(vii)
- ITAA 1936 177D(b)(viii)
- ITAA 1936 177F
- ITAA 1936 177F(1)
- ITAA 1936 177F(1)(a)
- ITAA 1936 177F(3)
- ITAA 1997 6-5
- ITAA 1997 15-2
- TAA 1953

*Legislative references:*

- ITAA 1936
- ITAA 1936 Pt IVA
- ITAA 1936 177A

*Other references:*

- Taxpayer Alert TA 2008/13
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ATO references

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