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Section 100A: When is a dealing between members of a family not in the course of ordinary family dealing?

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1 Introduction*

This paper will examine a question that is simple to ask, but potentially difficult to answer:

> When will an agreement, arrangement or understanding—between the members of a family—not be an "*ordinary family dealing*" for the purposes of section 100A of the *Income Tax Assessment Act* 1936 (**ITAA 1936**)?

Section 100A was enacted in 1978, over 40 years ago, as part of a package of anti-tax avoidance measures introduced by the then Federal Treasurer, the Hon. John Howard MP.

The Treasurer's Press Release, the Second Reading Speech and the Explanatory Memorandum made very clear that section 100A was designed to counter a specific form of "*trust stripping*".[1] Subsequent judicial comments have indicated, however, that section 100A potentially has a broader reach.

Nevertheless, section 100A does **not** apply to:

> … an agreement, arrangement or understanding entered into in the course of ordinary family or commercial dealing.

The intention of this paper is to identify when dealings between members of a family are **not** in the course of "*ordinary family dealing*".[2] As will be seen, this is by no means a straight forward task!

Although reference is made to the "*predication*" and "*ordinary business or family dealing*" tests laid down in the late 1950s by Lord Denning in *Newton & Ors. v FCT*,[3] the assumption such dealings can be readily identified in 2019 is open to serious challenge.

Despite many tax advisors and administrators believing they know—or at least having a view as to—what such dealings involve, there appears to be considerable disagreement as to precisely **how** such dealings should be defined.

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1 The Press Release, Second Reading Speech and Explanatory Memorandum are attached as Annexures A, B and C to this paper.

2 For a comprehensive examination of section 100A generally, see Paul Sokolowski & Kaitilin Lowdon, *Plato's cave: Trusts, section 100A and the reality behind the shadows* (Tax Institute, 25/26 October 2018).

3 [1958] UKPCHCA 1; (1958) 98 CLR 1.

In the last few years, the Commissioner has been examining whether certain transactions between beneficiaries of family trusts, the trustee of those trusts, and other family members, are ordinary dealings or, instead, are potentially subject to the application of section 100A.

The Commissioner has indicated a draft Public Ruling will be issued on the topic in the near future—although hopefully not before this paper is delivered on March 15, 2019![4]

The purpose of this paper is to promote some robust discussion.

It will therefore be argued below that—given the way in which family business and investment structures have developed over the last 40 years—a significant number of dealings that regularly take place in 2019 between family members—in relation to private companies and private trusts—should be treated as "*ordinary family dealings*" for section 100A purposes.

[4] Although the author has been fortunate enough to have had a number of very useful discussions with Mr Glenn Davies (ATO), who is responsible for carriage of the proposed Ruling, the author emphasizes he has neither seen the draft Ruling nor been informed of its contents.

2 Helicopter Overview

By way of "**100,000 foot helicopter overview**", this paper will:

- examine the "*state of the [tax] Nation*" in Australia in June 1978 when the Government announced the introduction of section 100A;
- provide a conspectus (summary and overview) of section 100A's provisions;
- review the origin of the expression "*ordinary family and business dealings*" and a number of difficulties associated with identifying ordinary *family* dealings;
- refer very briefly to the cases that have considered section 100A;
- hypothetically ask how the great Lord Denning would approach the issue in 2019;
- discuss the ATO's public statements and examples regarding section 100A; and
- conclude with some observations regarding the possible way forward.

3 State of the (Tax) Nation on June 11, 1978

The intention of this Part is to describe the background to the enactment of section 100A, in particular, the atmosphere and public perceptions surrounding tax planning in the mid- to late 1970s.

3.1 June 11, 1978 Press Release

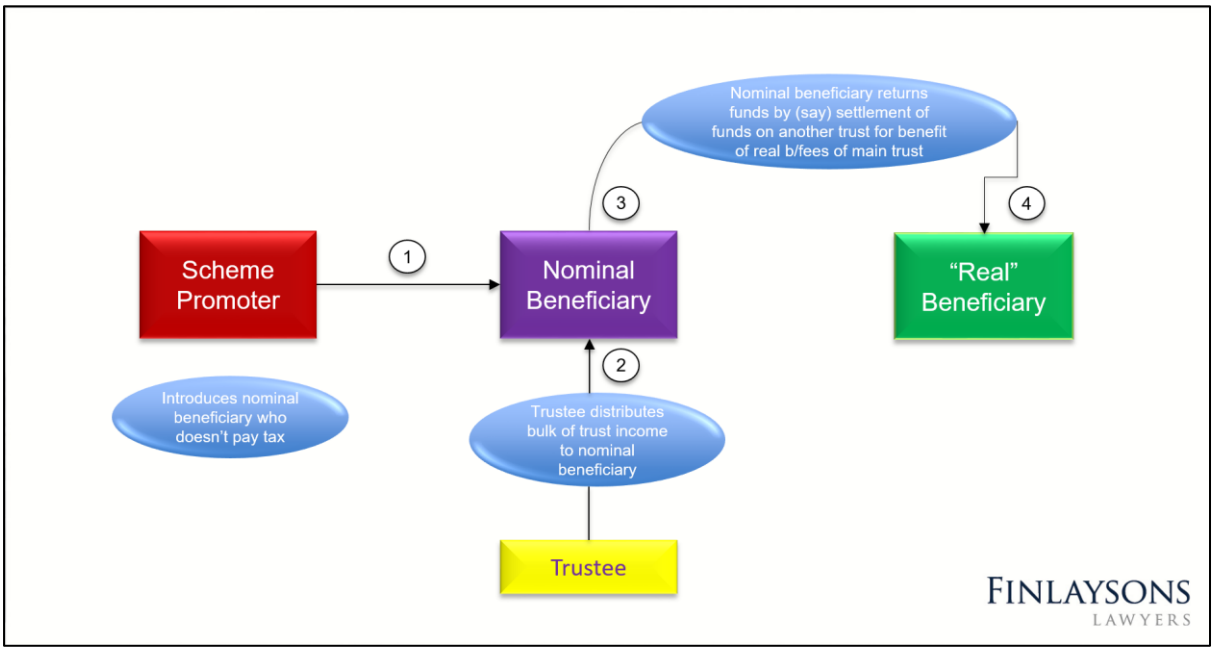
On June 11, 1978, the then Treasurer, the Hon. John Howard MP, issued a Press Release announcing the Government's intention to legislate to overturn schemes, which had the "*broad purpose of allowing income derived by trusts to be passed on to beneficiaries in a tax-free form*".

Given the importance of the Press Release, the Second Reading Speech and the Explanatory Memorandum that accompanied the *Income Tax Assessment Amendment Bill (No. 5)* 1978, those documents are attached to this paper and extracted below.

The Press Release stated that:

> A feature of several of the schemes is a very wide power given to the trustee under the terms of the trust instrument as to the distribution or application of trust income. In reliance on this power, the **trustee agrees with promoters of tax schemes** and other compliant parties **to distribute or apply the bulk of the trust income**–either directly or through an interposed trust—**for the apparent benefit of specially introduced beneficiaries who do not pay any, or any substantial, amount of tax** on the amount distributed or applied.
>
> In some cases the nominal beneficiary selected is a tax-exempt body, such as a charitable institution or sporting association. In other cases, it is a company, set up for the purpose by the promoters of the scheme, that by one means or another escapes payment of tax on the income. One technique is to set artificially-created paper 'losses' off against the income received from the trust. Another technique is to strip assets from the recipient company so that the tax assessed on the income cannot be collected. Yet again, the income may be distributed to non-resident individuals each of whom does not have enough Australian taxable income to be liable to tax, but who will account for the income to the Australian family concerned.
>
> The **essential element** common to the schemes **is that, while the income concerned is effectively freed from tax in the hands of the nominal beneficiary, the terms of the underlying arrangement ensure that the beneficiary does not enjoy anything like the full use or benefit of the income**. Instead, the arrangement, requires a broadly equivalent capital sum—but reduced by the promoter's fee and a modest reward for the services of any participating exempt body—to be directed to persons intended all along as the real beneficiaries of the trust.
>
> The arrangements are often very complex and the party responsible for putting the real beneficiaries in funds may be an associate of the nominal beneficiary. The **return of the funds may be achieved by a settlement on another trust established for the benefit of the real beneficiaries of the main trust** or their families, by the making to them of what is known colloquially as a 'collapsible loan', ie a loan that effectively does not have to be repaid, or through the nominal beneficiary having acquired the right to the income by payment to the real beneficiaries of a broadly equivalent sum. …
>
> The **legislation to counter tax avoidance through trust stripping schemes will broadly be on the lines that any distribution or application of income by a trustee**, pursuant to a relevant contract, arrangement or understanding, **will be treated as not having been made**. This means that the trustee will be liable to be assessed and pay tax at the rate of 60 per cent on the amount involved as if it had been accumulated in the trust.
>
> In broad terms, **a relevant contract**, arrangement or understanding **will be one** the terms of which contemplate **conferring on a particular beneficiary a 'present entitlement' to income of a trust**, and **under which the beneficiary** or an associated party **is to provide funds or benefits** in money's worth **for another person**, company or trust. [Emphasis added.]

The trust stripping scheme described in the Press Release can be illustrated diagrammatically as follows:



3.2 Explanatory Memorandum to ITAA Bill (No. 5) 1978

The *Income Tax Assessment Amendment Bill (No. 5)* 1978 (***Bill***), which contained the provisions to give effect to the Treasurer's announcement, was introduced into Parliament on November 23, 1978.

The Explanatory Memorandum accompanying the Bill (which is attached to this paper) stated:

> A **common feature** of the tax avoidance arrangements at which the proposed section is directed **is for a specifically introduced beneficiary to be made presently entitled** to income of the trust estate, **so that the trustee is relieved of any tax liability** on the income. Under the arrangements, the **beneficiary also does not pay tax**, e.g., because of a peculiar tax status. For example, the beneficiary may be a body or organisation that qualifies for exemption of its income under specific provisions, or it may be another trust that has sufficient deductible losses to absorb its share of income as a beneficiary of the first trust estate.
>
> Invariably, the **arrangements require this introduced beneficiary to retain only a minor portion of the trust income** and to **ensure that some other person** – the one actually intended to take the benefit – **effectively secures enjoyment** of the **major portion of the trust income** but in **tax-free form** (e.g., by the settlement of a capital sum in another trust estate for the benefit of that person).
>
> The proposed section 100A will look at the existence of an agreement or arrangement that is **entered into otherwise than in the course of ordinary family or commercial dealing** and under, or as a result of which, **present entitlement** to a share of trust income is **conferred on a beneficiary in return for the payment of money or the provision of valuable benefits to some other person, company or trust**. In those circumstances, the section will require the income of the trust that is dealt with under the "reimbursement agreement" to be treated as having been accumulated by the trustee as income to which no beneficiary is presently entitled. This will result in the trustee being liable to pay tax on the income under section 99A of the prescribed tax rate, 61.5 per cent for 1978–79. [Emphasis added.]

The Bill also introduced sections 82KH, 82KJ and 82KK, which were designed to deal with pre-paid interest, pre-paid rent and similar schemes, as subsequently considered in *FCT v Ilbery.*[5]

Finally, the Bill contained sections 99B, 99C and 99D, which were intended to prevent the avoidance of tax on foreign source income that had been accumulated in trusts, and to counter the High Court's decision in *Union Fidelity Trustee Co. v FCT*.[6] Interestingly, the operation of section 99B is also under review by the ATO in 2019.

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5 [1981] FCA 215; 12 ATR 563.

6 [1969] HCA 36; (1969) 119 CLR 177; 1 ATR 200.

3.3 Media reports

Newspaper reports in the late 1970s highlighted the Commissioner's limited ability to deal with tax avoidance schemes, principally as a result of the High Court's interpretation of section 260 in *Curran v FCT,*[7] *Mullens v FCT,*[8] *Slutzkin v FCT*[9] and *Cridland v FCT*.[10]

For example, Mr. Ross Gittings—in a comprehensive review of then current schemes—wrote that "*1978 may go down as the year of the tax dodger*";[11] while Andrew Watson discussed the manner in which "*the tax system is no longer just or equitable*" in an article entitled "*How the rip-off artists increase your tax*".[12]

by ROSS GITTINS, Economics Writer

Catching the big fish in the tax pool

NINETEEN seventy-eight may go down as the year of the tax dodger.

The controversy that has arisen over the income tax amendments at present before Federal Parliament seems to have done nothing to deter the Government from vigorously pursuing what it calls its "program to strike down tax avoidance arrangements."

Such is the zeal of the Treasurer, Mr Howard, that the subject of tax avoidance is likely to keep cropping up as the Government seeks to plug loopholes as fast as they are discovered and exploited by the small army of tax accountants, lawyers and "consultants" who make up the tax avoidance industry.

These men include some of the best brains of their professions, many of them having learned the tax game as employees of the Taxation Office.

The first thing to be said about the crackdown is that the average taxpayer has nothing to fear, and perhaps something to gain.

Generally speaking, it is only self-employed business and professional people earning more than $100,000 a year who can take advantage of sophisticated tax-avoidance schemes.

Lesser mortals usually cannot afford to pay for advice on such schemes, or do not know of the possibilities.

Moreover, the vast majority of employees, whose tax is deducted from their weekly pay before they see it, have very little scope to play winner-takes-all with the taxman.

Which is the reason why the Government is probably on an electoral winner in its crusade against upper-crust "tax bludgers."

Of course, tax avoidance is perfectly legal.

The much-discussed Curran tax-avoidance scheme, which the Government intends to defeat retrospectively, was ruled legal in 1974 by the High Court.

In the Curran case, what was in commonsense terms a profit of $2,783 was held by the learned judges to be a loss of $188,217.

This remarkable result was made possible because Mr Curran received "bonus" shares from a private company which he controlled.

As their name suggests, the bonus shares cost him nothing but, like most shares, they had a "par" or nominal value of $1 each.

The High Court ruled that Mr Curran could charge the nominal value of each share against his taxable income, as an expense.

The distinguishing feature of tax avoidance schemes is that they are, in Mr Phillip Lynch's words, "highly artificial and contrived." They are crazy financial contortions performed for no other reason than to avoid paying tax.

Mr Charles Curran was a Sydney stockbroker, so for people to benefit from his legal precedent they had to be share-traders.

"When a tax consultant plans Curran-style benefits for a client, he arranges for a flurry of share buying and selling to be done in the client's name so that the client becomes a "share-trader."

Capital profits

The Curran scheme also requires the availability of a private company which has undistributed capital profits to allow the bonus share issue.

The Curran scheme is one of six types of tax-avoidance arrangements which the current amendments seek to overturn. One of the other more colourful schemes involves tax-deductible gifts to charities.

Under one gift scheme the donor gets a deduction for a $10,000 gift.

But only $1,580 comes out of his pocket. The rest is lent to him, by the promoters of the scheme. The charity agrees to pay the promoters a 98.8 per cent "procuration fee," leaving it with an effective gift of only $120.

The donor does not repay his loan to the promoters, but they end up with a net profit of almost $1,400. In actual cases, all these figures could be multiplied by five or 10.

A simpler version of the gift scheme involves the donor giving the charity a painting or other work of art. He claims the full value of the work as a deduction; but requires the charity to lend it back to him or his relative.

A different scheme involves business and professional people receiving $1 income from a primary production trust.

This allows a doctor, for example, to claim that he is a primary producer and this, in turn, allows him to postpone much tax by averaging his rising income from medicine over a number of years, for tax purposes.

Other tax-avoidance arrangements are usually much less interesting and much more complicated.

They involve the artificial creation of share-trading losses, the use of techniques to avoid the undistributed-profits tax on private companies, and "dividend stripping" of companies.

The objection to all these games is that they allow very rich people to avoid carrying their share of the tax burden.

Of course, the more people who choose not to pay their tax, the bigger the burden everyone else has to carry.

For this reason the Government's efforts to crack down on Curran and various other tax-avoidance schemes have drawn widespread support in the community.

But there has also been very vocal criticism of the Government's intention to backdate the outlawing of the Curran schemes to August 16 last year.

This was the day the then Treasurer, Mr Lynch, announced the Government's intention to legislate against various unspecified tax-avoidance practices.

Not only did he fail to mention the Curran scheme specifically, but Government ministers declined to acknowledge that they had it in mind. The first indication that the Fraser Government intended to upset the Curran scheme did not come until April 7.

The objects' motives are obvious enough and not particularly impressive.

But the fact remains that they have a very impressive argument. And their cause has received a considerable boost from the support of the former Prime Minister and former Treasurer, Sir William McMahon.

Sir William outlined the arguments against retrospective tax laws in an article in the Herald last week.

He made the particularly weighty point that retrospective legislation strikes at the fundamental democratic principle of "the rule of law."

Public right

Every person has the right to know that if he orders his affairs to conform with the law of the land, he has nothing to fear from the Government.

But when Governments start to make laws retrospective, people cease to know exactly where they stand. Might not a precedent set in the area of tax law be used in future to justify a retrospective change that affected not just pocket-books, but basic civil rights?

The Government, and the people who support its intention to strike down the Curran schemes retrospectively, have several replies to Sir William's argument.

The least impressive is that a former Labor Treasurer, Mr Crean, announced his Government's intention to close the Curran loophole as long ago as December, 1974, when the High Court decision was handed down.

The best reply is that the question is not one of principle versus expediency, but of two principles in conflict. The first principle is the rule of law, the second is that the tax burden should be shared equitably.

The reader will make up his own mind on the question. Try as I may, I cannot avoid agreeing with the opponents of retrospectivity.

Once before, the Fraser Government has attempted to bring in retrospective tax legislation and been dissuaded at the last moment.

This time, Mr Fraser, Mr Howard and the Cabinet seem to be standing their ground. If, as seems likely, the Labor Opposition decides to support the Government on the question, Parliament is sure to pass the legislation.

Why is a coalition Government so determined to crack down on tax dodgers? The Whitlam Government, in contrast, was conspicuously inactive in the area.

The first reason is political. Although the people who use and promote tax avoidance schemes can safely be regarded as staunch and influential Liberal voters, they are unlikely to take their votes elsewhere.

Moreover, the last election left Mr Fraser with a particularly strong electoral majority. He can afford to take a few risks.

He may even pick up a few votes in the middle ground from people who object to the upper-crust tax "rip-off."

The other, and more compelling reason, is economic. The Fraser Government is committed to reducing the burden of income tax.

Now the Government is getting about making everyone pay his fair share.

Partly as a result of the Government's generous tax cuts, the economically important and politically sensitive Budget deficit has started rising again.

For the present financial year the deficit is likely to be nearer $3,000 million than the $2,200 million that the Government budgeted for. First estimates for next year's deficit are in the region of $6,000 million.

TOMORROW: Michael Baxton puts the case for retrospectivity.

Refer to Annexure D for the full-size version

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7 [1974] HCA 46; (1974) 131 CLR 409; 5 ATR 61.

8 [1976] HCA 47; (1976) 135 CLR 290; 6 ATR 504.

9 [1977] HCA 9; (1977) 140 CLR 314; 7 ATR 166.

10 [1977] HCA 61; (1977) 140 CLR 33; 8 ATR 169.

11 "Catching the big fish in the tax pool", *Sydney Morning Herald* (April 26, 1978).

12 *Sun-Herald* (July 1, 1979).

Wage and salary earners *are* being ripped off by the way our tax system now works. They are the ones who cannot use tax lurks, so they are paying more and more while the top people pay less and less. Our tax system is no longer just or equitable — it is breaking down. ANDREW WATSON reports . . .

How the rip-off artists increase your tax

The Australian wage earner can't join the tax revolt and fight — his tax money just disappears from his pay packet.

It's easy and regular money for the Government and as wages rise, so does the tax bite.

The wage earner doesn't have an arsenal of accountants and lawyers to devise tax dodging schemes — that is the prerogative of the rich, the self-employed, the sharp businessmen, who are supported, surprisingly, by decisions of the High Court of Australia.

And because the tax avoidance industry has been so successful in siphoning off millions of dollars in revenue from the Government, there is no chance of taxes coming down.

The Federal Treasurer, Mr John Howard, admitted in an interview with The Sun-Herald that the tax avoidance industry had created a great inequity for salary and wage earners.

"It means the rest of the community are paying higher taxes than they would otherwise pay," he said.

"Some of the tax avoiders preach we ought to have a lower tax rate.

"I would respond that if they didn't tax avoid, we could have a lower rate."

Mr Howard said the Government was trying to crack down on tax-avoiders, but it had a long way to go.

The very rich — advised by high-powered lawyers and accountants — have always avoided tax with complicated company structures, paper share transactions, the leasing of expensive cars, boats and homes for "business" purposes.

The soaring inflation of the mid-1970s pushed up the salaries and income of the professionals and the middle class.

When their marginal rate of tax — the rate paid on the top end of incomes — hit 62c in the dollar they panicked and sought help from the avoidance brokers.

They were advised to use the tax tricks of the rich.

One trick, the split income, works by the big money earner paying some of his income to his wife or children through a trust or private company. Suddenly he tumbles out of the top tax brackets with the tax money still in the family purse.

Mr Howard . . . long way to go on tax avoidance.

The professionals — lawyers doctors and architects — are also shown the value of leasing expensive office equipment, antiques and art. The lease payments are a tax deduction and when the lease ends, the item could have trebled in value.

Tax avoidance has become a lucrative industry with sophisticated marketing and high expectation advertising.

And the industry and its clients have found sanctuary in rulings by the High Court of Australia.

This court — under Chief Justice Sir Garfield Barwick — has turned the tables on the Taxation Commissioner by opening up legal loopholes with liberal interpretations of the tax laws.

The Government now finds that the man who helped to put it into office with his advice to Sir John Kerr on the dismissal of the Whitlam Government is one of the chief stumbling blocks to the effective management of the country's financial resources.

And now his court's rulings have cost the Fraser Government hundreds of millions of dollars in lost tax revenue.

* * *

The Treasurer admits $700 million of anticipated Government revenue is tied up as the avoiders test their schemes in the courts.

In the last Budget Mr Howard estimated tax avoidance would cost $50 million in lost revenue for this financial year.

But the loss through tax avoidance has turned out to be $230 million — $180 million more than the estimate.

And as the schemes are tested in the courts the taxpayer foots the bill for the salaries of the judges, court officials, Tax Office staff and lawyers fighting the costly cases that could run to $50,000 a case if they go to the High Court.

Prior to the Government's campaign to put the screws on avoidance it is estimated they lost $1,000 million in revenue between 1974-1977.

That would have reduced the Government's huge Budget deficit — the central problems of economic management today. Effective tax collecting could have saved the damaging cutting of State spending which occurred last week.

"This Government is making the most serious effort ever mounted to reduce tax avoidance," says Mr Howard.

But Mr Howard, 39, and a former solicitor quietly admits the Government has a long way to go.

Mr Howard believes inflation fuelled the avoidance industry and admits: "It gathered pace for a fair period of time because there wasn't much anti-avoidance legislation and the view developed that nothing much was going to be done about it.

"Two or three years ago tax avoidance schemes started to be thrust around and marketed in a more aggressive fashion," he said.

As well as the avoiders, there are the citizens who simply don't pay tax, because they get paid in cash and don't declare it.

Every time you pay cash at a restaurant or give cash for an odd job at home you are probably assisting tax evasion, which, unlike avoidance, is a crime.

The building industry is a big area of evasion and a special inquiry has been set up in the Tax Office to look at curbing it.

Already the Government has put on more tax inspectors to hunt out the evaders and is developing detection techniques.

"I'm not putting it in the too hard basket," claimed Mr Howard "but it is very hard."

But, no one will really know if the Government's new tax measures will get over Sir Garfield Barwick and the High Court.

NEXT WEEK: A report on Sir Garfield Barwick's High Court, and the tax trouble it created for the Fraser Government.

He calls it a game of cat-and-mouse

Harry Walsh sells tax avoidance schemes

For a fee of $250 plus a commission on the saving he helps the rich to dodge the taxman.

For 15 years he was an insurance broker, but now he's decided there is more money in being an avoidance entrepreneur.

If a top businessman goes to him, Mr Walsh will give advice on the best way he can arrange his affairs to get out of paying tax.

Mr Walsh might suggest his client gets into cattle leasing, or forms a family partnership or buy into an avocado farm.

Leasing cattle, which are used for breeding works as an avoidance scheme because the management fees and cattle lease repayments are tax deductible.

Forming a family partnership "splits" one high income between husband and wife — dramatically reducing the tax payout.

It takes about seven years for an avocado farm to produce and all the payments to set it up are tax deductions.

After assessing your situation, Mr Walsh refers you to the corps of lawyers and accountants who put his ideas into motion.

He gets a commission — which he won't disclose — if his client goes ahead with the deal and gets past the taxman.

Mr Walsh, 53, is a stocky man living and working from a harbour view suite at the North Sydney Travelodge.

He describes himself as a professional bachelor, a teetotaller and a person not inclined to socialise. "I lead a monastic life" he said.

The Government's clampdown on tax avoidance doesn't disturb him.

"It's a cat and mouse game," he said.

"They can amend the tax laws and tighten them and in another two or three years people will find ways around them," he claimed.

"The politicians and the bureaucrats are blaming the tax avoidance industry for their problems but, in fact it's themselves."

"Really tax avoidance is a perfectly natural thing to do, like sex. Even politicians do it."

Mr Walsh . . . keeping ahead of the taxman.

Carlo cooks the books

"Carlo" runs a leading Italian restaurant in Sydney and has to pay cash to get good waiters and a chef.

"Officially" he pays them the basic award wage for their jobs.

But then he hands them cash from the till, money they don't disclose to the taxman.

This is the "cash society."

Carlo doesn't like being a part of it but, he says he couldn't get top staff if he didn't give them the cash bonus.

He says a top waiter demands $300 a week and a chef $500 about double the award wages.

Carlo has to fake his own books to cover the cash payments.

"I play about with the food bills and especially the drink bills from suppliers," he says.

So Carlo, too, is misleading the taxman.

"It's the system — if I didn't do it I wouldn't have a restaurant," he says.

Refer to Annexure E for the full-size version

3.4 *Westraders*: High watermark of "strict literalism"

The taxpayer in *Westraders v FCT*[13] had also recently successfully appealed to the NSW Supreme Court against an unfavourable ATO assessment, in a decision that was, in due course, upheld by both the Full Federal Court[14] and the High Court.[15]

The judgment of Barwick CJ in the High Court is one of the strongest statements of the judicial approach to interpreting tax legislation during the 1970s; and that approach to some extent explains the complexity of section 100A. His Honour commenced that judgment as follows:

> The facts of this case disclose an ingenious use of the amended (the Act) to produce what is claimed to be an allowable deduction from a taxpayer's assessable income. …
>
> Because of the employment of the provisions of the Act to produce a very large diminution of tax, the case affords an occasion to point out the respective functions of the Parliament and of the courts in relation to the imposition of taxation. It is for the Parliament to specify, and to do so, in my opinion, as far as language will permit, with unambiguous clarity, the circumstances which will attract an obligation on the part of the citizen to pay tax. **The function of the court is to interpret and apply the language in which the Parliament has specified those circumstances. The court is to do so by determining the meaning of the words employed by the Parliament according to the intention of the Parliament which is discoverable from the language used by the Parliament.**
>
> **It is not for the court to mould or to attempt to mould the language of the statute so as to produce some result which it might be thought the Parliament may have intended to achieve, though not expressed in the actual language employed.**

His Honour then referred to the comments by Deane J in the Full Federal Court below:

> In this connection, **I would indorse what was said by Deane J**. in his reasons for judgment in this case, and which, in my opinion, are worthy of repetition. Speaking of the result of this case in upholding the taxpayer's claim to deduction, his Honour said (1979) 38 FLR, at pp 319-320; 24 ALR, at p 151; 9 ATR, at p 568; 79 ATC, at p 4098:
>
> > "**That result may seem both contrary to the general policy of the Act** (if it be possible to discern any general policy other than that people pay income tax) **and unfair to the ordinary taxpayer who willingly or reluctantly contributes, without resort to tax avoidance, the share of his net income which the Parliament has determined is required by the nation for the common good**. If there be, in truth, such contrariety or unfairness, the fault lies with the form of the legislation at the relevant time and not with the courts whose duty it is to apply the words which the Parliament has enacted. **For a court to arrogate to itself, without legislative warrant, the function of overriding the plain words of the Act in any case where it considers that overall considerations of fairness or some general policy of the Act would be best served by a decision against the taxpayer would be to substitute arbitrary taxation for taxation under the rule of law and, indeed, to subvert the rule of law itself** (see Ransom v. Higgs (1974) 1 WLR 1594, at p 1617 ; Inland Revenue Commissioners v. Duke of Westminster (1936) AC 1, at p 19)."
>
> **The principle to which his Honour calls attention is basic to the maintenance of a free society.**
>
> Parliament having prescribed the circumstances which will attract tax, or provide occasion for its reduction or elimination, the citizen has every right to mould the transaction into which he is about to enter into a form which satisfies the requirements of the statute. It is nothing to the point that he might have attained the same or a similar result as that achieved by the transaction into which he in fact entered by some other transaction, which, if he had entered into it, would or might have involved him in a liability to tax, or to more tax than that attracted by the transaction into which he in fact entered. Nor can it matter that his choice of transaction was influenced wholly or in part by its effect upon his obligation to pay tax. Of course, the transaction must not be a pretense obscuring or attempting to supplant some other transaction into which in fact the taxpayer had earlier entered.

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13 (1978) 8 ATR 43 (Rath J, 13 October 1977).

14 [1979] FCA 23; 9 ATR 558.

15 [1980] HCA 24; (1980) 144 CLR 55; 11 ATR 24. See also *FCT v Total Holdings (Australia) Pty Ltd* (1979) 9 ATR 885.

His Honour then concluded:

> Again, **the freedom to choose the form of transaction into which he shall enter is basic to the maintenance of a free society**. [Emphasis added.]

It should be noted that in 1977/78 the top marginal tax rate was 62.915% (plus Medibank levy of 2.5%), having been 66.7% as recently as 1974.

Accordingly, section 100A was enacted at a time when the Government was battling to stem revenue losses from tax avoidance arrangements and when strict literal interpretation of the ITAA 1936 was the ruling norm. When the Government introduced section 100A, it was therefore acutely aware of the need to spell out very clearly the circumstances in which tax liability would arise, in order to avoid judicial challenge.

At the same time, the Government was considering whether to address tax avoidance schemes with specific anti-avoidance provisions or, instead, to replace section 260 with a new general anti-avoidance rule. Section 260 was in due course superseded by Part IVA of the ITAA 1936; but the new provisions were not introduced until May 27, 1981—almost 3 years after the Treasurer's announcement regarding section 100A on June 11, 1987.

The Sydney Morning Herald

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Howard sets sights on $58m tax evader

From GREG BRIGHT

CANBERRA. — A Sydney businessman who has masterminded the evasion of almost $60 million in tax over the past 15 months is still operating evasion schemes.

This was revealed yesterday by the Treasurer, Mr Howard, as he introduced a new tax evasion law in Parliament aimed at stamping out tax scheme promoters.

The law carries, for the first time for tax offences, jail sentences of up to five years for people convicted of evading tax by creating "straw" companies or trusts.

The Sydney businessman, who was not named, was known to have stripped 2,086 companies. In 733 cases, the Tax Commissioner, who supplied Mr Howard with the information, was unable to collect tax on income of more than $128 million.

Company tax on that income would be $58m at normal rates.

A Treasury official said he presumed the man would close down his operation fairly soon. The law will probably be passed this session, which extends only to next week.

New law on 'bottom of harbour' schemes

The man is the biggest known evasion promoter operating in Australia.

He and similar "straw" company users buy cashed-up businesses from which all the assets are transferred, leaving only tax liabilities.

The directorships and shareholders are changed (usually to known criminals or vagrants) and the company records afterwards destroyed. It is known in tax circles as "the bottom - of - the - harbour" scheme.

Mr Howard said that as the Government closed avoidance loopholes, less scrupulous people had added a new and unacceptable dimension to escape tax.

If allowed to continue, it would render pointless the revision of Section 260 of the Income Tax Act, which attempts to prevent avoidance.

Mr Howard's new tax evasion law is called the Crimes (Taxation Offences) Bill.

It carries penalties on conviction of a jail term up to five years and a maximum $50,000 fine or both.

The court will also be empowered to order a convicted person to pay the Commonwealth the amount of income or sales tax evaded.

Mr Howard said the legislation was a move directed against calculated and fraudulent evasion of tax.

Such determined responses by the Government were designed to ensure that promoters of avoidance schemes could no longer predict with confidence that their schemes would prove effective.

The severe penalties contained in the bill will also apply to anyone aiding or abetting the formation of such companies and trusts or entering into an arrangement knowing it would result in such a company or trust.

The legislation will not be retrospective.

Mr Howard

4 Conspectus of Section 100A

4.1 Summary of section 100A's main provisions

Section 100A is lengthy and, in many respects, impenetrable.

Very briefly**, section 100A(1)** provides that where:

- a beneficiary is presently entitled to a share of the income of a trust estate; and
- that present entitlement arose out of a "reimbursement agreement";

the beneficiary is deemed **not** to be presently entitled to that share of the income.

Section 100A(2) is in similar terms. It deems a beneficiary **not** to be presently entitled to a share of income, where present entitlement would otherwise arise as a result of income being paid to (or applied for the benefit of) a beneficiary as a result of a "**reimbursement agreement**".

Section 100A(3) to (3C) ensure sections 100A(1) and 100A(2) apply where a beneficiary is presently entitled in the capacity of a trustee of another trust estate.

Section 100A(4) provides that if section 100A(1) or (2) applies, the trustee is assessable under section 99A at the top marginal rate (61.5% including Medicare Levy in 1978/79).

Sections 100A(5) to (6B) deal with the situation where a beneficiary's present entitlement is not entirely attributable to a reimbursement agreement; i.e. where the beneficiary would have been entitled to at least some share—albeit of a lesser amount—if the reimbursement agreement had not been entered into.

Section 100A(7) defines a "**reimbursement agreement**", in relation to a beneficiary, as an agreement providing for:

- the payment of money to;
- the transfer of property to; or
- the provision of services or other benefits for;

a person other than the beneficiary.

Sections 100A(8) and (9) require that an agreement must have been entered into for the purpose (or purposes that included the purpose of) making sure a person does not pay tax, or pays less tax than would otherwise be payable.

Under **section 100A(10)**, a reference to a payment of money includes a payment by way of loan.

Section 100A(11) ensures a reference to a person includes a reference to a person as a trustee.

Section 100A(12) provides that an agreement to release, abandon, fail to demand payment of, or postpone payment of, a debt shall be deemed to be an agreement for the payment of money.

Crucially for the purposes of this paper, **section 100A(13)** defines ***agreement*** as meaning:

> … any agreement, arrangement or understanding … **but does not include** an agreement, arrangement or understanding **entered into in the course of ordinary family or commercial dealing**. [Emphasis added.]

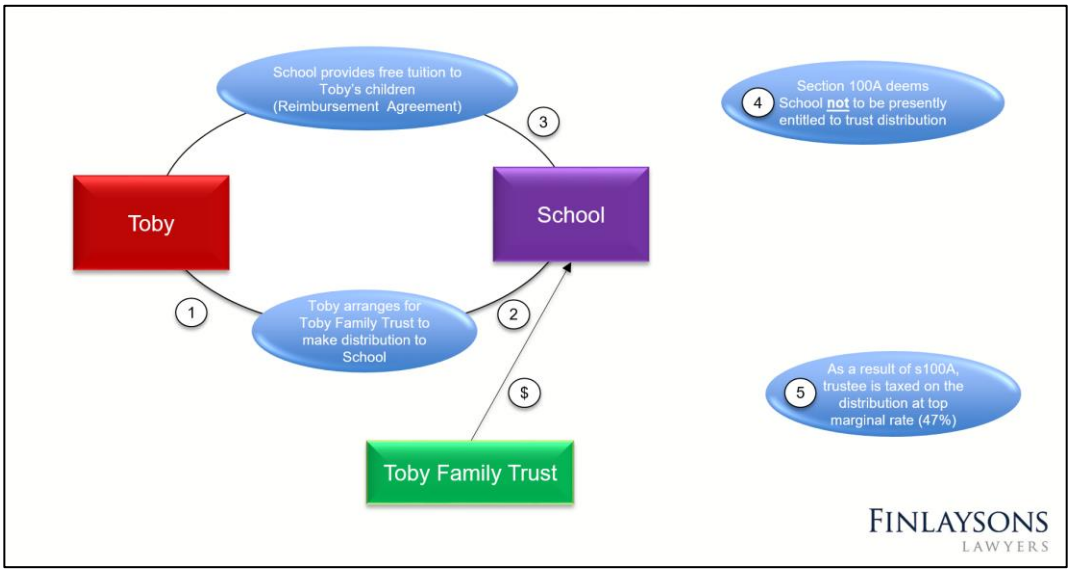
4.2 Section 100A example

By way of example, assume the Toby Family Trust makes a trust distribution to a (tax-exempt) School rather than Toby paying school fees, and the School agrees to accept that distribution and provide tuition to Toby's children in lieu of fees.

In the absence of section 100A, the distribution would be tax-free in the School's hands. However, as the distribution would be from pre-tax income, Toby would in effect obtain a tax deduction (since he would otherwise pay the fees out of after-tax dollars).

As a result of section 100A: (i) since a beneficiary (the School) is presently entitled to a share of the income of a trust estate; and (ii) the present entitlement arises out of a "*reimbursement agreement*"—being the agreement by the School to provide tuition to Toby's children, who are persons other than the beneficiary (i.e. the School):

- the beneficiary (the School) is deemed **not** to be presently entitled to the share of the income distributed to it; and
- the trustee of the Toby Family Trust instead is assessable on that share of the income under section 99A at the rate of (currently) 47%.



It can probably be said with some confidence that is unlikely Toby could argue his arrangement with the School was entered into "*in the course of ordinary family or commercial dealing*".

4.3 Section 100A not necessarily limited to "trust stripping"

The Federal Court has indicated that despite the Treasurer's 11 June 1978 announcement, the Second Reading Speech and the Explanatory Memorandum, section 100A's operation is not restricted to cancelling "trust stripping" arrangements.

In *FCT v Prestige Motors Pty Ltd*,[16] one of the early cases to consider section 100A, Hill and Sackville JJ (with whom Beaumont J agreed) observed that:[17]

> Much of Prestige's argument was directed to the proposition that the text of s 100A of the ITAA should be read in the light of the extraneous materials to which we have referred.

Prestige had urged the Federal Court to limit section 100A to the types of schemes highlighted in the Treasurer's Press Release and the Explanatory Memorandum, arguing:[18]

> … [a] specific anti-avoidance provision should be given on interpretation sufficient to deal with the mischief identified by Parliament and should not be read so widely as to embrace matters which were not the mischief sought to be remedied.

Hill and Sackville JJ squashed that argument, stating:[19]

> But as Mason CJ, Wilson and Dawson JJ said in *Re Bolton*; *Ex parte Beane* (1987) 162 CLR 514 at 518, of a Second Reading Speech by the Minister:
>
> > … while deserving serious consideration, [it] cannot be determinative; it is available as an aid to interpretation. The words of a Minister must not be substituted for the text of the law … The function of the Court is to give effect to the will of Parliament as expressed in the law.

Again, at first instance in *Idlecroft Pty Ltd v FCT*,[20] Spender J referred[21] to the statement by the Full Court in *Prestige Motors* (ATR at 589) that:

> … the mere fact that s 100A can be characterised as a specific anti-avoidance provision does not demonstrate that it should be given a narrower approach that its ordinary meaning and grammatical sense suggest.

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16 (1998) 38 ATR 568.

17 (1998) 38 ATR 568 at 586.

18 (1998) 38 ATR 568 at 582.

19 (1998) 38 ATR 568 at 586 and 590.

20 (2004) 56 ATR 699 (FCA); (2005) 60 ATR 224 (FCFCA).

21 (2004) 56 ATR 699 at 722.

Spender J continued:[22]

> It is apparent that the parliamentary intention was that s 100A have a very wide scope, catching not only those present entitlements which arose out of a reimbursement agreement, but also those which arose by reason of any act, transaction or circumstance that occurred in connection with the reimbursement agreement.

On appeal, the Full Federal Court (Ryan, Tamberlin and Kiefel JJ) referred extensively to the Explanatory Memorandum which "*describe[d] the intended use of s 100A*" , although did not themselves make any further specific comments (presumably accepting Spender J's analysis).[23]

It is therefore reasonably clear that section 100A is **not** limited only to trust stripping schemes.

[22] (2004) 56 ATR 699 at 772-3.

[23] (2005) 60 ATR 224 at 230-1.

5 What is "ordinary family dealing"?

The expression "**ordinary family dealing**" can be traced back to the Privy Council's decision over 60 years ago in *Newton v FCT*.[24]

In order to understand the meaning of the expression, *Newton* will be reviewed below in some detail: and a number of the significant difficulties in identifying what is—and what is not—an ordinary family dealing will be discussed.

As will be seen, the passage of time since 1958 has not made understanding the expression any easier.

5.1 *Newton v FCT*

In *Newton*, the Privy Council considered whether a complex dividend-stripping arrangement was subject to the general anti-avoidance provisions in section 260 of the ITAA 1936.

Section 260 provided that:

> **Every contract, agreement, or arrangement** made or entered into, orally or in writing … **shall so far as it has or purports to have the purpose or effect of in any way**, directly or indirectly - (a) altering the incidence of any income tax; (b) relieving any person from liability to pay income tax or make any return; (c) **defeating, evading, or avoiding any duty or liability imposed on any person by this Act**; or (d) preventing the operation of this Act in any respect, **be absolutely void**, as against the Commissioner, or in regard to any proceeding under this Act … . [Emphasis added.]

5.1.1 "*Predication*" and "*ordinary business or family dealing*" tests

In delivering the Privy Council's decision, Lord Denning set out the so-called "*predication"* and "*ordinary business or family dealing*" tests:[25]

> **In order to bring the arrangement within the section you must be able to predicate** - by looking at the overt acts by which it was implemented - **that it was implemented in that particular way so as to avoid tax**. **If you cannot so predicate**, but have to acknowledge that the **transactions are capable of explanation by reference to ordinary business or family dealing**, without necessarily being labelled as a means to avoid tax, then the **arrangement does not come within the section**. [Emphasis added.]

[24] [1958] UKPCHCA 1; (1958) 98 CLR 1

[25] [1958] UKPCHCA 1 at [15]; (1958) 98 CLR 1 at 8.

5.1.2 Examples of those tests in operation

Lord Denning then provided a number of examples of those tests in operation:[26]

> **Thus, no one**, by looking at a **transfer of shares cum dividend**, can **predicate that the transfer was made to avoid tax**. Nor can anyone, by seeing a **private company turned into a non-private company**, predicate that it was done to avoid Div. 7 tax, see *W. P. Keighery Pty. Ltd. v. Commissioner of Taxation* [1957] HCA 2;(1958) 32 ALJR 118; 11 ATD 359 . Nor could anyone, on seeing a **declaration of trust made by a father in favour of his wife and daughter**, predicate that it was done to avoid tax, see *Deputy Federal Commissioner of Taxation v. Purcell* [1921] HCA 59; (1921) 29 CLR 464. [Emphasis added.]

In each of those three examples—(i) the transfer of shares cum dividend, (ii) turning a private company into a public company, and (iii) declaring a trust in favour of a wife and daughter—his Lordship indicated one had:[27]

> … to acknowledge that the **transactions [were] capable of explanation by reference to ordinary business or family dealing**, **without necessarily being labelled as a means to avoid tax**. [Emphasis added.]

His Lordship continued:[28]

> **But when one looks at the way the transactions were effected in *Jaques*** *v. FCT* [1923] HCA 70; (1924) 34 CLR 328; ***Clarke*** *v. FCT* [1932] HCA 46; (1932) 48 CLR 56; and ***Bell*** *v. FCT* (1953) 87 CLR 548 - the way cheques were exchanged for like amounts and so forth - there can be **no doubt at all that the purpose and effect of that way of doing things was to avoid tax**. [Emphasis added.]

His Lordship thus established a clear dichotomy between, on the one hand, transactions "*capable of explanation by reference to ordinary business or family dealings*" and, on the other hand, arrangements "*implemented in [a] particular way so as to avoid tax*".

5.1.3 Application of tests in *Newton*

By reference to the facts in *Newton*, Lord Denning concluded:[29]

> Looking at the whole of this arrangement, their Lordships have no doubt that it was an arrangement which is caught by s. 260. The **whole of the transactions show that there was concerted action to an end - and that one of the ends sought to be achieved was the avoidance of liability for tax**. [Emphasis added.]

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26 Idem.

27 Idem.

28 Idem.

29 [1958] UKPCHCA 1 at [21]; (1958) 98 CLR 1 at 10.

5.2 Searching for "*ordinary family dealing*"

The draftsman of section 100A clearly intended that "*ordinary business and family dealings*"—in the sense envisaged by Lord Denning in *Newton*—would ***not*** come within section 100A. Yet neither the ITAA 1936 nor the ITAA 1997 contains a definition of that expression. It seems to have been assumed by the draftsman—and indeed by Lord Denning—that certain transactions could or would be:

> … capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax.

However, a dealing will not be an ordinary ***business*** dealing simply because it takes place in a business or commercial setting. In the same way, a dealing will not be an ordinary ***family*** dealing simply because it takes place between members of a family. Something more is required to explain and identify an "*ordinary family dealing*".

5.2.1 Dictionary definitions

The Macquarie and Oxford Dictionaries confirm that "**ordinary**" means regular, normal, customary, or usual;[30] and define "**dealing**" as a person's conduct in relation to others, behaviour, or a transaction.[31]

At first sight, a reference to "ordinary family dealing" is thus to the regular, normal, customary or usual conduct, or behaviour, of—or transactions entered into by—a family and its members.

5.2.2 Family dealings vs. business dealings

The concept of an ordinary <u>family</u> dealing stands in contradistinction to an ordinary <u>business</u> dealing.

Members of families do not generally deal with other family members as if they were unrelated third parties. Family members often do things to assist each other, and confer benefits on each other, without any expectation of receiving payment or reward, in the same way they might expect if they did those things for, or conferred benefits on, unrelated parties.

In particular, when family members enter into agreements or transactions with other family members, they do not generally behave the same way as might be expected if they entered into similar transactions, *as <u>business</u> dealings*, with unrelated third parties.

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[30] For example, the Macquarie Dictionary (5th ed) defines "ordinary", as "*such as is commonly met with; of the usual kind … customary; normal; for all ordinary purposes … somewhat regular, customary, or usual*". Similarly, the *Shorter Oxford Dictionary* (2nd ed) defines "ordinary" as "*regular, normal, customary, usual … not singular or exceptional*".

[31] The Macquarie *Dictionary* defines "dealing" as "*relations, trading; business dealings; conduct in relation to others; treatment*"; while the Shorter Oxford Dictionary defines "dealing" as "*way of acting, conduct, behaviour"*. The Concise Oxford Dictionary also refers to a dealing as a *"transaction"*.

An unusual—and thus not an ordinary—transaction or dealing between *unrelated* parties might therefore be "*ordinary*", in the sense of normal or standard, as between family members.

For example, it might be unusual to lend money to an unrelated person on an interest-free basis, or without first discussing and agreeing the terms of repayment. However, that might be ordinary in a family context.

Again, it might be considered unusual simply to confer a benefit on, or pay money to, a third party without receiving something in return (leaving to one side the obvious case of charitable gifts); but that might be quite ordinary in a family context.

In *Peacock v FCT*,[32] Nettlefold J appears to have agreed with this view when he considered whether section 260 applied to an arrangement which involved the taxpayer—a quantity surveyor—entering into partnership with his wife (who was not such a surveyor).

Mr Peacock claimed he did so because: (i) he was concerned about his health and the future of his family, and wanted his wife to understand his business so she could carry it on in his absence "*from illness or otherwise*"; (ii) he wanted her to have authority over employees; and (iii) he wanted her to accumulate assets of her own, in her own name, "*earned by her*", and to acquire business knowledge for her own protection if something happened to him.[33]

Nettlefold J noted that "[i]t is said that this was an unusual agreement" but continued:[34]

> … one has to be careful about that submission. **If the parties were strangers it would, indeed, be unusual. But**, speaking in the broad, **it is not unusual for a businessman to take his wife into business** and that is so even in cases where the business involves the exercise of technical skill. [Emphasis added.]

[32] (1976) 6 ATR 677.

[33] (1976) 6 ATR 677 at 678-9.

[34] (1976) 6 ATR 677 at 688.

5.2.3 Redistribution of family assets is "*ordinary family dealing*"

The idea of a transaction being an "ordinary family dealing" is well-demonstrated by the decisions of Bray CJ of the South Australian Supreme Court in *Bayly v FCT*[35] and *Jones v FCT*.[36]

In those cases, Bray CJ considered whether section 260 applied to the transfers by pharmacy owners of half interests in their respective pharmacy businesses to their spouses. His Honour allowed the taxpayers' appeals on the basis that redistributions of assets between family members were "*normal, ordinary, everyday*" transactions and thus were ordinary family dealings.

The Commissioner, relying on the decisions in *Peate v FCT*[37] and *Hollyock v FCT*,[38] argued that the transfers of the half interests—which the ATO accepted were not shams—were nevertheless void under section 260.

However, Bray CJ stated in *Jones* (and repeated in *Bayly*):[39]

> In my view the **arrangement is capable of explanation by reference to ordinary family dealing and is not necessarily to be labelled as a means to avoid tax**. It falls within the class of case illustrated by *Peacock v F.C. of T.* 76 ATC 4375 rather than within the class of case illustrated by ***Peate's case*** (116 C.L.R. 38) or ***Hollyock's case*** above. [Emphasis added.]

His Honour continued:[40]

> … a **redistribution of family assets including a family business, as between husband and wife is a normal, ordinary, everyday family transaction** which would not normally attract sec. 260 where there is no professional element in the business. Farmers, shopkeepers, factory owners do it frequently. As the Privy Council has recently pointed out, **in modern times marriage has come to be regarded as a partnership of free equals in which the partners perform complementary functions and appropriate proprietary adjustments are regarded with approval**, *Haldane v. Haldane* (1976) 3 W.L.R. 760 at p. 767. [Emphasis added.]

His Honour clearly considered that a gifting, sharing or redistribution of assets, between the members of a family, was very much an "*ordinary*" family dealing.

It is worth noting that section 100A was drafted and enacted after the decisions were handed down, and the above statements were made, in *Peacock*, *Bayly* and *Jones*.

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35 (1977) 15 SASR 446; 7 ATR 215.

36 (1977) 15 SASR 462: 7 ATR 229.

37 (1964) 116 CLR 38.

38 (1971) 125 CLR 647; 2 ATR 601.

39 (1977) 7 ATR at 238.

40 Idem.

5.2.4 Using legal structures to ensure financial benefits go to family members also is "*ordinary family dealing*"

The decision of Heerey J in *Rippon v FCT*[41] is a further example of family asset protection planning being treated as "ordinary family dealing".

Mr Rippon was an engineer who had worked for a number of employers until he joined the Gollin Group; but when the Group collapsed, he decided to go into business on his own as a project management consultant.

After discussing the matter with a solicitor, Mr Rippon established a structure involving John T Rippon Pty Ltd acting as trustee for the John T Rippon Unit Trust. All of the units in the Unit Trust were held by John T Rippon Holdings Pty Ltd, as trustee for the John T Rippon Family Trust, the beneficiaries of which were the taxpayer's wife and children.

The Commissioner applied section 260 and reassessed Mr Rippon on the amounts received by the Unit Trust.

Heerey J allowed Mr Rippon's appeal, clearly considering that the establishment of a legal investment or business structure—which was intended to provide benefits to family members—was an example of an ordinary dealing, even though it resulted in an improved tax position than otherwise might have been the case.

His Honour stated that:[42]

> 22. A **person with a family who establishes a business will often want to use a legal structure to achieve the result that some or all of the financial benefits** which, hopefully, the business will generate **will go to family members**. Both legal obligation and natural love and affection encourage such an objective. The **adoption of a structure that will achieve it is, to my mind, an ordinary family dealing**. It is comparable to one of the examples of ordinary business or family dealings given by the Privy Council in Newton immediately following the passage quoted in this judgment, viz a declaration of trust made by a father in favour of his wife and daughter: see 98 CLR at 9. Whether the structure actually chosen is a company with different classes of shares or a discretionary trust or a combination of both, **such an arrangement does not necessarily bear the stamp of tax avoidance, notwithstanding that the person establishing the structure may be better off in terms of his personal tax liability** compared with his position were he to embark on the new venture as a sole trader on his own account. [Emphasis added.]

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41 [1992] FCA 172; (1992) 23 ATR 209.

42 [1992] FCA 172; (1992) 23 ATR 209 at 214.

5.3 Further issues

In defining and identifying "*ordinary family dealings*", the following five [5] issues will be addressed.

First, assuming the meaning of "*ordinary dealing*" is likely to alter over time—and may well differ from person to person and, probably most importantly, from judge to judge—what is the meaning of an "*ordinary dealing*" **in 2019**?

Second, when determining whether a "*family dealing*" is "*ordinary*", what ***type*** of family needs to be examined?

Third, does a family dealing ***become*** "*ordinary*" simply because it is commonplace?

Fourth, does a family dealing ***cease*** to be "*ordinary*" because it is complicated?

Fifth, if an agreement is an "ordinary family dealing", does it matter that the main purpose is the purpose of tax avoidance?

5.4 Effect of changing social & economic factors

It seems to be generally accepted that the meaning of "*ordinary dealing*" is likely to alter over time, and may differ from person to person and, perhaps most importantly, from judge to judge.

5.4.1 What may have been "blatant" in 1950s became "ordinary" in 1970s

A review of case law since *Newton* indicates that transactions which were possibly considered blatant attempts to avoid tax in the 1950s and 60s became "*ordinary*" by the late 1970s. Changing social and economic factors appear to have had an important influence on the interpretation and application of section 260.

One example is the incorporation of medical practices. When the taxpayer in *Peate v FCT*[43] attempted to do that in the late 1950s, the concept appears to have been nothing short of revolutionary. However, when doctors were permitted to incorporate in the 1980s, scarcely an eyebrow appears to have been raised. Incorporation was seen as a way of enabling self-employed practitioners to superannuate themselves, in a manner similar to those employed by the government and private industry.[44]

Again, in *Hollyock v FCT*[45] the concept of selling a pharmaceutical practice to one's wife was considered an artificial means of avoiding tax and therefore liable to be struck down under section 260. A few years later, however, in *Jones* and *Bayly*,[46] such a sale was treated as an ordinary dealing between a husband and a wife—a means of sharing joint property and giving the wife security and financial independence.

Even in the early 1970s, "dividend stripping" was subject to the operation of section 260.[47] However, only a few years later, the High Court held that taxpayers were free to choose a form of disposal of their assets that took them outside the provisions of the Act.[48]

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43 (1964) 111 CLR 443.

44 In *Gulland v FCT* (1985) 160 CLR 55; 17 ATR 1, the High Court held that the incorporation of the taxpayers' medical practices was *ex facie* for tax reasons, and that section 260 therefore enabled the Commissioner to disregard those arrangements.

Nevertheless, Gibbs CJ stated (17 ATR at 10) that "*there [was] truth in [the] statement"* that:

> … **standards of ordinary and acceptable conduct have changed since *Peate v FCT* was decided two decades ago** and **practices then unacceptable in a profession are now tolerated** for the very reason that persons engaged in a profession would otherwise be in a position of disadvantage, from a taxation point of view, when compared with tradesmen and proprietors of small businesses. [Emphasis added.]

45 (1971) 125 CLR 647; 2 ATR 601.

46 See also *Peacock v FCT* (1976) ATR 677.

47 For example, *FCT v Ellers Motor Sales Pty. Ltd.* (1971) 3 ATR 45.

48 For example, *Slutzkin v FCT* (1976) 7 ATR 166.

5.4.2 And "*ordinary*" in 2019 is very different to "*ordinary*" in 1978!

In the same way the concept of "*ordinary*" appears to have changed significantly between 1958 and 1978, it is suggested it would extremely difficult to find a professional advisor in 2019 who would not agree that the nature of family legal structures has developed substantially since section 100A was introduced in 1978.

In the late 1970s, a family may possibly have organized a family trust or family company to hold and manage their business and/or investments.

In 2019, family structures are typically far more complicated. It is not uncommon for a family to have interests in a family trust ***and*** a family company, ***and*** a self-managed superannuation fund ***and***, potentially, a number of separate third-party investments through, for example, unit trusts.

It is also not uncommon for there to be indebtedness between those entities, arising by reason of Unpaid Present Entitlements, Division 7A loans, and short-term advances.

In those circumstances, it is submitted it would be **ordinary**—in the sense of "*regular, normal, customary, usual, non-exceptional*"—for those assets and liabilities to be transferred, gifted and released, as between members of the family and the family entities.

These dealings would be in no sense "*unusual*" (per *Peacock*), would be by way of "*proprietary adjustments*" (per *Bayly* and *Jones*), and would result in financial benefits going to family members (per *Rippon*).

5.5 When determining whether a dealing is "ordinary family dealing", what type of family does one examine?

In applying the "ordinary family dealing" exception, there appears to be an implicit assumption one can identify an "*ordinary*" family—in the same way the views of a "*reasonable man*" can be identified by reference to a hypothetical person on the Clapham omnibus or, in Australian terms, a hypothetical Bondi tram.[49]

5.5.1 What is an "*ordinary family*" in 2019?

It is respectfully submitted that the "ordinary family" has changed significantly since 1978 when section 100A was introduced; and that families in 2019 are in many respects very different compared with "ordinary families" in 1958.

Owing, for example, to the large numbers of foreign migrants who have settled in Australia since the 1950s—and the legalization of same-sex marriages in Australia in December 2017[50]—it is difficult to state with any certainty which type of "*family unit*" represents, in 2019, an "ordinary" Australian family, for Australian tax purposes.

Indeed, a partner in a national accountancy practice recently said to the author (words to the effect that):

> I am a member of a particular European ethnic group and what happens in our families probably doesn't happen in a lot of other families.

It is respectfully suggested that there could be real difficulties if it were argued that certain transactions were not "ordinary family dealings" in 2019—on the basis that although they were "*ordinary*" in some families, they were not in others, and thus could not be treated as "*generally ordinary*" for tax purposes.

Again, only 20 years ago in 1999, Professor Miranda Stewart suggested that the "*ideal family*", for Australian tax planning purposes, traditionally involved one headed by a husband, with a wife who was financially dependent on her husband—thus maximizing the benefits from income splitting.[51]

One wonders whether that would that be the case in 2019, especially given the increase in dual income families, where both spouses have their own incomes.

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[49] *Nomikos Papatonakis v Australian Telecommunications Commission* [1985] HCA 3; (1985) 156 CLR 7, per Deane J.

[50] *Marriage Amendment (Definition and Religious Freedoms) Act* 2017 (Cth).

[51] Professor Miranda Stewart, *Domesticating Tax Reform: The Family in Australian Tax in Transfer Law* (1999) 21 Sydney L. Rev. 453 at p 468. See also footnote 52.

Professor Stewart also questioned whether traditional income-splitting techniques would be available to "*non-normative families*" and observed:[52]

> … whether an assignment of income-producing property by a lesbian or gay man for the benefit of a lover and other dependants could qualify as an "ordinary family dealing" (and hence not taxable) is by no means certain, especially in view of the requirements of a legal obligation for support and "natural love and affection".

It is suggested that in 2019 there would be a strong argument that transactions involving same sex couples *would* be upheld for Australian tax purposes. It would be difficult to argue that those types of transactions are not now "*ordinary family dealings*".[53]

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[52] Professor Miranda Stewart, *Domesticating Tax Reform: The Family in Australian Tax in Transfer Law* (1999) 21 Sydney L. Rev. 453 at p 468. In more detail, Professor Stewart stated:

> **The ideal family in the context of property income splitting is the traditional private sphere represented by the husband as head of household, in which the state declines to intervene**. Judith Grbich has shown how the notion of 'ordinary family dealings' always constitutes the taxpayer and his spouse in a hierarchical and gendered fashion, and in particular, how the female subject is inevitably defined by her wifely status. [Footnote: 'The Position of Women in Family Dealing: The Australian Case' (1987) 15 *Int'l J of the Sociol of Law* 309 at 315.] **A wife's agency** (however actively she may participate in the plan) **is constrained by the structural requirements for successful income splitting set by the tax law. She must be financially dependent for her husband to obtain most benefit out of the income splitting**. **The taxpayer husband's control of the income (for non-tax purposes) is generally assured by convention and operation of law**. Settlers of family discretionary trusts usually ensure control by appointing a solicitor or associate as trustee. A trust deed will often spell out consequences if the family arrangement (for instance, the marriage) enabling the income splitting were to break down, for example, by ensuring that trust property is returned to the settler-husband following divorce. Such arrangements have been accepted by the ATO:*
>
> > It is in the nature of family-inspired arrangements that the head of the household may build into the divestment arrangement some sort of variation provision should things not work out, in family terms, as he or she would wish.
>
> * Footnote: Boucher T (later to be Commissioner of Taxation), 'Part IVA: Ordinary business and family dealings', *Supplement to Taxation in Australia* (August 1981), cited in Grbich, ibid at 325. See also Tax Rulings IT 2121 and IT 2330.

Professor Stewart continued (at p 469):

> **It is interesting to speculate whether these techniques of property income splitting are available to non-normative families**. It seems almost certain that an arrangement established by a de facto couple would be upheld. It also seems possible that persons not usually part of a normative family may be joined in an existing income splitting structure, for example, friends or lovers of children (gay or straight) may be made additional beneficiaries of a family trust; this is the model of the patriarch providing for his household and may be upheld if no tax avoidance purpose was apparent. **However, whether an assignment of income-producing property by a lesbian or gay man for the benefit of a lover and other dependents could qualify as an "*ordinary family dealing*" (and hence not tax avoidance) is by no means certain, especially in view of the requirements of a legal obligation for support and "natural love and affection"**. Same-sex love has scarcely been conceived of by the law as "natural" and, as noted in Part 2, it is only very recently that changes to state laws have begun to recognise the possibility of support and maintenance duties in the context of queer or other "domestic relationships". [Emphasis added.]

[53] One also wonders whether the programmers of early Australian television in the late 1950s would have envisaged the possibility of a program called "*Married at First Sight*", which anecdotally is somewhat of a popular success in 2019.

5.6 Can "*family dealing*" become "*ordinary*" on basis it is commonplace?

Another interesting question is whether family dealings—in the sense of conduct and transactions—can *become* "ordinary" because that conduct and/or those transactions are widespread.

On the basis of comments by the High Court in *FCT v Gulland* (the "Three Doctors case"),[54] it might be suggested that "*just because everybody is doing* it" does not make conduct "*ordinary*" in this sense. Gibbs CJ observed that:[55]

> … when Lord Denning in *Newton v FCT* spoke of "ordinary business or family dealing" he intended to refer to what was normal or regular, **rather than to what had become common or prevalent**; … . [Emphasis added.]

His Honour continued:[56]

> In my opinion the arrangements made by Dr Watson, like those in *Peate v. Federal Commissioner of Taxation*, bear on their face an indication of a purpose to avoid tax. It is true that the arrangement revealed other purposes as well, namely the desire to make adequate provision for the superannuation of Dr Watson and to benefit the members of his family.

His Honour then concluded that:[57]

> … **the arrangements in fact made went far beyond what was necessary to take advantage of the tax benefit provided by s.82AAC**. The creation of the unit trust, and the allocation of units in the trust to the trustees of the family trust, together with the employment agreement, viewed objectively, **can only be regarded as an attempt to split the income from Dr Watson's practice, and thus to avoid tax which Dr Watson would otherwise have paid**, or to alter the incidence of the tax payable on that income. **I am unable to agree that tax avoidance was an inessential or incidental feature of the arrangement**. At the very least it was one of the main purposes of the arrangement and s.260 accordingly applies. [Emphasis added.]

It is clear that Gibbs CJ considered the incorporation arrangements bore on their face "an indication of a purpose to avoid tax" that was not an "inessential or incidental feature of the arrangement". His Honour did not consider "the desire to make adequate provision for the superannuation of Dr Watson and to benefit the members of his family" outweighed those tax avoidance purposes or features. Nevertheless, as noted above, his Honour accepted there was "truth in [the] statement" that:[58]

> … **standards of ordinary acceptable conduct [had] changed since *Peate* had been decided two decades previously and practices then unacceptable in a profession are now tolerated** for the very reason that persons engaged in a profession would otherwise be in a position of disadvantage, from a taxation point of view, when compared with tradesmen and proprietors of small businesses. [Emphasis added.]

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54 [1985] HCA 83; (1985) 160 CLR 55; 17 ATR 1.

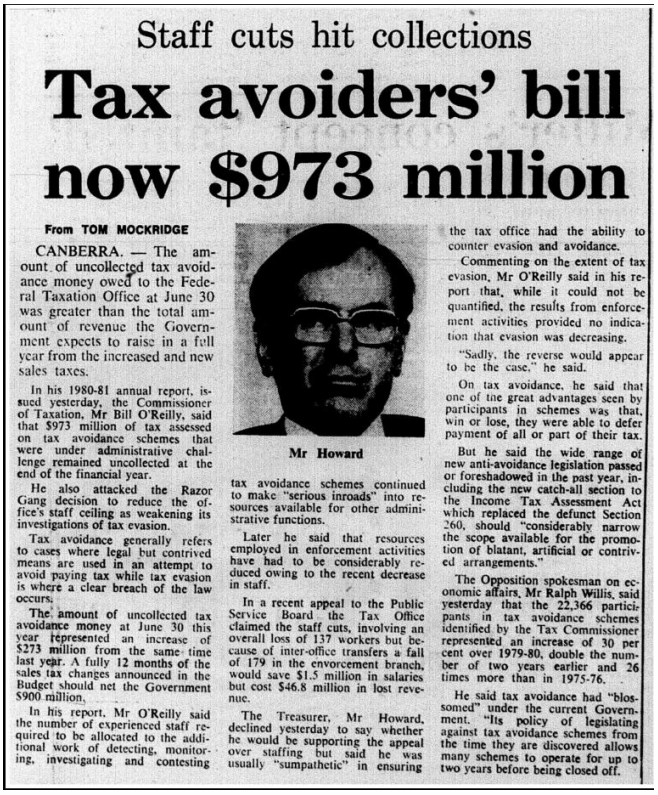
55 [1985] HCA 83; (1985) 160 CLR 55; 17 ATR 1 at 10.

56 Idem.

57 Idem.

58 Idem.

One wonders whether in 2019 the High Court would have reached the same decision on the facts in *Gulland*, given developments in relation to professional practices since 1985 and, in particular, the Commissioner's guidelines issued in 2014 regarding *Assessment of risk: Allocation of profits within professional firms*.[59]



Staff cuts hit collections

Tax avoiders' bill now $973 million

From TOM MOCKRIDGE

CANBERRA. — The amount of uncollected tax avoidance money owed to the Federal Taxation Office at June 30 was greater than the total amount of revenue the Government expects to raise in a full year from the increased and new sales taxes.

In his 1980-81 annual report, issued yesterday, the Commissioner of Taxation, Mr Bill O'Reilly, said that $973 million of tax assessed on tax avoidance schemes that were under administrative challenge remained uncollected at the end of the financial year.

He also attacked the Razor Gang decision to reduce the office's staff ceiling as weakening its investigations of tax evasion.

Tax avoidance generally refers to cases where legal but contrived means are used in an attempt to avoid paying tax while tax evasion is where a clear breach of the law occurs.

The amount of uncollected tax avoidance money at June 30 this year represented an increase of $273 million from the same time last year. A fully 12 months of the sales tax changes announced in the Budget should net the Government $900 million.

In his report, Mr O'Reilly said the number of experienced staff required to be allocated to the additional work of detecting, monitoring, investigating and contesting

Mr Howard

tax avoidance schemes continued to make "serious inroads" into resources available for other administrative functions.

Later he said that resources employed in enforcement activities have had to be considerably reduced owing to the recent decrease in staff.

In a recent appeal to the Public Service Board the Tax Office claimed the staff cuts, involving an overall loss of 137 workers but because of inter-office transfers a fall of 179 in the envorcement branch, would save $1.5 million in salaries but cost $46.8 million in lost revenue.

The Treasurer, Mr Howard, declined yesterday to say whether he would be supporting the appeal over staffing but said he was usually "sumpathetic" in ensuring the tax office had the ability to counter evasion and avoidance.

Commenting on the extent of tax evasion, Mr O'Reilly said in his report that, while it could not be quantified, the results from enforcement activities provided no indication that evasion was decreasing.

"Sadly, the reverse would appear to be the case," he said.

On tax avoidance, he said that one of the great advantages seen by participants in schemes was that, win or lose, they were able to defer payment of all or part of their tax.

But he said the wide range of new anti-avoidance legislation passed or foreshadowed in the past year, including the new catch-all section to the Income Tax Assessment Act which replaced the defunct Section 260, should "considerably narrow the scope available for the promotion of blatant, artificial or contrived arrangements."

The Opposition spokesman on economic affairs, Mr Ralph Willis, said yesterday that the 22,366 participants in tax avoidance schemes identified by the Tax Commissioner represented an increase of 30 per cent over 1979-80, double the number of two years earlier and 26 times more than in 1975-76.

He said tax avoidance had "blossomed" under the current Government. "Its policy of legislating against tax avoidance schemes from the time they are discovered allows many schemes to operate for up to two years before being closed off.

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59 See: https://www.ato.gov.au/business/income-and-deductions-for-business/in-detail/professional-firms/assessing-the-risk--allocation-of-profits-within-professional-firms/ (accessed 24 February 2019). Before this publication was withdrawn, the Commissioner referred to a number of practice structures, including companies and trusts, established by "individual professional practitioners" (IPPs), and set out the circumstances in which he did not consider that Part IVA would apply.

5.7 Can "*family dealing*" cease to be "*ordinary*", on basis it is complicated?

A related question is whether family dealings *cease* to be, or *cannot be*, "ordinary", if they are complex or complicated.

Statements by Heerey J in *Rippon v FCT*[60] (discussed in Part 5.2.4 above) suggest problems arise if a dealing is *artificial*, rather than complex. If a structure or transaction is explicable by reference to ordinary business and family arrangements, then complexity, in itself, should not cause issues.

In more detail, Heerey J stated:[61]

> 13. First, **the complexity of the structure is only of relevance insofar as that complexity in itself predicates that the structure was established for the purpose of tax avoidance. What is important for the purpose of s.260 is not so much complexity as artificiality**. If the structure adopted is explicable by reference to ordinary business and family arrangements, then complexity as such does not attract the operation of s.260.
>
> 14. Counsel for the Commissioner could not suggest any tax-related reason which explained the use of two trusts rather than one. One obvious non-tax reason which springs to mind is that the unit trust would be convenient in the future were the taxpayer to take a partner into the business. Units could be allotted to the new partner who could then make such personal trust arrangements as suited his or her own circumstances. As the taxpayer said in evidence, the business was very new, and he was concerned to provide "the maximum flexibility for whatever might occur in the future years."

His Honour concluded:[62]

> 22. **A person with a family who establishes a business will often want to use a legal structure to achieve the result that some or all of the financial benefits which, hopefully, the business will generate will go to family members. Both legal obligation and natural love and affection encourage such an objective. The adoption of a structure that will achieve it is, to my mind, an ordinary family dealing**. [Emphasis added.]

The decision of Heerey J was upheld by the Full Federal Court (Lockhart, Beaumont and Foster JJ), where their Honours stated:[63]

> In our opinion, it was reasonably open to his Honour to conclude, as he did, that the structure did not, on its face, bear the stamp of tax avoidance.

As suggested in Part 5.4.2 above, the legal structures used by families in 2019 are far more complex than in the late 1970s, and even in the early 1990s.

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60 [1992] FCA 172; (1992) 23 ATR 209

61 (1992) 23 ATR 209 at 212.

62 (1992) 23 ATR 209 at 214.

63 (1992) 24 ATR 119 at 124.

5.8 If agreement is "ordinary family dealing", does it matter the main purpose is tax avoidance?

A final question is whether the fact an agreement can be characterized as an "*ordinary family dealing*" means one can disregard the fact the "*family*" purpose is subsidiary to the main purpose of tax avoidance?

As noted by Mr Justice Pagone (in a paper written while his Honour was still at the Bar), in the Explanatory Memorandum that accompanied the introduction of Part IVA, the Treasurer:[64]

> … **placed emphasis on Part IVA applying to tax avoidance arrangements** that were "blatant, artificial or contrived" and **not transactions of a kind that might be thought to be "of a normal business or family kind, including those of the tax planning nature"**.[65] [His Honour's emphasis.]

Mr Pagone continued:

> In that regard, it was significant that tax **planning** as such was not thought to be within the scope of Part IVA. [Original emphasis.]

As noted in Part 5.2.4 above, in *Rippon v FCT* Heerey J indicated that:[66]

> … an arrangement **does not necessarily bear the stamp of tax avoidance, notwithstanding** that the person establishing the structure **may be better off in terms of his personal tax liability**. [Emphasis added.]

It is therefore suggested that the fact that a family dealing has as its purpose the reduction or avoidance of tax, and perhaps has that as its main purpose, should not prevent the "ordinary family dealing" exception in section 100A applying.[67]

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64 G.T. Pagone QC, *Where Are We With Part IVA? Current Issues Involving Part IVA* (unpublished paper, 28 March 2007).

65 House of Representatives, *Income Tax Law Amendment Bill (No. 2)*, Explanatory Memorandum at 2-18

66 [1992] FCA 172; (1992) 23 ATR 209 at 214.

67 See also *FCT v Prestige Motors Pty Ltd* (1998) 38 ATR 568, where Hill & Sackville JJ stated (at 592) that:

> ... we do not need to decide whether if an agreement is shown to have been "entered into the course (sic) of ordinary commercial dealing", the operation of s. 100A is spent, regardless of whether the commercial purpose was subsidiary of the purpose of tax avoidance. In our view, none of the transactions [in the present case] was entered into in the course of ordinary commercial dealing.

6 Cases on Section 100A

Although there have been a number of cases where the potential application of section 100A has been considered, none of those decisions examined what could be described as "*ordinary family dealing*" or provides any real guidance on the meaning of "*ordinary*".

In *East Finchley Pty Ltd v FCT,*[68] the trustee of a family trust resolved to distribute $585.00 to each of 126 non-resident beneficiaries, where the clear expectation was those beneficiaries would lend the relevant amounts back to the trustee.

The AAT held that the relevant agreements were not entered into in the course of ordinary family or commercial dealing and the relevant purpose of tax avoidance in section 100A(8) was present.[69]

In the Federal Court, Hill J held that the Tribunal had committed an error of law by not including in its written reasons for decision its findings of facts as to whether any persons were presently entitled to income of the trust estate.[70] His Honour therefore remitted the case back to the AAT and did not address the question of whether the transactions were ordinary family dealings. The subsequent hearing in the AAT does not appear to have been reported (or, possibly, the matter was settled).

In *FCT v Prestige Motors Pty Ltd*,[71] the Federal Court considered a complicated transaction involving the sale of the business to a unit trust, where the profits from the business where intended to be distributed to a unit holder with losses. This certainly was not a family dealing and it does not appear to have been strongly pressed that the arrangements involved an "*ordinary commercial dealing*".

In *Idlecroft Pty Ltd v FCT,*[72] two entities—one of which had substantial losses—entered into a joint venture agreement with the intention any profits should be absorbed by the loss trust. Again, the transaction did not involve a family dealing in any relevant sense.

In *Raftland Pty Ltd v FCT*,[73] a substantial distribution was also made to a "loss trust", where a fee was paid to the previous controllers of that trust. Justice Kiefel held, at first instance, that the transaction was not a commercial dealing and that finding was not disputed on appeal.

Put at its simplest, the facts in the above cases involved reasonably extreme facts and did not involve the fact patters similar to those considered, on a regular basis, by SME tax practitioners.

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68 [1989] FCA 720; (1989) 20 ATR 1623.

69 *AAT Case* 5153 (1989) 20 ATR 3662 at 3668.

70 [1989] FCA 720; (1989) 20 ATR 1623 at 1634.

71 [1998] FCFCA; (1998) 38 ATR 568.

72 [2005] FCFCA 141; (2005) 60 ATR 224.

73 [2008] HCA 21; (2008) 68 ATR 170.

7 What would Lord Denning have said?

So what would Lord Denning M.R.—widely regarded as the finest judge of the twentieth century—have said if asked in 2019 to rule again on the meaning of "*ordinary family dealing*"?[74]

It is very respectfully suggested his Lordship would have agreed that the transfer and redistribution of assets between family members is, and continues to be, an "ordinary" dealing. The decisions in *Peacock v FCT*, *Jones v FCT* and *Bayly v FCT* are further examples of the dealing in *Purcell v FCT*, which Lord Denning clearly accepted was "*ordinary*".

Again, it is very respectfully suggested his Lordship would agree the use of trusts and companies to own assets is an "ordinary" family dealing, and would agree that the touchstone is artificiality, not complexity.

As noted by Heerey J in *Rippon v FCT*, the use of trusts by Mr Rippon was:[75]

> … comparable to one of the examples of ordinary business or family dealings given by the Privy Council in Newton immediately following the passage quoted in this judgment, viz a declaration of trust made by a father in favour of his wife and daughter: see 98 CLR at 9. **Whether the structure actually chosen is a company with different classes of shares or a discretionary trust or a combination of both, such an arrangement does not necessarily bear the stamp of tax avoidance**, **notwithstanding** that the person establishing the structure may be **better off in terms of his personal tax liability** compared with his position were he to embark on the new venture as a sole trader on his own account. [Emphasis added.]

Lord Denning would almost certainly continue taking the position that arrangements that are "artificial", as opposed to simply being complex—and which involve a number of interconnected steps or transactions—some of which possibly cannot be explained other than for the purpose of avoiding tax (for example, a dividend stripping operation)—are **not** "ordinary".

It is interesting to note, however, that Lord Denning did ***not*** believe it could be predicated that the arrangements in *W. P. Keighery Pty Ltd v FCT*[76] were implemented to avoid tax

Those arrangements converted the taxpayer from a private company into a public company and, in the process, avoided a large assessment for undistributed profits tax.

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74 *Lord Denning, the century's greatest judge, dies at 100* (The Independent, 6 March 1999), see: https://www.independent.co.uk/news/lord-denning-the-centurys-greatest-judge-dies-at-100-1078587.html.

75 (1992) 23 ATR 209 at 214.

76 (1957) 100 CLR 66.

In *W. P. Keighery Pty Ltd*, Mr and Mrs Keighery, and their son Patrick, held 75% of the shares in Aquila Steel Pty Ltd (**ASPL**), while a Mr White held the remaining 25%. ASPL had a significant amount of profits available for distribution.

If ASPL had distributed those profits as dividends, they would have been "*largely absorbed by income tax assessed against [the shareholders] individually*". If the profits remained undistributed, the tax payable under Division 7 of the ITAA 1936 would also have "*absorb[ed] a large proportion*" of those profits.[77]

On the advice of their professional advisors:

1. On 20 June 1952, Mr and Mrs Keighery incorporated the taxpayer (**WPK**), with Mr and Mrs Keighery being the sole directors of WPK and the only shareholders (owning three and one ordinary shares respectively).

2. On 25 June 1952, the Directors of WPK (Mr and Mrs Keighery) resolved to purchase the ASPL shares from Mr and Mrs Keighery and Patrick.

3. On 27 June 1952, at an EGM of WPK (attended by Mr and Mrs Keighery), it was resolved to issue 100 redeemable preference shares, which carried the right to vote.

4. At a Meeting of Directors of WPK on the same day, it was resolved to issue one [1] redeemable preference share to each of twenty [20] unrelated individuals who had applied for same, being friends or acquaintances of Mr Keighery.

   > Those preference shares carried a dividend entitlement equal to 1/2,000th of any dividend paid on the ordinary shares and could be redeemed by the company on 7 days' notice.
   >
   > As a practical matter, Mr and Mrs Keighery could therefore at any time—albeit subject to 7 days' notice—redeem the preference shares and ensure they were the company's only shareholders.

5. By 30 June 1952, ASPL paid a dividend to WPK equal to its undistributed net profit, which was tax-free in WPK's hand owing to the intercorporate dividend rebate.

If WPK was a "*private company*" on 30 June 1952, WPK would have been liable to undistributed profits tax under Division 7. For this purpose, a company was a private company if it was:

> … capable of being controlled by any means whatever by one person or by persons not more than seven in number.

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[77] (1957) 100 CLR 66 at 91-92.

The Commissioner argued that on the last day of the income year, being 30 June 1952, Mr and Mrs Keighery, being less than seven persons, were capable of controlling the company by simply redeeming the preference shares.

However, the High Court held WPK was ***not*** a private company. That was because, on 30 June 1952, Mr and Mrs Keighery were ***not*** in fact "*capable*" of "*controlling*" WPK—since the power to redeem the preference shares was inoperative until 7 July; there was on 30 June no presently existing power of control.

Dixon CJ, Kitto and Taylor JJ stated (at 91-92):

> It is beyond question that the whole plan was carefully designed as a means of dealing with a problem of a familiar kind. … The course adopted was planned mainly, though perhaps not exclusively, with the object of enabling Aquila Steel to distribute its profits, so as not to incur Div. 7 tax, without causing any consequential increase in the assessable incomes of Mr. and Mrs. Keighery and their son. The appellant company was brought into being so that it might be interposed between Aquila Steel and the Keigherys, and **its affairs were so regulated that the dividend which it would receive from Aquila Steel might be retained by it and yet might be immune from Div. 7 tax**. **Mr. Keighery was cross-examined before the learned primary judge, and he was quite candid about the plan. …** He was asked: "The **object of the company** (in) making the allotment (of the preference shares) **was so that the company would not be required**, in your understanding, **to pay Div. 7 tax, or further tax on its undistributed profits; is that right**?" And he replied: "That is so. We attempted to attain public company status." [Emphasis added.]

Their Honours continued (at 92):

> **It would be a fair inference from the evidence that all the persons who took those shares**, and not only those of them who were acquaintances of Mr. Keighery, **did so by way of obliging him by assisting him to bring about a tax result that he desired**. There was nothing dishonest in it, from anyone's point of view; but **all concerned must have realised that they were participating in a course of action which had no substantial practical significance apart from its effect on income tax** (and possibly, as Mr. Keighery suggested in cross-examination, on probate duties). Still, so far as appears, the applications for shares were genuine, and the allotments were genuine. Hence the commissioner's need to rely upon s. 260. [Emphasis added.]

Their Honours concluded (at 93-94):

> The very **purpose or policy of Div. 7** is to present the **choice to a company between incurring the liability it provides and taking measures to enlarge the number capable of controlling its affairs. To choose the latter course cannot be to defeat evade or avoid a liability** imposed on any person by the Act or to prevent the operation of the Act. For that simple reason the attempt must fail, and the Commissioner cannot rely upon s. 260 … . [Emphasis added.]

It will be recalled that 7 months later Lord Denning stated in *Newton*:[78]

> Nor can anyone, by seeing a private company turned into a non-private company, predicate that it was done to avoid Div. 7 tax, see *W. P. Keighery Pty Ltd v Commissioner of Taxation* …

and that one had:

> … to acknowledge that the transaction [was] capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax.

Lord Denning clearly envisaged that if a corporate taxpayer made a choice between: (i) incurring a liability for undistributed profits tax under Division 7; and (ii) taking measures to enlarge the number capable of controlling the company's affairs, it could **not** be predicated that the choice was made to avoid tax and, instead, that the choice was an "*ordinary business or family dealing*".

His Lordship does not appear to have been too concerned that measures taken to give effect to that choice were not entirely straight forward—in that those measures involved the issue of low value preference share to a significant number of friends and colleagues. The High Court stated:[79]

> There was nothing dishonest in it, from anyone's point of view; but **all concerned must have realised that they were participating in a course of action which had no substantial practical significance apart from its effect on income tax**. [Emphasis added.]

While Part IVA only contains a limited "choice principle",[80] there is nothing that immediately excludes the very broad "choice principle" in section 260 from applying with section 100A.

Without meaning to pre-empt the discussion in Part 8 of this paper, it is respectfully submitted his Lordship would **not** have considered that the release or gifting of UPEs by beneficiaries could be predicated as being done to avoid tax.

Instead, it is respectfully submitted his Lordship would consider such a release or gifting of UPEs to be an ordinary family dealing that would be undertaken (in the words of Heerey J in *Rippon*):[81]

> … to achieve the result that some or all of the benefits which, hopefully, the business [or investments] will generate will go to family members [where] such an arrangement does not necessarily bear the stamp of tax avoidance, notwithstanding that the [persons involved with the arrangement] may be better off in terms of [their] personal tax liability.

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78 The High Court's judgment in *Keighery* was handed down on 19 December 1957, while the Privy Council's reasons in *Newton* were delivered on 7 July 1958.

79 (1957) 100 CLR 66 at 92.

80 ITAA 1936, section 177C(2). See also *Walters v Commissioner of Taxation* [2007] FCA 1270.

81 (1992) 23 ATR 209 at 214.

A “dealing” involving UPEs is typically a simple, one-step, transaction akin to transferring shares cum dividend (which has the effect of the transferor realizing a capital gain, rather than receiving dividend income) or the issue of preference shares in *Keighery* (which converted the taxpayer into a public company and thus was not liable to undistributed profits tax). There is no artificiality in sense described by Lord Denning in *Newton*.

Understandably, however, taxpayers and their advisors are keen to know where the line will be drawn; and there is a clear expectation in the tax professional community that the Commissioner should provide guidance in that regard.

8 ATO's Guidance and Views

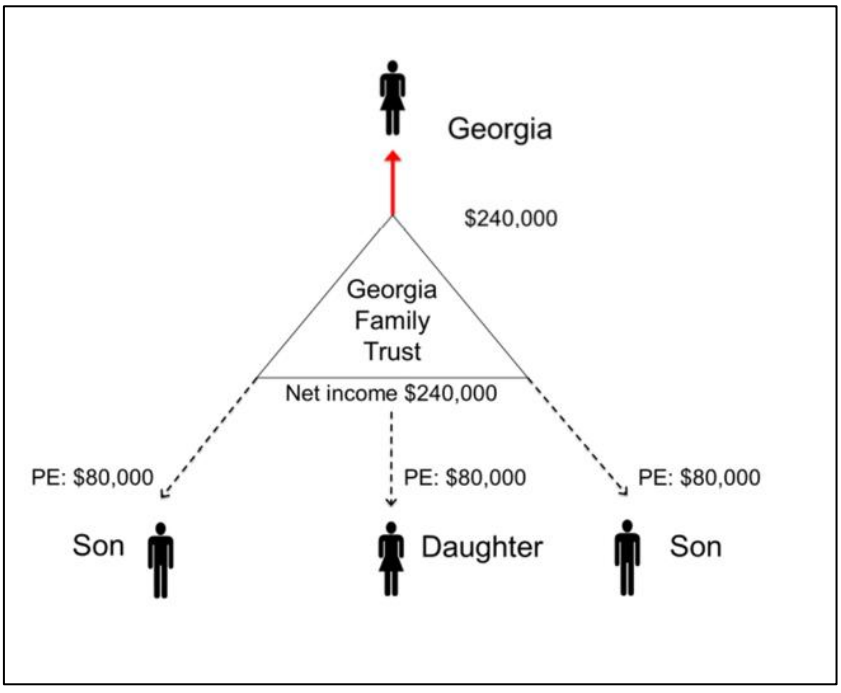
8.1 ATO interest in section 100A

It is reasonably well-known that the ATO has been considering the potential operation of section 100A for the last few years and on 12 May 2016 posted a document on its website entitled, *Trust Taxation—reimbursement agreement.*[82]

It is not intended to review that guidance or the historical background in any detail,[83] save to note the various issues were discussed at the Taxation Institute's 2018 National Convention last March.

8.2 Tax Institute National Convention (March 2018)

At the 2018 National Convention, in a paper entitled "*What's attracting Commissioner's attention*", the following example was discussed:[84]



82 https://www.ato.gov.au/general/trusts/in-detail/distributions/trust-taxation---reimbursement-agreement/ (accessed 22 February 2019).

83 For a comprehensive review, see Sokolowski & Lowdon, Footnote 2, above.

84 Will Day & Jade Isaacs, *What's Attracting the Commissioner's Attention*, (The Taxation Institute, 33rd National Convention, 14 March 2018),

In that example, the Georgia Family Trust has distributed its net income of $240,000 to 3 children. The issue is whether the gifting of the entitlements of the 3 children back to Georgia would be part of a "*reimbursement agreement*" that was not entered in the course of ordinary family or commercial dealing.

The various issues are considered further in Case Studies 2 and 3 below. Suffice to say that it is suggested the dealing in the Georgia Family Trust example clearly takes place in a family context and involves measures taken, within a family, voluntarily, for the benefit of the family members.

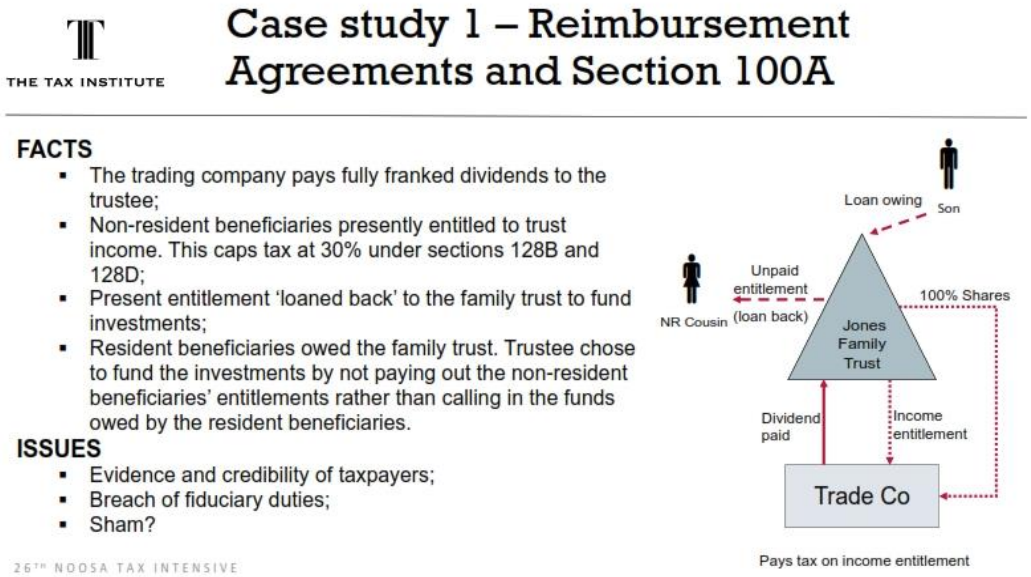
As argued above, this is a simple, one-step, transaction akin to transferring shares cum dividend or the issue of preference shares in the *Keighery* case. There is no artificiality in the *Newton* sense.

8.3 Case Studies at Noosa Tax Intensive (October 2018)

At The Tax Institute's 2018 National Tax Intensive Conference in October 2018, three further Case Studies were considered by Ms Fiona Knight (Assistant Commissioner, ATO).[85]

8.3.1 Case Study 1

Case Study 1 was illustrated by the following PPT slide:



Case Study 1 involved the Jones Family Trust creating an entitlement in a non-resident cousin, which is "*loaned back*" to the Family Trust to fund investments.

The ATO's concern appears to be that a resident beneficiary owes monies to the Family Trust and the Trustee has chosen to fund the Trust's investments by: (i) not paying out the **non**-resident beneficiaries' entitlements; rather than (ii) calling in the moneys owed by the **resident** beneficiary.

At first sight, this arrangement potentially bears some similarities to that considered in *East Finchley Pty Ltd v FCT* (see Part 6 above). However, *East Finchley* involved distributions to 126 beneficiaries, whereas there is no suggestion in the Case Study 1 that large numbers of potential family members were involved.

If a distribution is made to a genuine beneficiary of the Trust (in the sense the beneficiary is within one of the classes of discretionary beneficiary), the fact the Trustee chooses not immediately to pay out the entitlement in cash—and the non-resident chooses not to insist on payment—is surely beside the point.

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[85] Fiona Knight, *ATO Hot Spots* (The Taxation Institute, National Taxation Intensive Conference, Noosa, October 2018).

As argued above, this is a simple "family dealing" that contains no unusual features, in a family context, and thus cannot be described as anything but "ordinary".

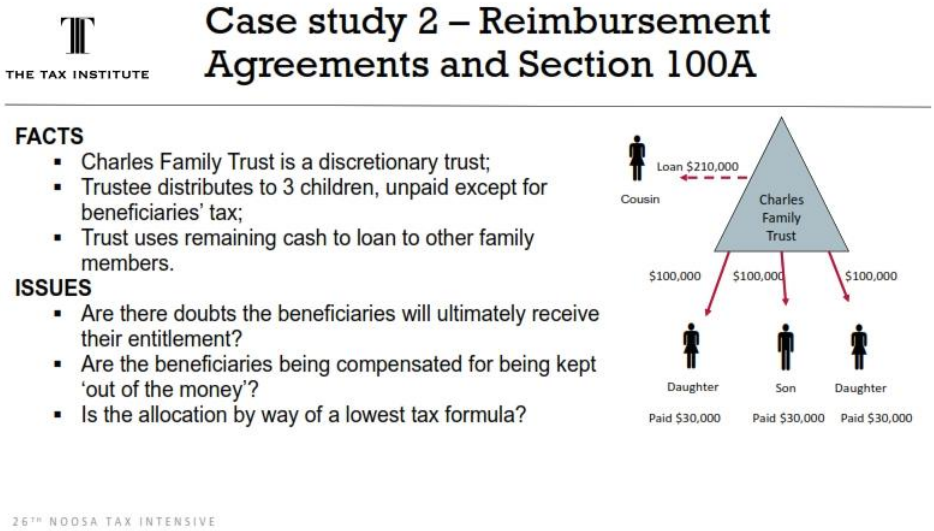
It will be recalled that the Federal Court indicated in *Prestige Motors* that section 100A is not restricted to "*trust stripping*" schemes, and such schemes are simply one example of the type of tax avoidance that could be dealt with using section 100A. At the same time, however, the Federal Court's comments support the view that section 100A is directed at tax avoidance schemes, and not legitimate tax planning in a family context.

Case Study 1 also raises several issues regarding the evidence and credibility of the taxpayers and the possibility of breach of financial duties, and raises the spectre of "sham".

However, if: (i) the Trustee has resolved, after consideration, to make the distributions; (ii) the distributions are made to beneficiaries of the Trust who acknowledge the distributions have been made; and (iii) the distributions are properly documented, it is difficult to see how it could be argued there was any "sham" or on what basis the distribution could be challenged.[86]

8.3.2 Case Study 2

Case Study 2 involved certain facts not dissimilar to those raised in the Georgia Trust example discussed at The Tax Institute's 2018 National Convention:



The Charles Family Trust has distributed $30,000 to 3 beneficiaries of the Trust, where the entitlements have remained unpaid, except for the amounts required to discharge the beneficiaries' tax obligations. The Trust has used the remaining (after-tax) cash to make a loan to another family member.

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[86] This paper will not examine the concept of "sham" but will simply note that the issue of sham, and the legal effect of certain transactions, was considered in some detail in *Raftland Pty Ltd v FCT* [2008] HCA 21; (2008) 68 ATR 170.

The ATO raises 3 issues.

First, are there doubts whether the beneficiaries will ultimately receive their entitlements?

In response, and at first sight, provided the entitlements have been properly created, the children could legally enforce those entitlements—regardless of the fact they might choose not to. The legal and equitable rights of the children, *vis-a-vis* the Trustee, cannot simply be ignored.

Indeed, there have been a number of cases (which, presumably for reasons of confidentiality, have not been reported and/or widely discussed), where disgruntled family members (in particular, adult children) have instituted proceedings to recover amounts distributed to them and in respect to which they have had legally enforceable entitlements.[87]

As noted by Justice Brereton:[88]

> As a member of the family will often hold the position of trustee, it is important that he or she understands the duties that the law imposes on trustees, as fiduciaries in respect of trust property and administration of the trust. Even though they may consider trust property to be 'their' property, that this is not the case and that special duties and responsibilities must be fulfilled. **While child beneficiaries may be kept in ignorance while a parent manages a trust, ostensibly created for the benefit of the children, for years, subsequent discovery of a history of breaches of trust and use of its assets for the benefit of the parent not infrequently produces bitter litigation**. [Emphasis added.]

Second, the ATO asks whether the beneficiaries are being compensated for "*being kept out of the money*"; and let it be assumed the beneficiaries are not being paid any interest.

With respect, it would be abnormal or unusual for a Trustee to pay interest in a family situation. The "ordinary" manner of dealing is for such amounts to be left outstanding on an interest-free basis.

Third, the ATO raises the question whether the allocation of net income is "*by way of a lowest tax formula*".

With respect, if that gives the ATO concerns, they may need to reconsider and review "*ordinary family tax arrangements*" for the last 40 or 50 years.

Trust distributions are typically—indeed invariably—designed to ensure the least possible amount of tax overall is paid.

For example, in the 1973 edition of *Australian Tax Planning,* Mr Phillip Adams QC openly discussed the income tax and estate duty advantages of a taxpayer settling part of their income-producing producing property for the benefit of other family members.[89]

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87 See also: *Fisher v Nemeske Pty Ltd* [2016] HCA 11, where a family trust made a distribution of capital to the husband and wife who controlled a trust, which was left outstanding as a secured loan. After the death of the husband and wife, their executors demanded repayment of the loan from the trustees of the trust. The High Court held, by majority, that the loan/debt/entitlement was a legally enforceable obligation which the executors could seek to recover.

88 *A Trustee's Lot is Not a Happy One: Discretionary Trust and Superannuation Funds* (National Family Law Conference, Canberra, 19 October 2010).

89 P R Adams QC, *Australian Tax Planning* (Butterworths, 1973) at p 64.

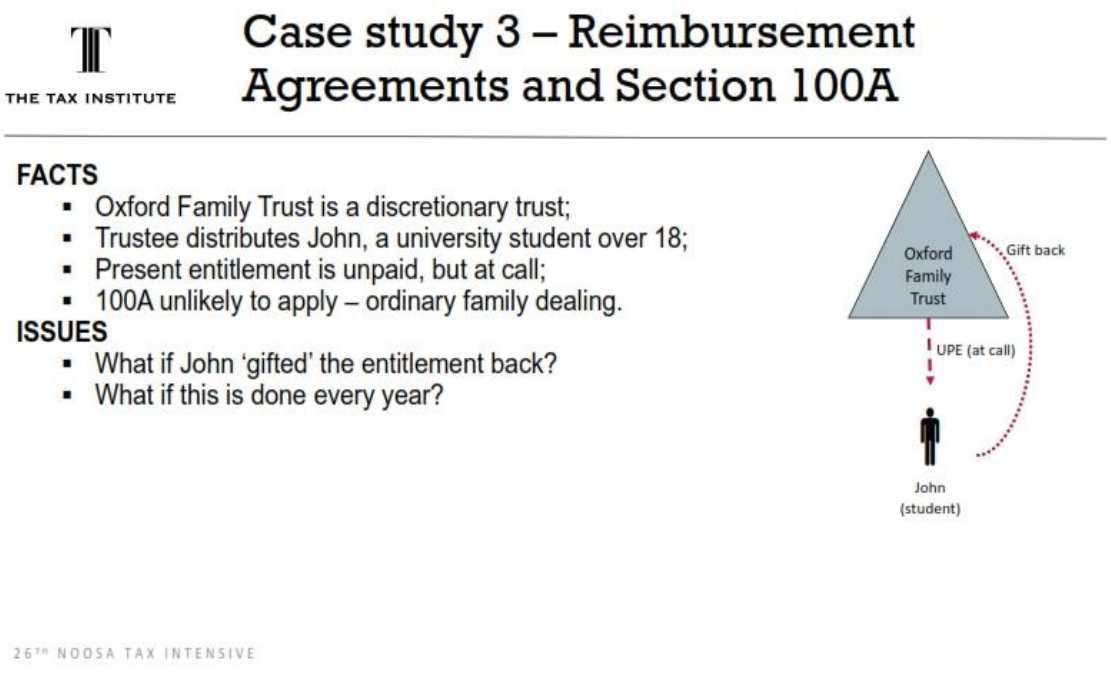
As noted in Part 5.8 above, in the Explanatory Memorandum for Part IVA it was noted that:

> … transactions of a normal business or family kind, **including those of a tax planning nature**, will not be subject to the new rules. [Emphasis added.]

Family tax planning was therefore clearly envisaged as an ordinarily family dealing; and it respectfully suggested the type of planning considered in Case Study 2 (and Case Studies 1 and 3) is precisely the type of "dealing" that, in 2019, is "ordinary" between the members of families.

8.3.3 Case Study 3

Case Study 3 also involves some facts that are not dissimilar to those raised in the Georgia Trust example discussed at the 2018 National Convention:



The Trustee of the Oxford Family Trust distributes to John, a university student over 18—by which one assumes John has no other sources of income and is financially dependent on his parents—where the present entitlement is unpaid but "at call".

Case Study 3 accepts, uncontroversially, that section 100A is "*unlikely to apply – ordinary family dealing*". However, the Case Study raises as an issue the position if John "*gifted*" his entitlement back to the Trustee and the implications of this being done every year.

By referring in quotes to John "*gifting*" the entitlement back, the ATO appears to be suggesting this is a "***Clayton's gift***"—that is, the gift you make when you are not really making a gift.[90]

It is respectfully suggested that if John subsequently chooses, as an adult, to give his entitlement back to the Trust, or to another family member, the Commissioner will face a high evidentiary hurdle to demonstrate John was coerced and that there was no genuine gift.

The ATO presumably takes the view that if a gift back takes place every year, there is a pattern of conduct demonstrating there is not really a gift but, instead, a tax avoidance plan potentially liable to the operation of section 100A.

As demonstrated by the cases referred to above, this is a "*dealing*" between the members of a "*family*" that is "*ordinary*". It is done, for reasons of love and affection—the very purposes raised and considered in *Purcell*, *Bayly*, *Jones* and *Rippon*. Indeed, the arrangement is far simpler than that arrangement considered quite acceptable in *Keighery*; and again there is no artificiality.

8.3.4 What position will Commissioner take in proposed Ruling?

On the basis of the ATO's comments over the last few years, and the ATO's examples and case studies, one would expect that the proposed Ruling will express the view that certain transactions between trusts and family members will ***not*** be "ordinary dealings" for section 100A purposes.

Based on the ATO document, *Trust taxation—reimbursement agreement*,[91] it may well be the Ruling will provide a number of reasonably extreme examples, where there may be a basis for suggesting section 100A should apply. It is also likely the Ruling will include a number of other examples, where section 100A clearly will not apply.

What is to be hoped, however, is that the Ruling will include a number of examples where the position is less clear ("borderline") but where the Commissioner expresses a firm view, one way or the other.

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90 Per Wikipedia: https://en.wikipedia.org/wiki/Claytons:

> **Claytons** is the brand name of a non-alcoholic, non-carbonated beverage coloured and packaged to resemble bottled whisky. It was the subject of a major marketing campaign in Australia and New Zealand in the 1970s and 1980s, promoting it as "**the drink you have when you're not having a drink**" at a time when alcohol was being targeted as a major factor in the road death toll. …
>
> The product has not been advertised on television for 30 years (as of 2015), yet it remains widely known. The name has entered into Australian and New Zealand vernacular where it stands for an ersatz or dummy thing, or something that is obviously ineffective. For example, a common-law couple might be described as having a "Claytons marriage". A knowledgeable but unqualified handyman could be referred to as a "Claytons carpenter". The term can also be used as an insult.

91 *https://www.ato.gov.au/general/trusts/in-detail/distributions/trust-taxation---reimbursement-agreement/*.

9 Next steps?

When the Commissioner issues his much-anticipated Ruling on this issue, it is likely he will disagree with the views advanced above; and it is accepted this will reflect the fact that the expression "*ordinary family dealing*" will often mean different things to different people.

After the release of the draft Ruling, there will possibly be a call for a test case in order to obtain judicial clarification.

As argued above, section 100A was clearly introduced, and intended, to prevent tax *avoidance* and not legitimate *tax planning* in a family context. Such legitimate planning has been taking place for at least the last 40 or 45 years, and should not be disturbed by a literal approach to section 100A that disregards the clear context in which the provisions were introduced.

With respect, if the Commissioner believes taxpayers shouldn't enter into arrangements such as those raised in the above Case Studies, that is tantamount to saying taxpayers should not be allowed to split their income; and taxpayers have been able to do that, legitimately, since the mid to late 1970s.

If there is perceived to be a problem, surely that is precisely the reason the *Income Tax Assessment Act* contains Part IVA.

Michael Butler
Finlaysons
March 12, 2019

Annexure A

1978

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

INCOME TAX ASSESSMENT AMENDMENT BILL (NO. 5) 1978

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer, the Hon. John Howard, M.P.)

Introductory note

The purpose of this memorandum is to explain the provisions of the above Bill. The provisions are designed to counter tax avoidance and cover three main matters.

The first concerns "pre-payment" schemes under which taxpayers seek to achieve deductions in excess of net outlays on deductible items. Deductions will be denied in these cases. The measures will also apply to tax avoidance arrangements between associated taxpayers under which the taxation of the amount passing between the parties is deferred to a later year.

A second set of provisions is designed to overcome a High Court decision that the existing trust provisions in Division 6 of the Income Tax Assessment Act (the "Principal Act") only have application to Australian source income of trusts. As the law now stands, Australian residents can defer, or escape completely, the payment of tax on foreign source income accumulated in trusts for their benefit. Associated measures relating to partnerships are designed to remove any doubt, arising from the Court decision, about the application of the partnership provisions of the income tax law to partnership income from sources out of Australia.

A third set of provisions is designed to counter trust-stripping schemes which attempt to pass income derived by trusts on to beneficiaries in a tax-free form.

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Pre-paid outgoings and arrangements between associated parties for deferral of tax

(Clause 6)

This clause will incorporate into the Principal Act additional provisions to counter schemes for tax avoidance that fall within two general categories.

Under one category of schemes, the most common of which are known as "pre-paid interest" and "pre-paid rent" schemes, a taxpayer incurs and pre-pays a liability for interest, rent or other outgoings of a tax deductible nature.

Under the pre-paid interest schemes, a taxpayer seeks to obtain a deduction for an amount far in excess of his net outlay in what is essentially a transaction arranged to manufacture a tax deduction. This is because payment of the interest for which a deduction is sought gives rise to a corresponding reduction in the amount of loan moneys that are effectively to be repaid.

Under the pre-paid rent schemes, a taxpayer seeks to obtain a deduction, in the form of rent, for the major part of the cost of a capital item such as a building for which no tax deduction is available if acquired by a straight forward purchase.

The new provisions are directed to ensuring that no deductions will be allowable in respect of expenditure incurred under such schemes where the expenditure is incurred after 19 April 1978, the date on which the amendments were announced.

Schemes within the other category involve arrangements between associated parties for the purpose of securing that one party will obtain a deduction while the other party will not bear tax on a matching amount in the same year of income. The associated parties thus aim to defer income tax liabilities.

The new provisions, to be effective from 20 April 1978, will deal with schemes of this nature in two ways. In cases involving outgoings in respect of the future provision of goods or services, a deduction is to be available in a particular year of income only for so much of the particular outgoing as is reasonable having regard to the extent to which goods or services were provided in that year. In other cases, the level of a deduction in a particular year of income is to be limited to any amount actually paid in that year.

Foreign source income of trusts for Australians

(Clauses 3 to 5, 10 to 17, 19 and 21)

The broad policy underlying the income tax law is that residents are liable to tax on income from all sources, whether in or out of Australia, at the time that it is derived, but subject to measures to prevent double taxation of foreign source income that has been taxed abroad.

However, in *Union Fidelity Trustee Co. of Australia Ltd v. F.C. of T.* (1969) 119 C.L.R. 177, the High Court held that, in calculating the net income of a trust estate for the purposes of Division 6 of Part III of the Principal Act (the part of the Act dealing with the taxation of trustees and beneficiaries), only income from sources in Australia could be taken into account. Income of a trust estate from foreign sources could not be taxed under that Division as it was derived, but only at the time when a resident beneficiary received the income (section 26(b)). An effect of the decision was that foreign source income could be accumulated by Australian residents in a trust without liability for Australian tax unless and until the trust income was distributed to a resident beneficiary.

To overcome the effects of the decision, the Bill proposes three main changes.

In consequence of one of them, an Australian resident beneficiary will be taxed under Division 6 on trust income to which he is presently entitled, whether the income has a source in Australia or overseas (clause 12) and the trustee will be taxed on such income where the resident beneficiary presently entitled to the income is under some legal disability, such as being a minor (clause 13). To this end, clause 11 will require that the "net income" of a trust estate be calculated on the same basis as if it were the income of a resident individual.

A second major proposed change concerns circumstances in which there is income of a trust estate to which beneficiaries are not presently entitled. It is necessary to tax the trustee on this "accumulating income" to which no beneficiary is presently entitled, if tax is to be obtained each year as income is derived. But under the High Court interpretation of the existing law, the trustee is only taxed on such accumulating income which has an Australian source. To bring foreign source accumulating income to tax as it is derived, the Bill first contains a definition of a "resident trust estate" - that is, a trust estate with a resident trustee or with its central management and control in Australia at any time during the year of income (clause 11, proposed section 95(2)). The next step is to tax the trustee of a resident trust estate on income to which no beneficiary is presently entitled, whether the income comes from Australian or foreign sources, and regardless of the residence of the ultimate beneficiaries (clauses 14 and 15). There will be no effective change to the present law under

which a non-resident trustee is subject to tax on accumulating income from sources in Australia, although the rule is to be spelt out more fully in clauses 14 and 15.

A consequential amendment proposed is that if foreign-source accumulated income that has been taxed to the trustee of a resident trust estate is later distributed to a beneficiary who was a non-resident at the time the income was derived, the tax on that income is to be refunded on an application being made by the beneficiary (clause 16, proposed section 99D). This follows the policy of the income tax law that a non-resident is not liable to tax on ex-Australian source income.

The third major amendment proposed is designed to ensure that a resident beneficiary will be liable to tax on trust income paid or applied for his benefit and to which Division 6 has not previously applied (clause 16, proposed section 99B). Thus, an amount paid to an Australian resident beneficiary out of income from foreign sources that has been accumulated in a non-resident trust estate (and would not have been taxed while the income accumulated) will be taxed to the beneficiary under the rules proposed in the Bill (clause 16, proposed section 99C).

Other significant effects of these provisions of the Bill are -

- that a trust with a business in Australia or income from Australian property (except dividends or interest subject to withholding tax), which does not have a resident trustee, is to be required to appoint a resident public officer to ensure that the trust's taxation responsibilities are met (clause 21, proposed section 252A);

- to make it clear that the fact that trust income to which a beneficiary is presently entitled in a year of income is paid or applied for the benefit of a beneficiary during the year does not mean that the present entitlement provisions of Division 6 (section 97 or 98) do not apply to that income (clause 11, proposed section 95A).

These proposed amendments to the trust provisions are to apply to 1978-79 and later income years.

A non-resident beneficiary will continue to be taxed, as at present, on income from Australian sources to which he is presently entitled, except where the beneficiary is under a legal disability, when the trustee will be assessed on the income.

The trust provisions will continue to be subject to existing provisions giving relief from double taxation of foreign source income that has been taxed in the country of source.

Foreign source income of partnerships

(Clauses 3, 7 to 9)

As it could be argued that the reasoning of the Union Fidelity decision applies also to partnerships, it is proposed to clarify the law to ensure that income from foreign sources is included in calculating the net income of a partnership, and that a resident partner is liable to tax on his share of the partnership's world income, subject to the existing provisions giving relief from double taxation. A non-resident partner will continue to be liable to tax only on that part of his or her share of the partnership income that is attributable to sources in Australia.

The amendments are to apply to 1978-79 and later income years.

Tax avoidance by trust-stripping arrangements

(Clause 18)

By this clause it is proposed to overcome certain tax avoidance arrangements designed to enable trading profits and other income derived by trusts to escape tax completely.

Section 97 of the Principal Act provides for a beneficiary who is presently entitled to a share of the income of a trust estate and not under any legal disability to be taxable in respect of that share. In those circumstances, the beneficiary's share of the trust income is included in his assessable income, and the trustee is not required to pay tax on the beneficiary's share. Where a trustee who has a discretion to pay or apply income for the benefit of specified beneficiaries, exercises the discretion in favour of a beneficiary, section 101 deems the beneficiary to be presently entitled to the amount paid or applied, and such an amount is also assessed to the beneficiary under section 97.

The particular tax avoidance arrangements rely on a nominal "beneficiary" being introduced into the trust and being made presently entitled to income of the trust, thus relieving the trustee of any tax liability in respect of the income. However, it is a feature of the arrangements that the introduced beneficiary also escapes tax by one means or another, e.g., as a tax-exempt body or organisation. This "beneficiary" retains only a minor portion of the trust income, while the group in whose favour the trust in substance exists effectively enjoys the major portion, but in a tax-free form. For example, a corresponding amount may be gifted to form the corpus of a further trust for the group's benefit.

The amendment proposed will look to the existence of an agreement or arrangement that is entered into otherwise than in the course of ordinary family or commercial dealing and under which present entitlement to a share of trust income is conferred on a beneficiary in return for the payment of money or the provision of benefits to some other person, company or trust. In those circumstances, the amendment will treat trust income dealt with under the "reimbursement agreement" as not being income to which any beneficiary is presently entitled but as having been accumulated by the trustee, who will then be liable to pay tax on the income under section 99A at the prescribed tax rate (61.5 per cent for 1978-79).

The amendment will apply to trust income paid to or applied on behalf of a beneficiary on or after 12 June 1978, being the date of the announcement to legislate against these schemes.

The following are notes on each of the clauses of the Bill.

Clause 1 : Short title, etc.

This clause formally provides for the short title and citation of the amending Act and the Income Tax Assessment Act 1936 (the "Principal Act").

Clause 2 : Commencement

Under section 5(1A) of the Acts Interpretation Act 1901, every Act is to come into operation on the twenty-eighth day after the day on which the Act receives the Royal Assent, unless the contrary intention appears in the Act. By this clause, it is proposed that the amending Act shall come into operation on the day on which it receives the Royal Assent.

Clause 3 : Source of royalty income derived by non-resident

Sub-clause (1) of clause 3 will insert a new sub-section - sub-section (1A) - into section 6C of the Principal Act. That section contains rules for establishing, for the purposes of specified provisions of the Principal Act, when royalties due to non-residents are to be treated as having been derived from a source in Australia. This is, broadly, where the royalties are an expense of a business carried on in Australia.

By reason of proposed sub-section (1A) the same source rules are to apply in establishing for the purposes of Divisions 5 and 6 of Part III of the Principal Act (principally in relation to the taxation of non-resident partners and beneficiaries), whether royalties are to be treated as attributable to sources in Australia. Those Divisions, which govern the taxation of income derived by partnerships and trust

estates, are to be amended by clauses 7 to 17 and 19 of the Bill. The amendment proposed by this clause is consequential upon those amendments and, like them, is to apply to assessments in respect of the 1978-79 and subsequent income years.

Clause 4 : Exemption from tax of certain income derived from sources outside Australia

The amendment to be made by this clause is also consequential upon amendments proposed by clauses 7 to 17 and 19 of the amending Bill. Sub-clause (1) of clause 4 will amend section 24F of the Principal Act by omitting sub-section (1) of that section and substituting a new sub-section.

Section 24F of the Principal Act exempts from tax income derived from sources outside Australia by individuals and companies who are "genuine" residents of certain external Territories, but not income derived by trustees. Because of the decision by the High Court in *Union Fidelity Trustee Co. v F.C. of T.* (1969) 119 C.L.R. 177 that the general trust provisions of the income tax law only have application to the Australian source income of a trust estate, there was no need, when section 24F was enacted, to make any provision for the exemption of foreign source income derived by trusts established in those Territories. As other amendments to be made by this Bill will make the general trust provisions applicable to foreign source income it will be necessary now to make specific provision to exempt income derived from sources outside Australia by trusts that qualify as "Territory trusts" - trusts that are solely for the benefit of "genuine" residents of the Territories.

Proposed new sub-section (1) of section 24F substantially repeats in paragraph (a) the existing sub-section that it is to replace and makes specific provision, in paragraph (b), for the exemption of foreign source income of Territory trusts. The amended sub-section is to apply to assessments in respect of the 1978-79 and subsequent income years.

Clause 5 : Certain items of assessable income

Clause 5 proposes to amend section 26 of the Principal Act by omitting paragraph (b) and inserting a new paragraph. Paragraph (b) provides that a taxpayer's assessable income shall include his beneficial interest in income derived under any will, settlement, deed of gift or instrument of trust. At the same time, however, Division 6 of Part III of the Principal Act provides comprehensively for the net income of a trust estate to be assessed in the hands of the trustee or beneficiaries in the trust estate. This has raised some doubt, on occasion, as to the relationship between section 26(b) and Division 6.

Other amendments proposed to be made by the Bill are designed to ensure that Division 6 will be the dominant source for the liability of beneficiaries and trustees to tax on

the income of trust estates. Consequential upon, and supporting those amendments, sub-clause (1) of clause 5 will alter section 26(b) so that, while it will continue in conjunction with section 25 to require the inclusion in assessable income of amounts representing a beneficial interest in assessable income derived under a will, settlement, deed of gift or instrument of trust, there will be specifically excluded from its operation, amounts included in the assessable income of the beneficiary of a trust estate under section 97 and proposed section 99B and amounts in respect of which a trustee of a trust estate is assessable under section 98, 99 or 99A of that Act.

By sub-clause (2) the amendments made by sub-clause (1) are to apply to assessments of income of the 1978-79 and subsequent years of income.

Clause 6 : Losses and outgoings incurred under certain tax avoidance schemes

Introductory note

The amendments proposed by clause 6 will insert a new Subdivision - Subdivision D - in Division 3 of Part III of the Principal Act to limit the availability of deductions in respect of losses or outgoings incurred under certain tax avoidance schemes.

One category of schemes in relation to which the proposed amendments are to apply involves the pre-payment of an otherwise deductible expense, the effect of which is to reduce the consideration payable in respect of the acquisition of property that is, as part of the tax avoidance arrangement, to be acquired by the taxpayer or an associate.

Under one such scheme, the taxpayer borrows (say) $1,000, ostensibly for income producing purposes, and promptly makes a payment of $700 which represents a pre-payment of interest at 14% for 5 years. Upon payment of that interest, the taxpayer or an associate is entitled to acquire the lender's rights under the loan agreement. Because the terms of the loan provide for a reduced interest rate of 4% to apply after the pre-payment of 5 years' interest, the loan has a reduced value and can be acquired for $370.

The effects of the arrangement are such that the taxpayer claims a deduction for $700 in respect of a net outlay of $70 (i.e., $1,070 in respect of interest and the acquisition of the rights under the loan less the $1,000 loan). The lender, on the other hand, will have received $700 interest but will seek, as a money lender, to offset against this interest income the loss sustained in selling for $370 the rights in the $1,000 loan.

A second scheme involves the pre-payment of rent under arrangements whereby property valued at (say) $1m. that the taxpayer wishes to acquire is purchased by an exempt institution for that amount with funds provided by the promoter of the scheme. The taxpayer leases the property from the exempt institution under arrangements that provide that, on payment of $800,000 rent in advance, the property can be acquired by an associate of the taxpayer for $250,000.

The exempt institution thus receives $1,050,000 from which it repays the loan to the promoter together with a fee in the form of interest and is left with a small return for its services. Because of its exempt status, the institution is not subject to tax on the $800,000 rent received. On the other hand, for an outlay of an additional $50,000, the taxpayer, who normally would not be entitled to any income tax deduction at all in respect of the purchase of the building, claims a deduction for the $800,000 rent paid.

Broadly, the amendments proposed by clause 6 to counter schemes of this type will operate to deny a deduction in respect of a loss or outgoing incurred after 19 April 1978 as part of a tax avoidance agreement where -

(a) the amount of the loss or outgoing exceeds the amount that, but for the tax avoidance agreement, might reasonably be expected to have been incurred at that time in respect of the benefits to which the loss or outgoing relates; and

(b) as part of the tax avoidance agreement, property is to be acquired by the taxpayer or an associate for an amount that is less than the amount that might reasonably be expected to have been payable in respect of that property if the loss or outgoing had not been incurred.

The second category of schemes in relation to which the proposed amendments are to apply involves arrangements between associated parties that are designed to secure that a deduction is available to one party in a year of income in respect of an amount that in whole or in part is not taxable to the other party until a later year or years of income.

One such scheme involves arrangements under which interest, while not paid to the associate, has accrued under the terms of the relevant loan agreement. The taxpayer claims that the interest is incurred within the terms of the general deduction provisions of the income tax law while, on the other hand, the associate claims not to have derived the income (and therefore not to be taxable on the income) until a later year when the interest is paid or is otherwise dealt with on his behalf by the taxpayer. Where the associate is an overseas resident, these arrangements are used to defer a liability to withholding tax in respect of that interest.

Other schemes involve a payment in advance for goods or services that are to be provided by the associate in a future year or future years of income. In these cases, the taxpayer claims a deduction in respect of the amount paid, while the associate seeks to spread the income over the years in which the goods or services are provided.

The amendments proposed by clause 6 will operate to limit the availability of deductions for losses or outgoings incurred after 19 April 1978 under arrangements of this type where those arrangements are entered into by associated persons for tax avoidance purposes. In a case where the loss or outgoing is incurred in respect of the future provision of goods or services, a deduction is to be allowable in a year of income to the extent only that the loss or outgoing relates to goods or services actually provided in that year of income. In a case not involving the future provision of goods or services, the deduction is to be allowable in the year of income in which the relevant amount is actually paid.

Notes on the proposed provisions of the new Subdivision D of Division 3 follow.

Section 82KH : Interpretation

Sub-section (1) of section 82KH defines various terms used in the Subdivision -

"agreement" is being defined to mean any agreement, arrangement, understanding or scheme whether that agreement, arrangement, understanding or scheme is formal or informal, express or implied and whether or not enforceable by legal proceedings, irrespective of whether it was intended to be so enforceable;

"associate" is being defined so as to mean -

(a) in relation to a taxpayer other than a trustee or partnership

- a relative of the taxpayer
- a partner of the taxpayer
- a spouse or child of a partner of the taxpayer
- a trustee of a trust estate where the taxpayer or a person who is, by reason of this definition, an associate of the taxpayer benefits or is capable of benefiting under the trust either directly or through any interposed companies, partnerships or trusts

- a company that is effectively controlled (either individually or collectively) by the taxpayer or by persons who are, by reason of this definition, associates of the taxpayer - including any companies that are controlled by that company

and, in addition, where the taxpayer is a company -

- a person who, either alone or together with persons who are, in the terms of this definition, associates of that person, is able effectively to control the taxpayer company, and

- persons who are, in the terms of this definition, associates of a person who controls the taxpayer company;

(b) in relation to a taxpayer in the capacity of a trustee -

- any person who benefits or is capable of benefiting under the trust estate either directly or through any interposed companies, partnerships or trusts

- persons who are, in the terms of this definition, associates of a person who benefits or is capable of benefiting under the trust;

(c) in relation to a taxpayer being a partnership -

- a partner in the partnership

- persons who are, in the terms of this definition, associates of a partner in the partnership;

"property" is to be defined to include a chose in action and also any estate, interest, right or power, in or over property;

"tax avoidance agreement" is being defined so as to mean any agreement (as previously defined) that was entered into or carried out for a purpose of securing for any person a reduction in what would otherwise be that person's liability to income tax in respect of a year of income.

Sub-section (2) is a drafting measure that will make it clear for the purposes of sub-section 82KK(2) that a reference to the supply of goods or the provision of services

is not to be taken to include a reference to the making available of money by way of loan. As explained in the notes on sub-section 82KK(2), this will ensure that a loss or outgoing incurred in respect of interest will come within that sub-section if it meets the conditions contained in paragraph (b) of that sub-section.

Sub-section (3) ensures that a reference in new Subdivision D to an agreement having been entered into for a particular purpose shall be taken as including a reference to an agreement that was entered into for that purpose by any one or more of the parties to the agreement.

Sub-section (4) is to make it clear that a reference to a person in the new Subdivision will be taken as including a reference to a person (including a company) in the capacity of a trustee.

Section 82KJ : Deduction not allowable in respect of certain pre-paid outgoings

Section 82KJ is the operative provision with respect to losses or outgoings incurred under tax avoidance arrangements involving, broadly, the pre-payment of an otherwise deductible expense.

As set out in paragraphs (a) to (d) of proposed section 82KJ, a deduction is not to be available in respect of a loss or outgoing incurred by a taxpayer where -

(a) the loss or outgoing was incurred by the taxpayer after 19 April 1978 by reason of, as a result of or as part of a tax avoidance agreement (as defined in section 82KH);

(b) the amount of that loss or outgoing exceeds the amount that might reasonably be expected to have been incurred at that time in respect of the benefit to which the loss or outgoing relates if that loss or outgoing had not been incurred as part of a tax avoidance agreement;

(c) property has been or might reasonably be expected to be acquired by the taxpayer or by an associate by reason of, as a result of or as part of the tax avoidance agreement; and

(d) the consideration payable, or expected to be payable, in respect of the acquisition of the property is less than the amount that might reasonably be expected to be payable if the loss or outgoing had not been incurred.

The test of "pre-payment" embodied in paragraph (b) will ensure that the provisions will apply equally to arrangements where the loss or outgoing is incurred in respect of the

pre-payment of future liability (as in the examples cited in the introductory note to clause 6) and to arrangements where the loss or outgoing is incurred under an agreement that is so structured, for the purposes of the scheme, to require advance payment (e.g., a payment in respect of 5 years' rent payable in advance under the terms of the relevant lease agreement).

For example, where the benefit in respect of which the loss or outgoing is incurred is a right to the lease of property for 5 years and it would be normal for rent on that property to be payable monthly, the situation would be within the ambit of paragraph (b) whether the payment of 5 years' rent in advance was made at the option of the taxpayer or was required by the particular lease agreement. The issue to be determined in these circumstances is whether the amount of the loss or outgoing was greater, having regard to the benefit in respect of which it was incurred, than the amount that might reasonably be expected to be incurred at that time in respect of a 5 year lease of that property.

In determining that issue, regard is not to be had to any benefit in relation to the acquisition of the property referred to in paragraph (c) that might flow from the loss or outgoing being incurred.

Section 82KK : Schemes designed to postpone tax liability

The proposed new section 82KK will operate to limit the availability of deductions in respect of losses or outgoings incurred between associated parties under arrangements that are designed to postpone the liability to tax on the amount receivable by the associate.

Sub-section (1) of section 82KK specifies the losses or outgoings to which the section is to apply. As detailed in paragraphs (a) to (c) of that sub-section, the section is to apply to a loss or outgoing incurred by a taxpayer if -

(a) the loss or outgoing was incurred after 19 April 1978 to an associate of the taxpayer;

(b) a deduction is allowable in respect of that loss or outgoing; and

(c) the deduction would, but for the operation of the section, be allowable to the taxpayer in the year of income in which the loss or outgoing was incurred and the whole or a part of the amount receivable by the associate would not be included in the associate's assessable income (or, where applicable, would not be subject to withholding tax) until a subsequent year of income.

The reference to withholding tax in paragraph (c) refers to withholding tax payable under Division 11A of the Principal Act. Under that Division, interest payable to a non-resident is subject to withholding tax rather than being included in the assessable income of the recipient. Where a scheme of a kind with which section 82KK is concerned operates with respect to interest payable to a non-resident, the deferral of a liability to withholding tax substitutes for the deferral of the inclusion of an amount in the assessable income of the associate in other cases.

Sub-sections (2) and (3) lay down the basis on which deductions are to be available in respect of losses or outgoings to which the section applies. As explained in the notes on these sub-sections, the provisions of section 82KK will operate to restrict the availability of deductions in respect of losses and outgoings to which the section applies only where the loss or outgoing was incurred as part of an arrangement that was entered into for a purpose of securing the deferral of the liability to tax on the amount receivable by the associate.

Sub-section (2) is to be the operative provision in relation to losses or outgoings to which section 82KK applies by virtue of sub-section (1) where such a loss or outgoing is not incurred in respect of the supply of goods or the provision of services at a time that occurs after, or during a period that occurs after or extends beyond, the year of income in which the loss or outgoing was incurred.

Where sub-section (2) applies, a loss or outgoing will be taken to have been incurred in any particular year of income only to the extent that it represents an amount actually paid during that year of income. As already mentioned, the sub-section will apply only where that loss or outgoing was incurred by reason of, as a result of, as part of or in connection with an agreement, course of conduct or course of business that was entered into or carried out for a purpose of securing either that the amount receivable by the associate would not be subject to withholding tax, or would not be included in the assessable income of the associate, until a later year of income.

Losses or outgoings not incurred under an agreement, etc., entered into for that purpose will not be affected by the operation of the sub-section.

As explained in the notes on proposed sub-section (2) of section 82KH, a loss or outgoing in respect of interest will not be taken to be incurred in respect of the provision of services. The provisions of sub-section (2) of section 82KK will operate with respect to interest schemes of the kind outlined in the introductory note to permit a deduction only in the year of income in which the interest is actually paid to the associate.

Sub-section (3) is to be the operative provision in relation to losses or outgoings to which section 82KK applies where such a loss or outgoing was incurred in respect of the supply of goods or the provision of services at a time that occurs after, or during a period that occurs after or extends beyond, the year of income in which the loss or outgoing is incurred.

Sub-section (3) operates to restrict the availability of deductions only where that loss or outgoing was incurred by reason of, as a result of, or as part of, an agreement that was entered into or carried out for a purpose of securing that a deduction would be allowable to the taxpayer in respect of the loss or outgoing in circumstances where the whole or a part of the amount will not be included in the assessable income of the associate until a later year of income.

Where sub-section (3) applies, the loss or outgoing will be deemed to have been incurred in the year or years of income in which the relevant goods or services are provided.

Sub-section (4) will operate in circumstances where, by virtue of sub-section (3), a loss or outgoing is deemed to have been incurred in two or more years of income, i.e., because the goods or services are provided in two or more years.

In these circumstances, sub-section (4) will have the effect that the deduction available in respect of that loss or outgoing in each of those years of income will be so much only of the loss or outgoing as the Commissioner of Taxation considers reasonable. In determining the amount that is to be allowable in a particular year of income, the Commissioner is required to have regard to the extent to which the relevant goods or services are provided in that year of income.

Clauses 7 to 17 : Partnerships and trust estates

Introductory note

These clauses arise from the decision of the High Court in *Union Fidelity Trustee Co. v. F.C. of T.* (1969) 119 CLR 177, to the effect that the existing trust provisions in Division 6 of Part III of the Principal Act only have application to the Australian source income of a trust estate. The decision also has implications for the taxation of partnership income and the amendments are designed to ensure that both the trust estate and partnership provisions are not limited in scope to Australian source income, but apply to foreign source income as well.

Trust estates. The broad purpose of the present income tax law in relation to income derived by or through a trust estate is to ensure that income of the trust estate of a year of income is taxable in that year to either the beneficiaries or the trustee. The starting point is the calculation of the net income of the trust estate and this represents in the ordinary situation the difference between assessable income and allowable deductions, calculated as if the trustee were a taxpayer.

Where a beneficiary who is not under a legal disability is presently entitled to a share of the income of a trust estate, that share of the net income is included in the assessable income of the beneficiary under section 97 of the Principal Act. The trustee is liable for tax where a beneficiary under a legal disability is presently entitled to a share in the income of a trust estate (section 98) or where some or all of the net income of the trust estate represents income to which no beneficiary is presently entitled (section 99 or 99A). In the light of the Court decision, these rules are not applicable in the assessment of foreign source income derived by trustees.

In broad terms, the amendments to be made by these clauses are designed to ensure that resident beneficiaries are subject to Australian tax under the trust estate provisions both on income from Australian sources and, subject to relief from double taxation where it is also taxed in the country of source, on income from foreign sources, while non-resident beneficiaries are taxed only on income from Australian sources. To achieve these results, the net income of a trust estate is to be calculated as if the trustee were a resident taxpayer. The assumption that the trustee is a resident will have the effect of bringing into the calculation of net income, assessable income from foreign sources and deductions related to that foreign source income.

A resident beneficiary presently entitled to a share of the income of a trust estate and not under a legal disability is to be required to include his share of net

income in his assessable income, while a non-resident beneficiary will only be required to include in his assessable income his share of so much of the net income of a trust estate as is attributable to sources in Australia.

Similarly, a trustee assessable under section 98 of the Principal Act in respect of a share of the income of a trust estate to which a beneficiary who is under a legal disability is presently entitled, will be subject to tax on all that share of the net income where the beneficiary is a resident of Australia, but will be subject to tax on only so much of that share as is attributable to sources in Australia when the beneficiary is not so resident.

In cases where there is income of the trust estate to which no beneficiary is presently entitled (very broadly, income accumulating in the trust), the basis of taxation will depend upon whether or not the trust estate is a resident trust estate.

A resident trust estate is, broadly, to be a trust estate that has one or more Australian residents as trustees or one that is managed and controlled in Australia. The trustee of a resident trust estate is to be liable to tax on all the net income of the trust estate in respect of which no beneficiary has present entitlement, while the trustee of a non-resident trust estate will be liable to tax only on so much of such income of the trust estate as is attributable to sources in Australia.

Where a non-resident beneficiary receives income paid out of the foreign source accumulated income of a resident trust estate that has been taxed in Australia in the trustee's hands, provision is to be made for the tax paid on that income to be refunded.

A corresponding amendment is designed to ensure that any amount received by a resident beneficiary from or representing the accumulated foreign source income of a non-resident trust estate which has not been taxable in Australia in the hands of the trustee, but would have been so taxable had the trust estate been a resident trust estate, will be included in that beneficiary's assessable income in the year of receipt.

Finally, a technical amendment is proposed to clarify the intention of the law that the payment to or application of income for the benefit of a beneficiary who was presently entitled to the income does not prevent the assessment of that income on the basis of the rules that apply to income to which a beneficiary has a present entitlement.

Partnerships. The general approach of the income tax law to the taxation of income derived by a partnership is (by section 92 of the Principal Act) to include in the assessable income of each partner his individual interest (or share) in the net income of the partnership. In broad terms, the net income of the partnership is ascertained by deducting from the assessable

income of the partnership, calculated as if the partnership were a taxpayer, losses and outgoings incurred by the partnership in gaining or producing that income. If a partnership incurs a loss in a year of income, i.e., if the allowable deductions exceed the assessable income, each partner's interest in that loss is an allowable deduction to the partner.

The Court decision referred to earlier may mean that net income of a partnership is to be calculated on the basis only of Australian source income of the partnership. In keeping with the proposed amendments to the trust provisions, the law is to be amended to require that the net income of a partnership (or partnership loss) is to be calculated as if the partnership were a resident taxpayer, i.e., on the basis of both Australian and foreign source income. A resident partner will be liable to tax on the basis of his individual interest in this net income, and a non-resident partner only on the basis of the Australian source component of the net income.

Clauses 7 to 17 are explained more fully in the notes that follow.

Clause 7 : Interpretation

Clause 7 proposes, by sub-clause (1), to repeal section 90 of the Principal Act and to substitute a new section. Existing section 90 relates to partnerships and defines, for the purposes of Division 5 of Part III of the Principal Act, the terms "net income" and "partnership loss".

Proposed new section 90 will redefine those terms and define a new term, "exempt income", in such a manner as to ensure that Australian and foreign income and deductions are included on the same basis as if the partnership were a resident individual. At present, the definitions in section 90 do not require the adoption of the hypothesis that the partnership is a resident and that leaves open the possibility that "net income" and "partnership loss" are confined to partnership activities in Australia:

"exempt income" is to be defined as the exempt income of the partnership calculated as if that partnership were a resident taxpayer.

"net income" is to be defined as the assessable income of the partnership, less all allowable deductions other than concessional deductions and deductions in respect of losses of previous years (the present definition), but calculated as if that partnership were a resident taxpayer.

"partnership loss" is to be defined as the excess, if any, of allowable deductions (other than concessional deductions and deductions in respect of losses of previous years) over the assessable income of the

partnership (the present definition), calculated as if that partnership were a resident taxpayer.

By sub-clause (2) of clause 7, the amendment will apply in calculating partnership net income and partnership losses for the 1978-79 and all subsequent years of income.

Clause 8 : Income and deductions of partner

Clause 8 proposes the repeal of section 92 of the Principal Act and the substitution of a new section.

As it now stands, section 92 requires that the assessable income and exempt income of a partner shall include the partner's individual interest in the "net income" and "exempt income" of the partnership of which he is a member, and that his individual interest in a partnership loss shall be an allowable deduction. It is thus the policy of the Principal Act that a partnership itself is not liable to pay tax on the income it derives, and this will not be altered by the proposed amendments. The individual partners will continue to be assessed to tax by reference to their shares of the net and exempt income of the partnership and of any partnership loss. However, as observed in the notes on clause 7, there is to be an alteration in the basis specified for calculating a partnership's net income, exempt income or loss.

While world income of a partnership is to be used for this purpose, proposed new section 92 will be consistent with the general principle that while residents are subject to tax on their income from all sources, non-residents are only subject to tax on income from sources in Australia. Accordingly, paragraph (a) of sub-section (1) will mean that the assessable income of a partner will include the whole of so much of the partner's share of the net income of the partnership, as is attributable to the period of the year when the partner was a resident. Correspondingly, paragraph (b) of sub-section (1) will, in relation to any period of the year during which a partner is a non-resident, have the effect that the partner's assessable income includes only so much of the partner's share of the net income of the partnership as is attributable to that period and is attributable to Australian source income of the partnership.

Sub-sections (2) and (3) of proposed new section 92 call for a partner's individual interest in a "partnership loss" (sub-section (2)) and in partnership "exempt income" (sub-section (3)) to be brought into account on the same basis as that on which the partner's individual interest in the net income of the partnership is brought into account under sub-section (1) in determining a partner's liability to Australian tax, i.e., on a basis that varies according to whether the partner is a resident of Australia or not.

By sub-clause (2) of clause 8, re-expressed section 92 is to apply for 1978-79 and subsequent years of income.

Clause 9 : Partner not having control and disposal of share in partnership income

Clause 9 proposes to amend section 94 of the Principal Act as a consequence of the amendments to be made by clauses 7 and 8. The amendments are to apply for 1978-79 and subsequent income years.

Broadly stated, section 94 provides for further tax at a special rate to be payable in relation to any share of the net income of a partnership over which a partner lacks real and effective control and disposal. A person deriving income to which section 94 applies is taxed at the special rate on the whole of that income included in his or her taxable income. This basic approach is not being altered, but it is necessary to take into account that net income of a partnership is specifically to include foreign source income of the partnership.

Paragraph (a) of sub-clause (1) of clause 9 proposes to amend section 94 by inserting a new sub-section - sub-section (8A) - after sub-section (8). New sub-section (8A) relates directly to sub-section (8) which authorises the Commissioner of Taxation not to apply section 94 to any income where he considers that, by reason of the existence of special circumstances, it would be unreasonable for the section to apply.

Sub-section (8A) will be relevant in circumstances that are not likely to be of common occurrence - where a partnership has income from foreign sources, a trustee of a trust estate is a partner and a beneficiary who is a non-resident is presently entitled to foreign source income that flows from the partnership and is income in respect of which there is a lack of real and effective control and disposal. Sub-section (8A) will enable the result that tax under section 94 does not fall on this income.

Paragraph (b) of sub-clause (1) of clause 9 will amend sub-section 94(13) of the Principal Act, which defines three expressions used in section 94. Paragraph (b) proposes the omission of the present definition of "share in the net income of a partnership" and the substitution of a new definition.

This expression is, at present, defined as meaning the individual interest of a partner in the net income of the partnership and any income derived from the partnership by the partner otherwise than as a partner, and makes no reference to the residential status of the partner or to whether the income is from sources in or out of Australia.

As redefined, the expression is to be given the meaning of -

(a) so much of the individual interest of the partner in the net income of the partnership and of any income derived by the partner from the partnership otherwise than as a partner as is attributable to a period during which the partner was a resident; and

(b) so much of the individual interest of the partner in the partnership and of any income derived by the partner from the partnership otherwise than as a partner as is attributable to a period during which the partner was not a resident and is also attributable to sources in Australia.

Clause 10 : Heading to Division 6 of Part III

Clause 10 will omit the present heading to Division 6 of Part III of the Principal Act - "Division 6 - Trustees" - and substitute a more appropriate heading - "Division 6 - Trust Income". Division 6 contains the basic provisions of the income tax law that deal with the taxation of trustees and beneficiaries.

Clause 11 : Interpretation

This clause will repeal section 95 of the Principal Act, which defines for the purposes of Division 6 the term "the net income of a trust estate", (very broadly, the assessable income of the trust estate, calculated as if the trustee were a taxpayer, less allowable deductions) and will substitute new sections 95 and 95A.

Sub-section (1) of proposed new section 95 defines two terms for the purposes of Division 6 - "exempt income" and "net income".

The term "exempt income" is being defined as meaning, in relation to a trust estate, the exempt income (defined in section 6 of the Principal Act as income which is exempt from income tax including income which is not assessable income) of the trust estate calculated as if the trustee were a resident taxpayer. It will therefore include exempt income from Australian and ex-Australian sources.

The term "net income" is to be defined as meaning, in relation to a trust estate, the total assessable income of the trust estate calculated as if the trustee were a resident taxpayer less all allowable deductions other than those deductions that are excluded from consideration by the present definition of "the net income of a trust estate". The excluded deductions are the concessional deductions, the deduction in respect of income equalization deposits and, in limited circumstances, the deduction for losses of previous years.

In effect, this new definition differs from the existing definition of "the net income of a trust estate" only in that it specifies that the total assessable income of the trust estate is to be calculated as if the trustee were a resident taxpayer. The effect of this change is that income, whether from sources in or out of Australia, is to be included in the calculation of the net income of the trust estate.

Sub-section (2) of proposed section 95 sets out the tests according to which a trust estate is to be regarded for the purposes of Division 6 of Part III of the Principal Act, as a resident trust estate. The distinction between resident and non-resident trust estates is necessary in cases where a trustee is liable to be assessed and to pay tax under section 99 or 99A of the Principal Act on income of the trust estate to which no beneficiary is presently entitled. In these cases, as explained earlier, the trustee of a resident trust estate will be assessed and liable to pay tax on all of the accumulated income of the trust estate, irrespective of the territorial source from which that income was derived, while the trustee of a non-resident trust estate will be assessed and liable to pay tax only on so much of that accumulated income as is derived from sources in Australia.

The effect of sub-section (2) will be that a trust estate is to be regarded as a resident trust estate in relation to a year of income if, at any time during that year of income, a trustee of that trust estate was a resident of Australia or if the central management and control of the trust estate was in Australia. The concept of "central management and control" in Australia forms the basis of one of the tests for determining when a company is a resident of Australia for income tax purposes.

Proposed section 95A is intended to remove any doubts that may exist that trust income to which a beneficiary is otherwise presently entitled in respect of a year of income does not, for the purposes of those provisions of the income tax law that turn on whether a beneficiary is presently entitled to income of a trust estate, cease to be income of that kind because the income concerned has been paid to or applied for the benefit of the beneficiary. For example, in a situation where a beneficiary in an "inter vivos" trust estate is under the age of 16 years on the last day of the income year and is on general principles presently entitled to an amount of income, the enactment of section 95A will obviate doubts that the trustee is assessable under section 98 of the Principal Act - and not entitled to the zero rate of tax - because the amount has been paid to the beneficiary.

Sub-clauses (2) and (3) govern the application of the amendments being made by clause 11. Generally, those amendments are to apply for the 1978-79 and subsequent income years, but new section 95A will, to the extent that proposed

section 100A is applicable for the 1977-78 income year, have effect also for that year. Section 100A is explained in the notes on clause 18 of the Bill.

Clause 12 : Beneficiary not under any legal disability

Clause 12 will repeal existing section 97 of the Principal Act and substitute a revised section. The present section 97 is to the effect that a beneficiary who is not under a legal disability and is presently entitled to a share of the income of a trust estate is to include that share of the net income in his or her assessable income. It also provides that the beneficiary's exempt income for a year of income is to include his or her individual interest in the exempt income of the trust estate that is not taken into account in calculating the net income of the trust estate. The revised section 97 does not alter this basic approach, but adds rules as to what part of the trust income to which the beneficiary is presently entitled is to be included in the assessable or exempt income of the beneficiary where the beneficiary is a resident and where the beneficiary is a non-resident.

Under paragraph (a) of the revised section 97 the assessable income of a beneficiary who was a resident throughout the year of income will include the beneficiary's share of the net income of the trust estate (i.e., net income from sources both in and out of Australia) of the year. If the beneficiary was a non-resident throughout the year, his assessable income will include so much of the year's net income as, in line with the rules for taxing Australian-source income of non-residents, relates to income from sources in Australia. Where the beneficiary was both a resident and a non-resident during the one year, the amount to be included in assessable income will be an appropriate part of the amounts that would be included if the beneficiary were a resident throughout, or a non-resident throughout, the year.

Paragraph (b) of revised section 97 will correspondingly include in the exempt income of the beneficiary so much of the beneficiary's share of the exempt income of the trust estate as is attributable to a period during which the beneficiary was a resident, and so much of the beneficiary's share of the exempt Australian source income of the trust estate as is attributable to a period during which the beneficiary was not a resident.

As under the existing section, where part of the exempt income of a trust estate is taken into account in calculating the net income of the trust estate, only the beneficiary's share in the excess of that exempt income is to be treated as exempt income of the beneficiary.

By sub-clause (2) of clause 12, the new section 97 will have effect in respect of income of the 1978-79 and subsequent years of income.

Clause 13 : Beneficiary under legal disability

This clause will repeal section 98 of the Principal Act, which provides, broadly, for the trustee of a trust estate to be assessed and liable to pay tax on the share of the net income of a trust estate in respect of which a beneficiary who is under a legal disability, e.g., infancy, is presently entitled, as if it were the income of an individual, and substitute a revised section.

The revised section 98 continues this approach but, as in the revised section 97 proposed by clause 12, the new section 98 will specify what part of that trust income will be subject to tax according to whether the beneficiary is a resident or a non-resident. The relevant background is, of course, that by reason of clause 11 the net income of a trust estate is to be calculated on the basis of the world-wide income of the trust estate and not, as previously, on the basis only of Australian source income.

In effect, the trustee will be liable to be assessed and to pay tax (to the extent specified in the Income Tax (Rates) Act) on all of the beneficiary's share of the net income of the trust estate in respect of which the beneficiary is presently entitled that is attributable to a period of the year in which the beneficiary is a resident (paragraph (a)) and on only so much of the share of the net income of the trust estate in respect of which the beneficiary has present entitlement as is attributable to a period of the year in which the beneficiary is not a resident of Australia and is also attributable to sources in Australia (paragraph (b)).

By sub-clause (2) of clause 13 the revised section 98 will apply in respect of the income of the 1978-79 income year and all subsequent years of income.

Clause 14 : Certain trust income to be taxed as income of an individual

This clause amends section 99 of the Principal Act which, along with section 99A, applies to the part of the net income of a trust estate in respect of which no beneficiary is presently entitled, i.e., the part of net income not assessable under section 97 and not taxable to the trustee under section 98. Such income is taxable under section 99 at the rates applicable for purposes of that section if the income is not taxable under the anti-avoidance provisions of section 99A.

Section 99 therefore complements section 97 under which a beneficiary not under a legal disability is taxable on

the share of the net income of a trust estate in respect of which the beneficiary is presently entitled, and section 98 under which the trustee is taxable on the share of the net income of a trust estate in respect of which a beneficiary under a legal disability is presently entitled and this basic position is to continue under the amendments that are to be made by this clause. The new element in the application of section 99 is that net income is to include not just net income from sources in Australia, but net income from world-wide sources.

Clause 14 will amend section 99 by omitting sub-section (2) and substituting four new sub-sections - sub-sections (2) to (5) - which will govern the calculation of the income on which a trustee will be liable to be assessed and to pay tax under section 99 where the trust estate is a resident trust estate - sub-sections (2) and (3) - or is not a resident trust estate - sub-sections (4) and (5).

Proposed sub-section 95(2) (to be inserted by clause 11 - see notes on that clause) sets out the tests by reference to which a trust estate will be regarded as a resident trust estate. A trust estate will be regarded as a resident trust estate where a trustee is a resident of Australia or where its central management and control is in Australia.

The trustee of a resident trust estate will be liable to tax on the accumulating income (income in respect of which there is no present entitlement in a beneficiary) of the trust estate irrespective of the territorial source of that income, while the trustee of a trust estate that is not a resident trust estate will be liable to tax on so much only of the accumulating income as is from sources in Australia.

Proposed sub-section (2) of section 99 deals with the case where there is no part of the net income of a resident trust estate that is included in the assessable income of a beneficiary under section 97 of the Principal Act (paragraph (a)), or in respect of which the trustee is liable to be assessed under section 98 of that Act (paragraph (b)), or that represents income attributable to foreign sources to which a non-resident beneficiary is presently entitled (paragraph (c)). In these circumstances, the trustee is to be taxed, as under existing section 99, on the whole of the net income of the trust estate as if it were the income of a resident individual (and to the extent required by the Income Tax (Rates) Act).

Proposed sub-section (3) will apply where there is some part of the net income of a resident trust estate that is not included in the assessable income of a beneficiary under section 97 (paragraph (a)), in respect of which the trustee is not liable to be assessed under section 98 (paragraph (b)), and that does not represent income attributable to foreign sources to which a non-resident beneficiary is presently entitled (paragraph (c)). In this case the trustee is to be taxed, again as under existing section 99, on that part of the net income of the trust estate as if it were the income of a resident individual.

Proposed sub-sections (4) and (5) will apply in the case of non-resident trust estates and will require the taxation only of Australian source income. Sub-section (4) will apply where there is no part of the net income of the trust estate that is taxed to the beneficiary under section 97 or to the trustee under section 98 as income in respect of which a beneficiary has a present entitlement, or that is attributable to foreign source income of the trust estate. In these circumstances, the non-resident trustee will be taxed on the whole of the net income of the trust estate as if it were the income of an individual. Where there is a part of the net income of a non-resident trust estate that is attributable to sources in Australia and that is not taxed under section 97 in the hands of a beneficiary presently entitled to the income and not under a legal disability or under section 98 in the hands of the trustee where a beneficiary under a legal disability is presently entitled, the trustee is to be taxed on that part of the net income of the trust estate as if it were the income of an individual (sub-section (5)).

Sub-clause (2) of clause 14 applies the amendments to section 99 to assessments in respect of income of the 1978-79 and subsequent years of income.

Clause 15 : Certain trust income to be taxed at special rate

Clause 15 will amend section 99A of the Principal Act, which is designed to apply to trust estates that are involved in tax avoidance arrangements. Section 99A imposes a special deterrent rate of tax (61.5 per cent for 1978-79) on income being accumulated in a trust estate (income to which no beneficiary is presently entitled) unless the Commissioner of Taxation considers, on the basis of guidelines contained in the section, that it would be unreasonable for the section to apply, in which case the income is to be taxed under section 99 - see the notes on clause 14.

Clause 15 will omit sub-section (4) of section 99A of the Principal Act and substitute four new sub-sections - sub-sections (4), (4A), (4B) and (4C). As with the amendments proposed to be made by clause 14 , these four sub-sections will specify the bases on which a trustee will be liable to be assessed and to pay tax under section 99A where the trust estate is a resident trust estate or a non-resident trust estate and where, in either case, broadly the whole or only a part of the trust income is accumulated. As explained earlier, the trustee of a resident trust estate will be liable to pay tax on the whole of the accumulated income of the trust estate while the trustee of a trust estate that is not a resident trust estate will only be liable to pay tax on so much of that accumulated income as is from sources in Australia.

Proposed new sub-sections (4) and (4A) apply to resident trust estates and are to the same effect as proposed sub-sections (2) and (3) respectively of section 99, except

of course that they provide for the trustee to be taxed on the whole (sub-section (4)) or part (sub-section (4A)) of the income of the trust estate at the special rate of tax declared for purposes of section 99A, rather than at the rates applicable under the Income Tax (Rates) Act to income taxable under section 99.

Proposed new sub-sections (4B) and (4C) apply to non-resident trust estates and, except that they provide for the trustee to be taxed on the whole (sub-section (4B)) or part (sub-section (4C)) of trust income from Australian sources at the special rate of tax rather than at the rates applicable for purposes of section 99, they are to the same effect as sub-sections (4) and (5) of section 99 - see notes on clause 14.

Paragraph (b) of sub-clause (1) is a drafting amendment to sub-section (5) of section 99A of the Principal Act consequential upon the substitution by paragraph (a) of four new sub-sections for the existing sub-section 99A(4).

Sub-clause (2) of clause 15 applies the amendments being made by sub-clause (1) to the 1978-79 and subsequent years of income.

Clause 16 : Distributions of accumulated trust income

Introductory note

This clause proposes to insert three new sub-sections - sub-sections 99B, 99C and 99D into the Principal Act. Sections 99B and 99C are concerned primarily with the receipt by resident beneficiaries of distributions from non-resident trust estates of previously untaxed foreign source income while section 99D relates to distributions to non-resident beneficiaries from resident trust estates of previously taxed foreign source income.

Section 99B : Receipt of trust income not previously subject to tax

Proposed section 99B will require the inclusion in a beneficiary's assessable income of amounts paid to or applied during a year of income for the benefit of a resident beneficiary where that amount represents trust income of a class which is taxable in Australia but which has not previously been subject to Australian tax in the hands of either the beneficiary or the trustee. It will normally apply where accumulated foreign-source income of a non-resident trust estate (or of a resident trust estate that previously was not able to be taxed in Australia in the light of the Union Fidelity decision) is distributed to a resident beneficiary.

Sub-section (1) of proposed section 99B, which is subject to the important qualifications expressed in sub-section (2), sets out the basic general rule that where during

a year of income a beneficiary who was a resident at any time during the year is paid a distribution from a trust estate or has an amount of trust property applied for his benefit, that amount is to be included in the assessable income of the beneficiary.

Proposed sub-section (2) modifies this general rule and will have the effect that the amount to be included in assessable income under sub-section (1) is not to include anything that represents either -

- corpus of the trust estate, but an amount will not be taken to represent corpus to the extent that it is attributable to income derived by the trust estate which would have been subject to tax had it been derived by a resident taxpayer (paragraph (a)); or

- amounts - such as capital gains, or ex-Australian income taxed abroad and exempt from tax under section 23(q) of the Principal Act - that would not be included in assessable income if derived by a resident taxpayer (paragraph (b)); or

- amounts that have been or will be liable to tax in the hands of the beneficiary under section 97 of the Principal Act or in the hands of the trustee under sections 98, 99 or 99A of that Act, whether or not (e.g., because the income is below a minimum amount) the amount has actually borne tax in the hands of the beneficiary or trustee (paragraph (c)).

Section 99C : Determining whether property is applied for benefit of beneficiary

Proposed section 99C is complementary to section 99B and is designed to ensure that a beneficiary will not escape the provisions of section 99B where indirect or artificial means are used to provide the beneficiary with the benefit of accumulated trust income.

Sub-section (1) of proposed section 99C states the general rule that, in determining for the purposes of section 99B whether any amount has been applied for the benefit of a beneficiary of a trust estate, regard is to be had to all benefits of whatever nature or form that have accrued to the beneficiary - and whether or not the beneficiary had rights at law or in equity in or to those benefits - as a result of the derivation of or in relation to that amount.

Sub-section (2) re-inforces the principle of sub-section (1) by setting out a number of situations where an amount is to be taken for purposes of sub-section (1) as having been applied for the benefit of a beneficiary. The provisions of proposed sub-sections (1) and (2) follow those

enacted for a comparable purpose in section 24H of the Principal Act.

The situations specified are those where -

(a) the amount will in any form enure for the beneficiary's benefit;

(b) the derivation of the amount increases the value of the beneficiary's property;

(c) the beneficiary receives a loan or other benefit provided out of the amount;

(d) the beneficiary has power to obtain the beneficial enjoyment of the amount; and

(e) the beneficiary assigns his interest in the amount or is able to control its application.

Section 99D : Refund of tax to non-resident beneficiary

Proposed section 99D provides the mechanism by which a non-resident beneficiary in a resident trust estate may obtain a refund of any Australian tax paid by the trustee under section 99 or section 99A in respect of amounts paid to him that are attributable to the foreign source income of the trust estate.

Sub-section (1) of proposed section 99D contains the basic rule that where in the specified circumstances an application supported by the necessary information is made to the Commissioner of Taxation, the Commissioner is, subject to sub-section (2), to refund to the non-resident beneficiary so much of the Australian tax paid by the trustee as is attributable to the amount of the foreign source accumulated income that is attributable to the period during which the beneficiary was a non-resident and is paid to the beneficiary.

Paragraphs (a) to (c) of sub-section (1) set out the circumstances in which an application may be made for a refund of tax under section 99D. These are -

- that the trustee of a resident trust estate has been assessed and was liable for tax in respect of all or part of the net income of a year of income of the trust estate under section 99 or 99A (being 1978-79 or a later year) (paragraph (a));

- that the tax so assessed has been paid (paragraph (b)); and

- that the trustee has, in accordance with the trust, paid to the beneficiary an amount of the accumulated income of the trust estate (paragraph (c)).

Paragraph (d) of sub-section (1) sets out that an application for a refund of tax under section 99D must be made in writing, by or on behalf of the beneficiary, within 60 days after the date on which the payment of accumulated trust income is made to the beneficiary, or within such further period as the Commissioner allows.

Before a refund may be made, the beneficiary is to be required, by paragraph (e), to satisfy the Commissioner that all or part of the payment -

- is attributable to a period when the beneficiary was not a resident and is attributable to income from sources out of Australia (sub-paragraph (i));

- was taken into account in calculating the net income of the trust estate (sub-paragraph (ii)); and

- is not income that is deemed not to have been paid to or applied for the benefit of the beneficiary or to be income to which the beneficiary is not presently entitled by the operation of proposed new section 100A that deals with "reimbursement agreement" arrangements - see the notes on clause 18 (sub-paragraph (iii)).

Sub-section (2) of proposed section 99D will allow the Commissioner to refuse to make a refund of Australian tax in relation to an amount paid to a beneficiary of a trust estate where he is of the opinion that the whole or a part of the amount was paid for a purpose of enabling the beneficiary to obtain a refund.

By sub-clause (2) of clause 16 sections 99B, 99C and 99D will apply in respect of the 1978-79 and subsequent income years.

Clause 17 : Beneficiary under disability deriving income from other sources

Sub-clause (1) of clause 17 proposes to amend section 100 of the Principal Act by omitting sub-section (1) of that section and substituting a revised sub-section. Under section 100, the assessable income of a beneficiary who is under a legal disability and who is a beneficiary in more than one trust estate or who derives income from any other source, for example, from salary or wages, is to include his individual interest in the net income of the trust estate or in those trust estates. Because the trustee of the trust estate will

also have been taxed under section 98 on this trust income to which the beneficiary under a legal disability is presently entitled, provision is made by sub-section 100(2) for the tax paid or payable by the trustee in respect of the beneficiary's interest to be deducted from the tax payable by the beneficiary.

Proposed sub-section 100(1) does not alter this basic approach but, consistently with amendments to be made to section 98 of the Principal Act by clause 13 (see the notes on that clause) the revised sub-section 100(1) will require a beneficiary to include in his assessable income the whole of his individual interest in net income of the trust estate (now to include income from sources in and out of Australia) attributable to the period of the year when he was a resident (paragraph (a)), but only that part of his individual interest in the net income of the trust estate attributable to the period when he was not a resident that is attributable to sources in Australia (paragraph (b)).

By sub-clause (2) of clause 17 the revised section 100 will apply in assessments in respect of income of the 1978-79 and subsequent years of income.

Clause 18 : Present entitlement arising from reimbursement agreement

Introductory note

It is proposed by this clause to insert a new section - section 100A - in the Principal Act to overcome certain tax avoidance arrangements designed to enable trading profits and other income derived by trusts to escape tax.

The arrangements generally turn on the operation of section 97 which, as described earlier in this memorandum, provides for a beneficiary to be subject to tax where the beneficiary is presently entitled to a share of the income of a trust estate and is not under any legal disability. In those circumstances, the beneficiary's share of the trust net income is included in his assessable income and the trustee is not required to pay tax on the income. Where the trustee has a discretion to pay or apply income for the benefit of one or more specified beneficiaries and the trustee exercises the discretion in favour of a beneficiary, section 101 deems the beneficiary to be presently entitled to the amount paid or applied. Such an amount thus also falls to be taxed to the beneficiary under section 97.

A common feature of the tax avoidance arrangements at which the proposed section is directed is for a specially introduced beneficiary to be made presently entitled to income of the trust estate, so that the trustee is relieved of any tax liability on the income. Under the arrangements, the beneficiary also does not pay tax, e.g., because of a peculiar tax status. For example, the beneficiary may be a

body or organisation that qualifies for exemption of its income under specific provisions, or it may be another trust that has sufficient deductible losses to absorb its share of income as a beneficiary of the first trust estate.

Invariably, the arrangements require this introduced beneficiary to retain only a minor portion of the trust income and to ensure that some other person - the one actually intended to take the benefit - effectively secures enjoyment of the major portion of the trust income but in tax-free form (e.g., by the settlement of a capital sum in another trust estate for the benefit of that person).

The proposed section 100A will look to the existence of an agreement or arrangement that is entered into otherwise than in the course of ordinary family or commercial dealing and under, or as a result of which, present entitlement to a share of trust income is conferred on a beneficiary in return for the payment of money or the provision of valuable benefits to some other person, company or trust. In those circumstances, the section will require the income of the trust that is dealt with under the "reimbursement agreement" to be treated as having been accumulated by the trustee as income to which no beneficiary is presently entitled. This will result in the trustee being liable to pay tax on the income under section 99A at the prescribed tax rate, 61.5 per cent for 1978-79.

The new section is to apply to reimbursement arrangements giving present entitlement to an introduced beneficiary where the relevant trust income is paid to or applied for the benefit of the beneficiary after 11 June 1978, the day on which the Government announced its intention to introduce legislation to overcome these arrangements.

Clause 18 will, by sub-clause (1), insert the new section 100A into the Principal Act. Notes on each of the proposed sub-sections of section 100A follow.

Sub-section (1) will apply in a case where a beneficiary who is not under any legal disability becomes presently entitled to a share of the income of a trust estate under, or as a result of, a reimbursement agreement. Sub-section (1) ensures that, for the purposes of the Principal Act, the beneficiary will be treated as not having been presently entitled to the relevant trust income. The effect of this will be that the income is not treated as income of the beneficiary under section 97, but that the trustee will be assessable on the income under section 99A.

It should be explained here that the expression "reimbursement agreement" as used throughout section 100A is defined in sub-section (7) as being an agreement ("agreement" is defined in proposed sub-section (13)) that provides for money to be paid, property transferred, or services or other benefits provided to someone other than the beneficiary or to the beneficiary and some other person or persons. The

definition extends to agreements entered into before as well as after the commencement of section 100A. It should also be noted that the payment of money or transfer of property etc. envisaged by the reimbursement agreement will not necessarily be made by the beneficiary who obtains a share of trust income under the agreement but may be made by, for example, an associate of the beneficiary.

Sub-section (2) of section 100A will apply in a case where the trustee exercises a discretion given to him under a trust instrument to pay or apply income of a trust estate for the benefit of a particular beneficiary or beneficiaries not under any legal disability. In that case, section 101 would normally operate to deem the beneficiary concerned to be presently entitled to the amount paid or applied for the beneficiary's benefit, and so fall to be assessed to the beneficiary in terms of section 97.

Where any part of the trust income paid to or applied for the benefit of a beneficiary in exercise of a trustee's discretion is paid or applied as a result of a reimbursement agreement, however, sub-section 100A(2) will override section 101 and deem the relevant trust income not to have been paid or applied for the benefit of the beneficiary. As a consequence, the amount paid or applied will fall to be assessed to the trustee under section 99A as if it too were income to which no beneficiary is presently entitled.

By paragraph (a) of sub-section (3) the operation of sub-section (1) is to be qualified so as not to apply section 100A to income of a trust estate -

- if it is income to which a beneficiary is presently entitled in the capacity of a trustee of another trust estate; or

- if it is income that was paid to, or applied for the benefit of, a beneficiary before 12 June 1978.

The first of these two qualifications applies where trust income flows through more than one trust estate (i.e., where one or more interposed trusts stand between the original trust estate and the ultimate beneficiaries) under the terms of a reimbursement agreement and prevents the provisions of section 100A from applying more than once in respect of that income. It ensures that only the trustee of the last of the successive trusts in a series will be liable to pay tax in accordance with section 99A on trust income that changes hands under a reimbursement agreement.

The second qualification limits the operation of sub-section (1) to trust income that is paid to or applied for the benefit of a beneficiary on or after 12 June 1978. Where a beneficiary became presently entitled to a share of relevant trust income before 12 June 1978 but that share had not been

paid to him or applied for his benefit before that date, the sub-section may have application in relation to the income.

Paragraph (b) of sub-section 100A(3) similarly qualifies the operation of sub-section (2) in these two respects.

The purpose of sub-section 100A(4) is to ensure that where tax is to be paid by a trustee in relation to income to which sub-section (1) or (2) applies, the tax will be at the prescribed rate of tax imposed on income falling to be assessed under section 99A and not at the ordinary, and generally lower, rates of tax that apply where income is assessed to a trustee under section 99.

Trust income to which no beneficiary is presently entitled is generally subject to tax under section 99A unless the Commissioner of Taxation forms an opinion in accordance with sub-section 99A(2) that, on the basis of guidelines contained in sub-section (3), it would be unreasonable for section 99A to apply. In that event, the income is taxed under section 99 at ordinary rates. Sub-section 99A(5) provides further that section 99A is not to apply to so much of the net income of a trust estate as, in the opinion of the Commissioner, relates to income that is accumulated for the benefit of certain funds, organisation and institutions whose income is exempt from tax under specific provisions of section 23.

Paragraph (a) of sub-section 100A(4) will ensure that when ever the circumstances for the application of section 99A are raised by the operation of sub-section (1) or (2) of section 100A) section 99A will apply regardless of the exclusions that might otherwise be provided by sub-sections 99A(2), (3) and (5).

Paragraph (b) of sub-section 100A(4) will mean that where sub-section (1) or (2) applies in relation to any trust income, the trust estate is to be deemed to be a resident trust estate for the purposes of assessing the amount of tax that the trustee is required to pay under section 99A. Explanations of the way in which the law is to apply in relation to resident trust estates are contained in earlier notes.

The purpose of paragraph (b) is to ensure that the trustee will be liable to be assessed on the whole of the relevant trust income that is the subject of a reimbursement agreement notwithstanding that some of that income may have been derived from sources out of Australia and would, but for paragraph (b), be excluded from the amount assessable to the trustee by virtue of the new sub-sections 99A(4B) and (4C) proposed to be inserted by clause 15.

Sub-section (5) of section 100A complements sub-section (1) and will apply in the case of a beneficiary not

under a legal disability whose present entitlement to a share of the income of a trust estate is not entirely attributable to a reimbursement agreement, i.e., where the beneficiary would have been, or could reasonably be expected to have been, presently entitled to some share, albeit of a lesser amount, of the trust income even if the reimbursement agreement had not been entered into.

In those circumstances, sub-section (5) requires a calculation to be made of the increase in the present entitlement of the beneficiary that is attributable to the reimbursement agreement. For the purposes of sub-section (1) the increased amount of entitlement will be taken to be the present entitlement of the beneficiary that has arisen out of the reimbursement agreement. Thus a trustee will not become liable to tax under section 99A by virtue of section 100A in respect of any part of a beneficiary's present entitlement that is not attributable to a reimbursement agreement.

Sub-section (5) will apply where a reimbursement agreement is entered into at or after the time when the person or organisation etc. became a beneficiary in the trust estate and notwithstanding that the beneficiary may have become a beneficiary before the commencement of section 100A.

Sub-section (6) complements sub-section (2) in a way similar to the relationship between sub-sections (5) and (1), and applies in situations where an amount of trust income is paid to or applied for the benefit of a beneficiary not under a legal disability and who, under the normal operation of section 101, would be deemed to be presently entitled to that amount.

The sub-section deals with cases where some lesser amount of trust income would have been, or could reasonably be expected to have been, paid to or applied for the benefit of a beneficiary but a greater amount has been paid or applied as a result of a reimbursement agreement entered into at or after the time when the person or organisation etc. concerned became a beneficiary of the trust estate.

A notional calculation will be made of the extent to which the amount actually paid or applied exceeds the amount that would or could be expected to have been paid or applied to or for the beneficiary in the absence of the reimbursement agreement. The increase so calculated will be taken to be the sum that, for the purposes of sub-section 100A(2), is to be treated as paid or applied as a result of the reimbursement agreement.

As discussed in the notes on proposed sub-section 100A(1), sub-section (7) contains a definition of the expression "reimbursement agreement" adopted throughout the new section in relation to a beneficiary of a trust estate. Reference should also be made to the notes that follow on proposed sub-sections (8) to (13) which qualify in several respects the meaning to be given to that expression.

Sub-section (8) will effectively exclude from the scope of section 100A any agreement that was not entered into or carried out for a purpose of securing for any person a reduction in that person's liability to income tax in respect of a year of income, i.e., section 100A is only concerned with tax avoidance arrangements.

In that context, sub-section (9) will require an agreement to be treated as having been entered into or carried out for a tax avoidance purpose of the kind referred to in sub-section (8) if any person who is a party to the agreement had such a purpose.

Sub-section (10) is a drafting measure to ensure that agreements providing for loans of money to be made to persons will be treated as agreements that provide for the payment of money to those persons.

Sub-section 6(1) of the Principal Act defines "person" to include a company. By proposed sub-section 100A(11) this expression is further extended for the purposes of section 100A to be read as also including any person in the capacity of a trustee. Thus, references to a person or persons in section 100A include natural persons, companies and trustees.

Sub-section (12) will deal with agreements under which a debt is released or abandoned or a person fails to demand payment of a debt when it falls due or allows payment of a debt to be postponed. Such an agreement will be deemed to be an agreement under which an amount of money is to be paid to a person.

Sub-section (13) will extend references to an "agreement", where used in the section, to include arrangements or understandings and to cover agreements that are not legally enforceable. However, specifically excluded from the definition is an agreement, arrangement or understanding entered into in the course of ordinary family or commercial dealing.

The sub-section also extends references to "property" to include choses in action (e.g., shares or debentures) and also to include legal or equitable interests or rights in property.

Sub-clause (2) of clause 18 provides for the new section 100A to apply to assessments in respect of 1977-78 and the subsequent income years. However, under specific provisions of section 100A explained in preceding pages, the section will not affect the income tax treatment of amounts of trust income that were paid to or applied for the benefit of beneficiaries prior to 12 June 1978.

Clause 19 : Revocable trusts

Clause 19 will amend section 102 of the Principal Act by inserting a new sub-section - sub-section (2B). Section 102 applies, where a settlor has created a revocable trust, that is, broadly, one that he can revoke or alter so as to himself acquire a beneficial interest in corpus or income, or a trust under which income is payable to, or accumulated or applicable for the settlor's unmarried children under the age of 21 years. In this situation the Commissioner of Taxation may require the trustee to pay tax equivalent to the reduction in the tax payable by the settlor because of the existence of the trust.

New sub-section 102(2B) will require the Commissioner of Taxation in calculating the tax payable by the trustee under section 102 of the Principal Act to exclude any part of the net income of the trust estate that is attributable to sources out of Australia and that is attributable to a period in which the settlor was not a resident of Australia. This sub-section will have effect in respect of the 1978-79 and subsequent years of income.

Clause 20 : Amendment of assessments

This clause will amend section 170 of the Principal Act which governs the power of the Commissioner of Taxation to amend income tax assessments. Sub-section (10) of section 170 provides that nothing in the section is to prevent the amendment of an assessment at any time for the purpose of giving effect to specified provisions.

Sub-clause (1) of clause 20 will insert in sub-section 170(10) references to the new sections 82KJ and 82KK that are proposed by clause 6 of the Bill, and the new section 100A proposed by clause 18. As amended, sub-section 170(10) will enable the Commissioner to give effect to the nominated provisions by amending the assessments of taxpayers at any time. Thus, when facts emerge that justify that course the Commissioner will be authorised to amend assessments to disallow deductions for expenditure incurred under "pre-payment" schemes and income tax deferral schemes described in the notes explaining clause 6. Authority will also be available to amend assessments of trustees to include amounts of trust income that are found to be the subject of a reimbursement agreement. Sub-clause (2) means that this power to amend assessments will be available in respect of the 1977-78 and subsequent income years.

Clause 21 : Public officer of trust estate

Clause 21 will insert a new section - section 252A - into the Principal Act. Proposed section 252A will require, in certain circumstances in which a trust estate does not have a resident trustee, the appointment by the trustee of a public

officer who will be responsible for seeing to the observance of the trustee's taxation responsibilities. Section 252A is based on section 252 of the Principal Act which requires the appointment of public officers by companies.

The section will, under penalty of a fine, require the appointment of a resident public officer where a trust estate carries on business in Australia or derives property income from sources in Australia (other than dividend or interest income on which withholding tax is payable) and none of the trustees of the trust estate is a resident of Australia (sub-section (1)). The Commissioner of Taxation is to be given power to grant exemption (conditionally or unconditionally) to particular trust estates (sub-sections (3) and (4)), and trustees concerned are to have 90 days from the commencement of the section (sub-section (1)) or, for trusts that in future commence to derive Australian income, 90 days from so commencing (sub-section (2))to comply.

Sub-section (5) will require the formal appointment of a public officer and sub-section (6) sets out circumstances in which such an appointment ceases to be in force.

Sub-sections (7), (8) and (11) deal with the service of documents relating to the taxation affairs of a trust estate while sub-section (9) makes an appointed public officer answerable for doing things required of the trustee under the income tax law. By sub-section (10) proceedings against a public officer are to be taken as also being against the trustee, and under sub-section (12) acts of the public officer are to be treated as acts done by the trustee. If there is not an appointed public officer, sub-section (11), makes it clear that the trustee must still carry out his taxation responsibilities as trustee.

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Annexure B

implementation should be investigated rather than reason sought as to why they should not.

In conclusion, I thank the officers of the AGPS who throughout the inquiry offered a great deal of assistance and thoughtful advice to the Committee. In particular, I must also thank the members of the Committee both past and present who have taken part in this inquiry. I draw particular attention to my Deputy Chairman, Senator Missen, who has always given ready attention to the inquiry. It has been a long inquiry and one which has made great demands on its members. Finally, I must commend the staff of the Committee, namely, Mr Tom Wharton, who is Deputy Usher of the Black Rod and has acted in a part time capacity as Secretary of this Committee; Mr Craddock Morton who is a research officer for several Senate committees; and Mrs Nancy Saunders, a typist.

I should say that if inquiries of this nature are to be conducted in the future, availability of staff will be a real problem. I believe part time staff to be inadequate. During the period of any inquiry in the future extra staff should be obtained or at least secondments should be made from other departments on a full time basis to enable such an inquiry to be conducted satisfactorily. I believe that it is unfair to expect part time staff to be involved in giving so much of their out-of-work time to ensure that these inquiries are completed satisfactorily. I commend the report to the House.

INCOME TAX ASSESSMENT AMENDMENT BILL (No. 5) 1978

Bill presented by Mr **Howard**, and read a first time.

Second Reading

Mr **HOWARD** (Bennelong—Treasurer) (3.15)—I move:

That the Bill be now read a second time.

This Bill contains further measures designed to prevent income tax avoidance. It covers three main matters and in each case the amendment now proposed was foreshadowed in announcements I made earlier this year. The measures contained in this Bill, along with those that have already been introduced in both the income tax and the sales tax fields, constitute a most significant attack on tax avoidance. They are further evidence of the Government's continuing effort to ensure greater equity in the tax system. Other legislation against tax avoidance was foreshadowed during the year and I regret that it has not been practicable to bring forward all the planned measures before Parliament rises for the summer recess. Legislative form remains to be given to proposals outlined in my statements of 24 September and 3 October 1978. I assure honourable members that avoidance schemes identified in these announcements will be the subject of legislation introduced soon after the recess.

I would like to think that it is understood that anti-avoidance and other taxation legislation introduced this year has, because of its wide scope and unavoidable complexity, placed a considerable strain on those responsible for its preparation. It has just not been possible to do any more in the time. So I think those who might be inclined to be critical that this or that has not yet been done might acknowledge that an extraordinary amount of difficult tax legislation has been produced and a lot of it put into the administrative system. There has been some criticism of the Government's policy of announcing an intention to legislate against particular avoidance schemes as soon as they are identified, with legislation being introduced at a later date to take effect from the date of the announcement. I am convinced, however, that this is the right way to take action against what, in most instances, are blatantly contrived and artificial arrangements. At the same time, an early announcement is vital to prevent a continuing and substantial loss of revenue. I do accept, however, that lengthy intervals between announcement and introduction of legislation should not occur. The Government will be guided by that objective.

Turning now to the subjects of this Bill, I point out that the first group of amendments are about the pre-payment schemes I referred to in my statement of 19 April 1978. The second group is concerned with avoidance of tax on income from ex-Australian sources derived through trusts, and related problems concerning partnerships. I spoke about these in my statement on 8 June 1978. The third lot of amendments is concerned with tax avoidance arrangements involving trust-stripping. I made a statement on this subject on 12 June 1978.

Pre-paid Interest, Pre-paid Rent and Similar Schemes

In my statement of 19 April 1978, I described schemes involving pre-payments that fall within two general classes and outlined remedial measures proposed. The first class embraces schemes for pre-payments of amounts under arrangements designed to secure an income tax allowance for what purports to be deductible expenditure but is, in essence, either not a real expense or one of a non-deductible capital

nature. An example of a scheme designed to secure an income tax deduction for an unreal or manufactured expense is the pre-paid interest scheme described in my announcement of 19 April 1978. Under that scheme, a taxpayer obtains a loan of $1,000, promptly pays $700 as a pre-payment of interest, and then buys back, or has an associate buy back, the rights in the loan for $370. The aim is to secure a $700 tax deduction for interest for a net outlay of only $70. The $70 is the lenders reward for participating in the scheme.

An example of a scheme designed to secure a deduction for an otherwise non-deductible capital expense is the pre-paid rent scheme I referred to last April. Under this scheme, a taxpayer wishing to obtain new business premises worth $1m arranges for a tax-exempt institution to purchase the premises for that amount, then leases the premises from the institution and pays it $800,000 rent for five years in advance. The taxpayer also takes up an option to acquire the premises for $250,000. The institution makes a non-taxable profit of $50,000 and the taxpayer aims to secure a deduction, in the guise of an expenditure on rent, for the major part of the capital cost of the building. Provisions of the Bill relating to these pre-payment schemes will preclude the allowance of income tax deductions for outgoings incurred under such schemes after 19 April 1978.

The second type of scheme referred to in my April statement embraces tax avoidance arrangements between associated parties designed to provide a tax deduction to one of the parties in a year of income for an amount that, in whole or in part, will not be taxable to the other party until a later year or over a series of later years. Provisions of the Bill relating to these schemes will apply in two different ways according to whether or not the arrangements involve outlays for the future provision of goods or services. In cases involving such outlays, a deduction is to be available in a particular year of income for only so much of the total amount as can reasonably be apportioned to the goods or services actually provided in the year. In other cases, the deduction in a particular year of income is to be limited to the amount actually paid in the year. The provisions will apply only where the arrangements between the associated parties are entered into for the purpose of tax avoidance and the outgoings are incurred after 19 April 1978. I stress that the provisions of this Bill designed to counter pre-payment schemes are concerned only with the schemes outlined in my announcement of 19 April. They do not extend to variations of the schemes referred to in my later statement on 24 September. Legislation directed against the further schemes will be introduced early in the autumn sittings.

Foreign Source Income of Trusts and Partnerships

The second group of measures contained in the Bill is designed to limit opportunities to avoid tax on income from an ex-Australian source that is derived through a trust or a partnership. These measures were foreshadowed in my statement on 8 June 1978, and as indicated then, will apply for the 1978-79 income year. The need for these amendments arose out of a High Court decision to the effect that the trust provisions of the income tax law do not apply to income of a trust that is derived from a foreign source. The Asprey Committee described this result as 'unacceptable' because it means that Australian residents can defer—or even escape completely—tax on foreign source income that is accumulated for their benefit.

The basic thrust of the proposed provisions is to ensure that both Australian and foreign source trust income to which an Australian resident beneficiary is presently entitled in the year of income will be taxed under the trust provisions to the beneficiary or, if the beneficiary is under a legal disability, such as infancy, to the trustee. To provide also for situations in which there is trust income to which no beneficiary is presently entitled—broadly, income that is being accumulated without any beneficiary having a right to demand it from the trustee—a concept of a resident trust estate is being introduced. This was recommended by the Asprey Committee. A resident trust estate will be one with a resident trustee, or with its central management and control in Australia, at any time during the year. In terms of the Bill, a trustee of a resident trust estate will be taxed on the part of world-wide income of the trust estate that is assessable income under the general provisions of the income tax law and to which no beneficiary is presently entitled. As at present, no further Australian tax will be payable by a beneficiary to whom such income is subsequently distributed. The Bill provides, however, for refunds of Australian tax in a special and unusual case. This is the case where foreign source income is later distributed to a beneficiary who was a non-resident at the time the income was derived by the trust estate. In that case Australian tax attributable to the foreign income so distributed is to be refunded on application by the beneficiary.

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Provisions are also included to ensure that a resident beneficiary is taxed on foreign source income that had first been accumulated but was later paid or applied for the beneficiary's benefit. These provisions will apply if the income was not taxed in Australia while accumulating in a trust estate that is not a resident trust estate and would have been taxable to a resident beneficiary had he or she been presently entitled to it when it was derived by the trustee. The provisions include rules designed to prevent a beneficiary escaping tax on a technicality that an amount or benefit is not received as income. Existing provisions of the Income Tax Assessment Act will prevent double taxation of foreign source income to which the amended trust provisions potentially apply where that income has also been taxed in the foreign country of source. To aid administration, a trust which does not have a resident trustee, and which carries on business or derives income from property in Australia, will be required to appoint a public officer in the same way as a company is now similarly required.

The Bill also contains provisions to make it clear that income from abroad is to be included in calculating the net income of a partnership, and that a resident partner is liable to tax on a share of the partnership's world income, subject to provisions giving relief from double taxation of foreign source income that is taxed in the country in which it arises. Non-resident partners will continue to be subject to Australian tax only on income attributable to sources in Australia. Before moving to the next group of amendments I note that, as I said in my statement on 8 June 1978, the taxation of trust income of beneficiaries is—as has always been intended—based specifically on the present entitlement of the beneficiaries. The fact that a beneficiary is paid income to which he or she is otherwise presently entitled will not impair the operation of provisions of the income tax law the application of which depends on the beneficiary being presently entitled to income.

Trust Stripping Schemes

The remaining provisions of the Bill will implement proposals I announced on 11 June 1978 to deal with trust and associated arrangements seeking to bring about the happy situation that neither the trustee nor an intended beneficiary, nor anyone else, pays tax on substantial income derived by the trust estate. As explained in my earlier statement, there are several variants of the schemes but, for the most part, they rely on a nominal beneficiary being introduced into a trust and being made presently entitled to income, thus relieving the trustee of any tax liability in respect of the income. It is, however, a feature of the arrangements that the introduced beneficiary also escapes tax by one means or another. For example, the nominal beneficiary may be a tax-exempt body such as a charitable institution. In any event, this nominal beneficiary retains only a minor portion of the trust income, while the group for whose benefit the trust in substance exists secures effective enjoyment of the major portion, but in a tax-free form. For instance, the nominal beneficiary may have acquired its interest in the income by payment of a broadly equivalent sum to the persons really intended to take the benefit.

The provisions designed to counter these schemes will look to the existence of an agreement or arrangement under which, for purposes of tax avoidance, present entitlement to a share of trust income is conferred on a beneficiary in return for the payment of money or the provision of benefits to some other person, company or trust. In those circumstances, the provisions will treat trust income dealt with under what is aptly termed the 'reimbursement agreement' as not being income to which any beneficiary is presently entitled. The effect will be to make the trustee liable to tax on the income under section 99A of the Income Tax Assessment Act at the prescribed tax rate, which is 61.5 per cent for 1978-79. The change in the law will apply to trust income paid to or applied for the benefit of a beneficiary on or after 12 June 1978 under tax avoidance schemes of the kinds mentioned and will not apply in the context of an agreement or arrangement that is entered into in the course of ordinary family or commercial dealing.

Mr Deputy Speaker, I mention that the Government does not seek passage of this Bill until the autumn sittings. As I indicated earlier, I readily accept the need to bring in legislation as soon as practicable after an announcement is made. It is to this end that the Bill is being introduced so that provisions giving effect to the earlier announcements on subjects of the Bill are available for study by interested members of the public and the Parliament, before being debated by the Parliament. The Government is strongly committed to the policy expressed in the legislation but it is of course ready to examine any constructive comments that might be made about technical features of the legislation after it has been examined by interested parties. Details of the various provisions of the Bill are contained in an explanatory memorandum that is being circulated to honourable members. I commend the Bill to the House.

Annexure C

78/203

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INCOME TAX ASSESSMENT AMENDMENT BILL (No. 5) 1978

Date Introduced: 23 November 1978
House: House of Representatives
Presented by: Hon. John Howard, Treasurer

Short Digest of Bill

Purpose

To block tax avoidance schemes involving pre-payment schemes, trust income derived outside Australia, and trust-stripping.

Background and Main Provisions

The Treasurer announced in a Press Statement on 19 April 1978 that the first category of schemes involving pre-payments would be legislated against, effective from 20 April. These schemes involved the "taxpayer" obtaining a tax deduction for pre-payments of interest on a loan which is artificial in that it is then effectively cancelled by the taxpayer buying back the rights in it.

Clause 6 inserts new s.82KJ in the Income Tax Assessment Act 1936 so as to disallow any deduction for outgoings incurred as a result of a tax avoidance agreement where the outgoing exceeds the amount that might reasonably be expected to have been incurred at that time in respect of the related benefit (e.g. due to pre-payment), and property is acquired by the taxpayer or an associate, and the consideration payable for the acquisition of the property is less than what might have been reasonably incurred if the outgoing had not been incurred.

Clause 6 also inserts new s.82KK. Sub-section (1) specifies certain types of losses or outgoings to which the section applies under arrangements between associated parties for the purposes of securing that one party will obtain a deduction while the other party will not bear tax on a matching amount in the same year of income. Sub-sections (2) and (3) will deny a deduction for such outgoings where they were incurred as part of an arrangement for deferring tax on the amount receivable by the associate.

The second broad category, covered by a Press Statement of 8 June 1978, relates to avoidance of tax on income derived outside Australia through a trust or partnership.

Clause 11 inserts new sub-section 95(1) by which the 'net income' of a trust estate will be calculated broadly as if the trustee was a resident taxpayer. The effect of this will be to extend its assessable income to include income from outside Australia.

Clauses 12 and 13 amend s.97 and 98 respectively, covering the case of beneficiaries presently entitled to a share of the income of a trust estate. S.97 covers the case of beneficiaries not under a legal disability, and s.98 the case where they are under a legal disability (e.g. infancy). The amendments ensure that assessable income will include the net income of the trust estate (i.e. from sources in and out of Australia) derived when the beneficiary was a resident and, when the beneficiary is a non-resident, only income from sources in Australia.

Clause 14 inserts new sub-sections 99(2) and (3) to similarly extend tax to the ex-Australia component of accumulating income in resident trust estates in respect of which no beneficiary is presently entitled. New sub-sections 99(4) and (5) cover non-resident trust estates and will require the taxation only of Australian source income.

Clause 15 makes similar amendments to s.99A which imposes a special tax rate (61.5% for 1978-79) on trusts that are involved in tax avoidance arrangements.

Clause 7 amends s.90 relating to partnerships to define their net income as for a resident individual to ensure that ex-Australia income is included.

The third category involved 'trust-stripping', covered by the Treasurer's Statement of 11 June 1978. Here, the trustee avoids tax by directing income to the trust beneficiary who is presently entitled to a share of the income and not under any legal disability, and where the beneficiary also is tax-exempt for some reason, and there is a "reimbursement agreement" under which the beneficiary redirects the benefit of the trust income to the trustee.

Clause 18 inserts new sub-section 100A(1) which provides that, in cases involving tax avoidance arrangements of the above type, the beneficiary will be regarded as not being presently entitled to the income, so that it will be taxed in the hands of the trustee under s.99A instead of s.97. The amendment is to operate from 11 June 1978.

Finance, Industries, Trade & Development Group
LEGISLATIVE RESEARCH SERVICE

5 December 1978

Annexure D

Catching the big fish in the tax pool

by ROSS GITTINS, Economics Writer

NINETEEN seventy-eight may go down as the year of the tax dodger.

The controversy that has arisen over the income tax amendments at present before Federal Parliament seems to have done nothing to deter the Government from vigorously pursuing what it calls its "program to strike down tax avoidance arrangements."

Such is the zeal of the Treasurer, Mr Howard, that the subject of tax avoidance is likely to keep cropping up as the Government seeks to plug loopholes as fast as they are discovered and exploited by the small army of tax accountants, lawyers and "consultants" who make up the tax avoidance industry.

These men include some of the best brains of their professions, many of them having learned the tax game as employees of the Taxation Office.

The first thing to be said about the crackdown is that the average taxpayer has nothing to fear, and perhaps something to gain.

Generally speaking, it is only self-employed business and professional people earning more than $100,000 a year who can take advantage of sophisticated tax-avoidance schemes.

Lesser mortals usually cannot afford to pay for advice on such schemes, or do not know of the possibilities.

Moreover, the vast majority of employees, whose tax is deducted from their weekly pay before they see it, have very little scope to play winner-takes-all with the taxman.

Which is the reason why the Government is probably on an electoral winner in its crusade against upper-crust "tax bludgers."

Of course, tax avoidance is perfectly legal.

The much-discussed Curran tax-avoidance scheme, which the Government intends to defeat retrospectively, was ruled legal in 1974 by the High Court.

In the Curran case, what was, in commonsense terms, a profit of $2,783 was held by the learned judges to be a loss of $188,217.

This remarkable result was made possible because Mr Curran received "bonus" shares from a private company which he controlled.

As their name suggests, the bonus shares cost him nothing but, like most shares, they had a "par" or nominal value of $1 each.

The High Court ruled that Mr Curran could charge the nominal value of each share against his taxable income, as an expense.

The distinguishing feature of tax avoidance schemes is that they are, in Mr Phillip Lynch's words, "highly artificial and contrived." They are crazy financial contortions performed for no other reason than to avoid paying tax.

Mr Charles Curran was a Sydney stockbroker, so for people to benefit from his legal precedent they had to be share-traders.

When a tax consultant plans Curran-style benefits for a client, he arranges for a flurry of share buying and selling to be done in the client's name so that the client becomes a "share-trader."

Capital profits

The Curran scheme also requires the availability of a private company which has undistributed capital profits (to allow the bonus share issue).

The Curran scheme is one of six types of tax-avoidance arrangements which the current amendments seek to overturn. One of the other more colourful schemes involves tax-deductible gifts to charities.

Under one gift scheme the donor gets a deduction for a $10,000 gift.

But only $1,500 comes out of his pocket. The rest is lent to him by the promoters of the scheme. The charity agrees to pay the promoters a 98.8 per cent "procuration fee," leaving it with an effective gift of only $120.

The donor does not repay his loan to the promoters, but they end up with a net profit of almost $1,400. In actual cases, all these figures could be multiplied by five or 10.

A simpler version of the gift scheme involves the donor giving the charity a painting or other work of art. He claims the full value of the work as a deduction, but requires the charity to lend it back to him or his relative.

A different scheme involves business and professional people receiving $1 income from a primary production trust.

This allows a doctor, for example, to claim that he is a primary producer and this, in turn, allows him to postpone much tax by averaging his rising income from medicine, over a number of years, for tax purposes.

Other tax-avoidance arrangements are usually much less interesting and much more complicated.

They involve the artificial creation of share-trading losses, the use of techniques to avoid the undistributed-profits tax on private companies, and "dividend stripping" of companies.

The objection to all these games is that they allow very rich people to avoid carrying their share of the tax burden.

Of course, the more people who choose not to pay their tax, the bigger the burden everyone else has to carry.

For this reason the Government's efforts to crack down on Curran and various other tax-avoidance schemes have drawn widespread support in the community.

But there has also been very vocal criticism of the Government's intention to backdate the outlawing of the Curran schemes to August 16 last year.

This was the day the then Treasurer, Mr Lynch, announced the Government's intention to legislate against various unspecified tax-avoidance practices.

Not only did he fail to mention the Curran scheme specifically, but Government ministers declined to acknowledge that they had it in mind. The first indication that the Fraser Government intended to upset the Curran scheme did not come until April 7.

The objectors' motives are obvious enough and not particularly impressive.

But the fact remains that they have a very impressive argument. And their cause has received a considerable boost from the support of the former Prime Minister and former Treasurer, Sir William McMahon.

Sir William outlined the arguments against retrospective tax laws in an article in the Herald last week.

He made the particularly weighty point that retrospective legislation strikes at the fundamental democratic principle of "the rule of law."

Public right

Every person has the right to know that if he orders his affairs to conform with the law of the land, he has nothing to fear from the Government.

But when Governments start to make laws retrospective, people cease to know exactly where they stand. Might not a precedent set in the area of tax law be used in future to justify a retrospective change that affected not just pocketbooks, but basic civil rights?

The Government, and the people who support its intention to strike down the Curran schemes retrospectively, have several replies to Sir William's argument.

The least impressive is that a former Labor Treasurer, Mr Crean, announced his Government's intention to close the Curran loophole as long ago as December, 1974, when the High Court decision was handed down.

The best reply is that the question is not one of principle versus expediency, but of two principles in conflict. The first principle is the rule of law, the second is that the tax burden should be shared equitably.

The reader will make up his own mind on the question. Try as I may, I cannot avoid agreeing with the opponents of retrospectivity.

Once before, the Fraser Government has attempted to bring in retrospective tax legislation and been dissuaded at the last moment.

This time, Mr Fraser, Mr Howard and the Cabinet seem to be standing their ground. If, as seems likely, the Labor Opposition decides to support the Government on the question, Parliament is sure to pass the legislation.

Why is a coalition Government so determined to crack down on tax "dodgers"? The Whitlam Government, in contrast, was conspicuously inactive in the area.

The first reason is political. Although the people who use and promote tax avoidance schemes can safely be regarded as staunch and influential Liberal voters, they are unlikely to take their votes elsewhere.

Moreover, the last election left Mr Fraser with a particularly strong electoral majority. He can afford to take a few risks.

He may even pick up a few votes in the middle ground from people who object to the upper-crust tax "rip-off."

The other, and more compelling reason, is economic. The Fraser Government is committed to reducing the burden of income tax.

Now the Government is getting about making everyone pay his fair share.

Partly as a result of the Government's generous tax cuts, the economically important and politically sensitive Budget deficit has started rising again.

For the present financial year the deficit is likely to be nearer $3,000 million than the $2,200 million that the Government budgeted for. First estimates for next year's deficit are in the region of $6,000 million.

TOMORROW: Michael Sexton puts the case for retrospectivity.

Annexure E

Wage and salary earners *are* being ripped off by the way our tax system now works. They are the ones who cannot use tax lurks, so they are paying more and more while the top people pay less and less. Our tax system is no longer just or equitable — it is breaking down. ANDREW WATSON reports . . .

How the rip-off artists increase your tax

The Australian wage earner can't join the tax revolt and fight — his tax money just disappears from his pay packet.

It's easy and regular money for the Government and as wages rise, so does the tax bite.

The wage earner doesn't have an arsenal of accountants and lawyers to devise tax dodging schemes — that is the prerogative of the rich, the self-employed, the sharp businessmen, who are supported, surprisingly, by decisions of the High Court of Australia.

And because the tax avoidance industry has been so successful in siphoning off millions of dollars in revenue from the Government, there is no chance of taxes coming down.

The Federal Treasurer, Mr John Howard, admitted in an interview with The Sun-Herald that the tax avoidance industry had created a great inequity for salary and wage earners.

"It means the rest of the community are paying higher taxes than they would otherwise pay," he said.

"Some of the tax avoiders preach we ought to have a lower tax rate.

"I would respond that if they didn't tax avoid, we could have a lower rate."

Mr Howard said the Government was trying to crack down on tax-avoiders, but it had a long way to go.

Mr Howard . . . long way to go on tax avoidance.

The very rich — advised by high-powered lawyers and accountants — have always avoided tax with complicated company structures, paper share transactions, the leasing of expensive cars, boats and homes for "business" purposes.

The soaring inflation of the mid-1970s pushed up the salaries and income of the professionals and the middle class.

When their marginal rate of tax — the rate paid on the top end of incomes — hit 62c in the dollar they panicked and sought help from the avoidance brokers.

They were advised to use the tax tricks of the rich.

One trick, the split income, works by the big money earner paying some of his income to his wife or children through a trust or private company. Suddenly he tumbles out of the top tax brackets with the tax money still in the family purse.

The professionals — lawyers doctors and architects — are also shown the value of leasing expensive office equipment, antiques and art. The lease payments are a tax deduction and when the lease ends, the item could have trebled in value.

Tax avoidance has become a lucrative industry with sophisticated marketing and high expectation advertising.

And the industry and its clients have found sanctuary in rulings by the High Court of Australia.

This court — under Chief Justice Sir Garfield Barwick — has turned the tables on the Taxation Commissioner by opening up legal loopholes with literal interpretations of the tax laws.

The Government now finds that the man who helped to put it into office with his advice to Sir John Kerr on the dismissal of the Whitlam Government is one of the chief stumbling blocks to the effective management of the country's financial resources.

And now his court's rulings have cost the Fraser Government hundreds of millions of dollars in lost tax revenue.

* * *

The Treasurer admits $700 million of anticipated Government revenue is tied up as the avoiders test their schemes in the courts.

In the last Budget Mr Howard estimated tax avoidance would cost $50 million in lost revenue for this financial year.

But the loss through tax avoidance has turned out to be $230 million — $180 million more than the estimate.

And as the schemes are tested in the courts the taxpayer foots the bill for the salaries of the judges, court officials Tax Office staff and lawyers fighting the costly cases that could run to $50,000 a case if they go to the High Court.

Prior to the Government's campaign to put the screws on avoidance it is estimated they lost $1,000 million in revenue between 1974-1977.

That would have reduced the Government's huge Budget deficit — the central problems of economic management today. Effective tax collection could have saved the damaging cutting of State spending which occurred last week.

"This Government is making the most serious effort ever mounted to reduce tax avoidance," says Mr Howard.

But Mr Howard, 39, and a former solicitor quietly admits the Government has a long way to go.

Mr Howard believes inflation fuelled the avoidance industry and admits: "It gathered pace for a fair period of time because there wasn't much anti-avoidance legislation and the view developed that nothing much was going to be done about it.

"Two or three years ago tax avoidance schemes started to be thrust around and marketed in a more aggressive fashion," he said.

As well as the avoiders, there are the citizens who simply don't pay tax, because they get paid in cash and don't declare it.

Every time you pay cash at a restaurant or give cash for an odd job at home you are probably assisting tax evasion, which, unlike avoidance, is a crime.

The building industry is a big area of evasion and a special inquiry has been set up in the Tax Office to look at curbing it.

Already the Government has put on more tax inspectors to hunt out the evaders and is developing detection techniques.

"I'm not putting it in the too hard basket," claimed Mr Howard "but it is very hard."

But, no one will really know if the Government's new tax measures will get over Sir Garfield Barwick and the High Court.

NEXT WEEK: A report on Sir Garfield Barwick's High Court, and the tax trouble it created for the Fraser Government.

He calls it a game of cat-and-mouse

Harry Walsh sells tax avoidance schemes

For a fee of $250 plus a commission on the saving he helps the rich to dodge the taxman.

For 15 years he was an insurance broker, but now he's decided there is more money in being an avoidance entrepreneur.

If a top businessman goes to him, Mr Walsh will give advice on the best way he can arrange his affairs to get out of paying tax.

Mr Walsh might suggest his client gets into cattle, leasing, or form a family partnership or buy into an avocado farm.

Leasing cattle, which are used for breeding works as an avoidance scheme because the management fees and cattle lease repayments are tax deductible.

Mr Walsh . . . keeping ahead of the taxman.

Forming a family partnership "splits" one high income between husband and wife — dramatically reducing the tax payout.

It takes about seven years for an avocado farm to produce and all the payments to set it up are tax deductions.

After assessing your situation, Mr Walsh refers you to the corps of lawyers and accountants who put his ideas into motion.

He gets a commission — which he won't disclose — if his client goes ahead with the deal and gets past the taxmen.

Mr Walsh, 53, is a stocky man living and working from a harbour view suite at the North Sydney Travelodge.

He describes himself as a professional bachelor, a teetotaller and a person not inclined to socialise. "I lead a monastic life" he said.

The Government's clamp-down on avoidance doesn't disturb him.

"It's a cat and mouse game," he said.

"They can amend the tax laws and tighten them and in another two or three years people will find ways around them," he claimed.

"The politicians and the bureaucrats are blaming the tax avoidance industry for their problems but, in fact it's themselves."

"Really tax avoidance is a perfectly natural thing to do, like sex. Even politicians do it."

Carlo cooks the books

"Carlo" runs a leading Italian restaurant in Sydney and has to pay cash to get good waiters and a chef.

"Officially" he pays them the basic award wage for their jobs.

But then he hands them cash from the till, money they don't disclose to the taxman.

This is the "cash society."

Carlo doesn't like being a part of it but, he says he couldn't get top staff if he didn't give them the cash bonus.

He says a top waiter demands $300 a week and a chef $500 about double the award wages.

Carlo has to fake his own books to cover the cash payments.

"I play about with the food bills and especially the drink bills from suppliers," he says.

So Carlo, too, is misleading the taxman.

"It's the system — if I didn't do it I wouldn't have a restaurant," he says.