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.

15832/78—L Printed by Authority by the Commonwealth Government Printer