THE TAX INSTITUTE

2 October 2019

Mr Chris Leggett
Principal Adviser
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Langton Crescent
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By email: MiscAmendments@treasury.gov.au

Dear Mr Leggett,

**Miscellaneous Amendments to Treasury Portfolio Laws 2019**

The Tax Institute welcomes the opportunity to make a submission to Treasury in relation to the *Treasury Laws Amendment (Measures for a latter sitting) Bill 2019: miscellaneous amendments* Exposure Draft (**Exposure Draft**) and associated Explanatory Memorandum (**EM**).

**Summary**

Our submission below addresses matters related to amendments in the Exposure Draft to transfer pricing legislation and fringe benefits tax legislation. We also propose two further amendments to be included in the Exposure Draft.

**Discussion**

**1. Amendments to the Transfer Pricing rules**

*Overview*

The Tax Institute broadly agrees with the proposal to use the 2017 OECD Transfer Pricing Guidelines as guidance material rather than the combination of the 2010 OECD Transfer Pricing Guidelines and the 2015 Actions 8-10 Final BEPS report as is currently the case.

However, the draft EM as currently drafted does not identify the key changes that the proposed amendment will bring about. We also question whether it is desirable for all of the 2017 OECD Transfer Pricing Guidelines to actually constitute guidance material, for example, Chapter V (Documentation) (which includes Country-by-Country (CbC) reporting) given that Australia already has a number of provisions that deal with documentation (eg section 262A of the *Income Tax Assessment Act 1936* (Cth) (**1936 Act**) and Subdivision 284-E of Schedule 1 to the *Taxation Administration Act 1953* (Cth) (**TAA**) as well as Subdivision 815-E of the *Income Tax Assessment Act 1997* (Cth) (**1997 Act**) that deals with CbC reporting).

*Specific comments on the Exposure Draft*

a) Clause 114: We suggest replacing '19 May 2017' with '23 May 2016', which is the date of approval by the OECD Council. Refer to the explanation below in relation to suggested changes to paragraph 1.110 of the EM.

b) Clause 116: We suggest replacing 'conditions' in line 29 with '*arm's length conditions'. As currently drafted, the clause is incorrect as the guidance material in section 815-135 is used for the purposes of identifying *arm's length conditions, not conditions; see subsection 815-135(1).

c) There is a further reference to paragraph 815-135(2)(aa) in subsection 815-135(3) which the Exposure Draft has overlooked proposing to omit and which should also be omitted.

*Specific Comments on the EM*

As a general comment, it is inaccurate for the EM to state, as paragraphs 1.109 and 1.110 currently do, that the proposed amendments are simply an 'update' of the references in subsection 815-135(2). This is because, as the following examples show, there are a number of parts of the 2017 OECD Transfer Pricing Guidelines that do not form part of either the 2010 OECD Transfer Pricing Guidelines or the 2015 Actions 8-10 Final BEPS Report or involve conforming changes to the 2010 OECD Transfer Pricing Guidelines as a result of the 2015 Actions 8-10 Final BEPS Report:

- Chapter V (Documentation) of the 2017 OECD Transfer Pricing Guidelines. Chapter V of the 2010 OECD Transfer Pricing Guidelines was replaced in its entirety by the *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 - 2015 Final Report*;

- Consistency changes made to Chapter IV (Administrative approaches) of the 2010 OECD Transfer Pricing Guidelines following the issue of the *Making Dispute Resolution Mechanisms More Effective, Action 14 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD, for example:
    - In Section C (Corresponding adjustments and the mutual agreement procedure); and
    - In Section F (Advance pricing arrangements).

- Revised guidance on safe harbours in Chapter IV of the OECD Transfer Pricing Guidelines. The revised guidance was approved by the OECD Council in May 2013, however, does not form part of either the 2010 OECD Transfer Pricing Guidelines or the 2015 Actions 8-10 Final BEPS Report.

We query whether it is intended that the new Chapter V (Documentation) referred to above should constitute guidance material for the purpose of section 815-135 given that Australia has general record keeping rules in section 262A of the 1936 Act, specific transfer pricing record keeping rules in Subdivision 284-E of the TAA and also Subdivision 815-E of the 1997 Act that deals with CbC reporting. As such, a case can be made for excluding Chapter V (Documentation) of the 2017 OECD Transfer Pricing Guidelines from constituting guidance material for the purpose of section 815-135.

We suggest paragraph 1.109 be replaced as follows:

> *The practical effect of the changes made by Part 2 is that the following parts of the 2017 OECD Transfer Pricing Guidelines which do not form part of either the 2010 OECD TP Guidelines or the 2015 Actions 8-10*

*Final BEPS Report - and therefore do not currently constitute guidance material for purposes of s815-135 - will constitute guidance material from the date of application of Part 2:*

- *Chapter V (Documentation) of the 2017 OECD Transfer Pricing Guidelines. Chapter V of the 2010 OECD Transfer Pricing Guidelines was replaced in its entirety by the Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 - 2015 Final Report;*
- *Consistency changes made to Chapter IV (Administrative approaches) of the 2010 OECD Transfer Pricing Guidelines following the issue of the Making Dispute Resolution Mechanisms More Effective, Action 14 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD, for example:*
  - *In Section C (Corresponding adjustments and the mutual agreement procedure); and*
  - *In Section F (Advance pricing arrangements); and*
- *Revised guidance on safe harbours in Chapter IV of the 2010 OECD Transfer Pricing Guidelines. The revised guidance was approved by the OECD Council in May 2013.*

A number of changes should be made to paragraph 1.110:

a) In the first sentence, replace '3 April 2017' with '23 May 2016' and replace 'were incorporated into' with 'were approved by the OECD Council and incorporated into': Paragraph 3.1 of the Revised Explanatory Memorandum to *Treasury Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017 Diverted Profits Tax Bill 2017;*

b) Delete the second sentence. Based on the OECD's media release '*OECD releases latest update to the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*' dated 10 July 2017[1], the reference to 19 May 2017 only relates to consistency changes made to the OECD Transfer Pricing Guidelines in order to produce the consolidated version (ie the 2017 OECD Transfer Pricing Guidelines). These consistency changes are minor in nature and were approved by the OECD's Committee on Fiscal Affairs on 19 May 2017; and

c) In the last sentence, replace 'conditions' with '*arm's length conditions' (per our comments on clause 116 of the Exposure Draft above).

## 2. Fringe Benefits Tax amendments for the treatment of Taxi travel

The Tax Institute has advocated for clarification of the treatment of travel in a ride-sharing vehicle (ride sharing services) for the purpose of determining the correct treatment under the *Fringe Benefits Tax Assessment Act 1986* (Cth) (**FBTAA**) following the decision in *Uber B.V v FCT* [2017] FCA 110 (though that case clarified the relevant GST treatment under the tax law and not the fringe benefits tax (**FBT**) treatment).

We applaud the underlying rationale for the proposed amendments to the FBTAA in respect of the FBT treatment for ride sharing services. However, we do not see any reason or justification for the 'other than a limousine' exclusion being introduced in Item 62 of the Exposure Draft.

We do not see any sound policy reason for distinguishing travel in a limousine for FBT purposes. This distinction will also create additional administrative burdens for employers who will have to separate out the costs of limousine travel for FBT purposes from other ride sharing services when there is otherwise no need,

[1] https://www.oecd.org/tax/oecd-releases-latest-updates-to-the-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations.htm

particularly when one of the reasons for the amendment is to reduce the administrative burden on employers (per paragraph 1.60 of the EM).

Also, no definition of 'limousine' is provided in the FBTAA or the Exposure Draft, so it is unclear whether it is intended to only exclude travel in the colloquially understood meaning of a limousine, i.e. a stretch luxury vehicle, or is intended to extend out further and include all travel in a hire car provided with a driver. We would not support the exclusion of hire car services from exempt FBT treatment either.

Also, what levels of ride-sharing services would amount to travel in a limousine (for example would travel in an 'Uber Premium' vehicle amount to this?)? The lack of clarity in the absence of a definition of 'limousine' would create confusion and add to employers' compliance burden should the exclusion be maintained.

## 3. Other matters that should be addressed in the ED

### a) Deceased Estates

It is necessary that a Legal Personal Representative (**LPR**) who is administering a deceased estate be able to access the historical tax information pertaining to the deceased estate. Currently, an appointed registered tax agent is able to access the relevant historical information through the existing Tax Agent Portal. The new ATO Online service which is set to replace the Tax Agent Portal has recently been introduced. Presently, the two systems are running alongside each other as tax agents transition away from using the Tax Agent Portal to using the ATO Online service. The Tax Agent Portal is set to be decommissioned in March 2020.

The issue that arises is that a tax agent will be unable to access historical tax information of a deceased estate through the ATO Online service (this issue does not exist under the Tax Agent Portal), nor will they be able to access information over the phone or through other means by which they are liaising with the ATO regarding the tax affairs of the deceased estate. An entity who will be able to access historical tax information pertaining to a deceased estate includes, and will generally be, the LPR. However, an LPR will be restricted to engaging only in non-electronic (eg. mail) communication with the ATO rather than more efficient electronic transacting through an electronic service. This change will cause significant practical difficulties in administering the tax affairs of a deceased estate, not only for an appointed LPR but also for each State's Public Trustee which is required to administer high volumes of deceased estates.

Restricting the access to historical tax information of a deceased estate to an LPR only, which is evidenced by the ATO no longer permitting tax agents to access this historical tax information, arises from a clarification the ATO has made regarding their interpretation of the governing secrecy provisions of the TAA and bringing their systems into line with this clarification. The ATO is working with representative bodies to find a satisfactory administrative solution to this matter. However, stakeholders consider that a legislative reform provides the most certain solution. We suggest wording for a simple legislative amendment below.

It is our understanding that, while the old Tax Agent Portal access will continue until the end of March 2020 (when the last of the current digital certificates expire), ATO data will cease to be uploaded to the old Tax Agent Portal from the end of December 2019. While agents should retain access during the transition through to March 2020, the December 2019 change places more urgency on this issue.

Approximately 160,000 deaths are registered each year in Australia – per 2018 ABS data[2]. With such a significant number of deaths in Australia annually, which would equate to as many LPRs assuming the tax liabilities for the deceased estate, it is critical an LPR can access necessary tax information, be well informed, and be represented by qualified tax professionals.

We also note that there is a significant volume of deceased estates that have outstanding prior year tax returns lodgements - some more than 30 years. This results in millions of dollars of uncollected taxes having to be recovered using the services of tax agents. As noted above, LPRs can face significant assumed liabilities for the taxation of a deceased person. Policy to reduce the obligation and administrative burden on LPRs (via a minor legislative change) should be supported.

Recently, the Commissioner of Taxation acknowledged efforts to reduce the uncertainty around an LPR's liability for taxes in *Practical Compliance Guideline 2018/4 Income Tax – Liability of a legal personal representative of a deceased estate*. This PCG aims to effectively reduce periods of amendment for reasonably disclosed tax liabilities to six months.

Turning to the relevant legislative provision, under section 355-25 of the TAA, an officer of the Australian Taxation Office (**ATO**) commits an offence if they disclose 'protected information' (which is essentially tax information related to particular entity[3]). An exception to this is if the protected information is provided to a 'covered entity', which includes the primary entity's (ie a taxpayer's) registered tax agent (subsection 355-25(2)(a)) and a primary entity's (for example a deceased estate's) legal personal representative (subsection 355-25(2)(d)).

Section 355-25(2) as currently drafted does not permit an LPR to appoint a tax agent on their behalf who could then act on behalf of the deceased estate and access historical information and assist with administering the tax affairs of the deceased estate. This is because based on the way section 355-25(2) is currently drafted, a covered entity does not include a tax agent appointed by an LPR on behalf of a deceased estate (which is the 'primary entity'). In this scenario, the tax agent is one step removed from the deceased estate and therefore does not amount to a covered entity. Should a taxation officer provide information to a tax agent in this scenario, they could be in breach of section 355-25.

We submit this could be fixed with a minor technical amendment, being the inclusion of new subsection 355-25(2)(h) as follows:

> The covered entity is the *registered tax agent or BAS agent of a person mentioned in paragraph (d) above.

This would overcome the issue that is going to arise in March 2020 by allowing a taxation officer to provide information about a deceased estate to a tax agent appointed by an LPR. We believe this is consistent with the intention of the legislation that such an amendment should be made.

In this regard, we request this minor technical amendment be included in the final version of the ED.

[2] https://www.abs.gov.au/AUSSTATS/abs@.nsf/mf/3302.0

[3] See further section 355-30 of the TAA

**b) Treatment of capital gains of non-resident beneficiaries of trusts**

The ATO has recently issued two Taxation Determinations, Taxation Determination 2019/D6 and Taxation Determination TD 2019/D7, which indicate how the ATO will treat distribution of capital gains by trustees of resident non-fixed trusts to non-resident beneficiaries of the trust. The combined effect of the treatment outlined in the two Determinations produces an anomalous result from a policy perspective. This is outlined below. Further detail is contained in The Tax Institute's submission to the ATO in relation to the two Taxation Determinations (**ATO Submission**) (copy attached in the Appendix).

*Differing treatment between revenue and capital gains for non-resident beneficiaries*

TD 2019/D7 expresses the view that Subdivision 115-C of the 1997 Act treats a non-resident beneficiary of a resident trust as deriving 'capital gains' by reference to capital gains derived by the relevant trust, irrespective of whether the trust's capital gains were derived from an Australian source.

Correspondingly, TD 2019/D6 which was issued at the same time, expresses the view that such Subdivision 115-C capital gains of a non-fixed resident trust are taxable to the non-resident beneficiary irrespective of whether the trust's capital gains were related to 'taxable Australian property' (**TAP**). This arises because section 855-40 only applies to capital gains and losses of foreign residents flowing through fixed trusts. It does not apply to capital gains and losses of foreign residents flowing through non-fixed trusts.

The combined effect of the views in both TD 2019/D6 and TD 2019/D7 are anomalous from a policy perspective. For example, the conclusion has the effect that where a trustee derives a gain from a dealing with no connection whatsoever to Australia (and which is also not in respect of TAP):

a) if the gain is of a revenue nature, the gain is not subject to tax under section 98 of the *Income Tax Assessment Act 1936* (Cth) (**1936 Act**); but

b) if the gain is of a capital nature it will give rise to a taxable 'capital gain' under Subdivision 115-C.

*Differing treatment for non-resident beneficiaries whether capital gain is paid out immediately or accumulated first*

This issue is explained in detail in the ATO Submission attached.

As TD 2019/D7 notes at paragraph 21, section 99D of the 1936 Act provides that where a trust's capital gain from a non-Australian source has been subject to tax under section 99A of the 1936 Act and a non-resident beneficiary receives an amount attributable to that capital gain, the non-resident beneficiary can obtain a refund of the section 99A tax. It is clearly anomalous that a beneficiary should be subject to Australian tax on such a gain if it is distributed to the beneficiary directly on the one hand, but on the other hand not subject to Australian tax on the gain (effectively) if the gain is first accumulated and subsequently distributed.

In short, in relation to resident non-fixed trusts and non-resident beneficiaries, the effect of the combined views in TD 2019/D6 and TD 2019/D7 is that (refer to the ATO Submission for a detailed explanation):

a) capital gains are taxed in circumstances where a corresponding revenue amount would not be. This is due to Subdivision 115-C supposedly operating to attribute all capital gains, whether Australian sourced or not, to a (non-resident) beneficiary; and

b) distributed capital gains are taxed where accumulated capital gains paid out later would not be.

These are not suitable outcomes from a policy perspective.

The ATO Submission outlines one technical issue not expressly addressed in TD 2019/D7, though it is not clear whether the ATO has in fact considered it. However, extensive consultation has been conducted by the ATO in relation TD 2019/D6 and TD 2019/D7 and it is inferred from these consultations that the ATO is not likely to change its view. In any case, we submit that a matter as fundamental as the incidence of tax on gains with no substantive connection to Australia should not be left to a mere expression of an ATO view.

The right policy outcome should be consistent with the overall policy intention of Australia's taxation laws which is to tax non-residents only on their income and gains with a relevant connection with Australia eg Australian sourced income. While subsection 6-10(5) provides such limits on amounts which are 'statutory income' in Australia of a non-resident, it is inconsistent to interpret Subdivision 115-C as including a non-Australian sourced (and non-TAP) capital gain in calculating the assessable income of a non-resident beneficiary.

Further, we understand Division 855 is intended to operate to remove any non-Australian source as a basis for taxing capital gains to a non-resident beneficiary. *Tax Laws Amendment (2011 Measures No 5) Bill 2011* introduced interim changes to improve the taxation of trust income, including amendments to Subdivision 115-C. We note that these amendments omitted the previously included relevant source-based limitation in Subdivision 115-C (via reference to section 98 of the 1936 Act and similar provisions) without any indication that the omission was intended. This, along with the clear policy anomalies we have detailed above, strongly indicates that the omission was a mere technical error.

In our view, to ensure the correct policy outcome, technical amendments are required to be made to the law.

*Suggested solution*

To resolve the anomalous outcome, The Tax Institute suggests that a couple of minor technical amendments are required:

a) expressly limit the operation of Subdivision 115-C to attribute capital gains to a non-resident beneficiary that have an Australian source – or, if preferred, that relate to underlying TAP of the trust (including the note to section 855-40(2) which refers to section 115-215).

b) amend section 855-40 to extend its application from fixed trusts to non-fixed trusts.

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If you would like to discuss any of the above, please contact either myself or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours faithfully,

**Tim Neilson**
President

**APPENDIX**

**ATO Submission**

THE TAX INSTITUTE

30 September 2019

Ms Karen Rooke
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By email: karen.rooke@ato.gov.au

Dear Ms Rooke,

**Draft Taxation Determinations TD 2019/D6 and TD 2019/D7**

The Tax Institute welcomes the opportunity to make a submission to the Australian Taxation Office in relation to the following two draft Taxation Determinations:

- *TD 2019/D6 Income tax: does Subdivision 855-A (or subsection 768-915(1)) of the Income Tax Assessment Act 1997 disregard a capital gain that a foreign resident (or temporary resident) beneficiary of a resident non-fixed trust makes because of subsection 115-215(3)?* (**TD 2019/D6**);

- *TD 2019/D7 Income tax: is the source concept in Division 6 of Part III of the Income Tax Assessment Act 1936 relevant in determining whether a non-resident beneficiary of a resident trust (or trustee for them) is assessed on an amount of trust capital gain arising under Subdivision 115-C of the Income Tax Assessment Act 1997?* (**TD 2019/D7**).

**Summary**

Our submission below addresses our two main concerns in relation to TD 2019/D6 and TD 2019/D7:

- As a matter of policy, the effect of the combined views in TD 2019/D6 and TD 2019/D7 gives rise to anomalies which are:
  a) capital gains are taxed in circumstances where a corresponding revenue amount would not be; and
  b) distributed capital gains are taxed where accumulated capital gains paid out later would not be.

- As a matter of technical interpretation that policy outcome does not arise. Section 6-10 of the *Income Tax Assessment Act 1997* (Cth) (**1997 Act**) applies to modify Subdivision 115-C in determining how capital gains will be taxed. In most cases paragraph6-10(5)(b) applies via Subdivision 855-A in relation to capital gains of a non-resident, with the 'Taxable Australian property' rules being the

relevant 'basis' (within the meaning of paragraph 6-10(5)(b)). Subdivision 115-C does not, however, provide a 'basis' for including (via the net capital gain) in the Australian assessable income of a non-resident beneficiary that beneficiary's share of a capital gain of a resident non-fixed trust. Therefore paragraph 6-10(5)(a) applies to restrict the relevant components of the beneficiary's net capital gain to capital gains with an Australian source.

## Discussion

### 1. Overview

TD 2019/D7 expresses the view that Subdivision 115-C of the 1997 Act treats a non-resident beneficiary of a resident trust as deriving 'capital gains' by reference to capital gains derived by the relevant trust, irrespective of whether the trust's capital gains were derived from an Australian source.

Correspondingly, TD 2019/D6 which was issued at the same time, expresses the view that such Subdivision 115-C capital gains are taxable to the non-resident beneficiary irrespective of whether the trust's capital gains were related to 'taxable Australian property' (**TAP**).

The combined effect of the views in both TD 2019/D6 and TD 2019/D7 are anomalous from a policy perspective. For example, the conclusion has the effect that where a trustee derives a gain from a dealing with no connection whatsoever to Australia (and which is also not in respect of TAP):

a) if the gain is of a revenue nature, the gain is not subject to tax under section 98 of the *Income Tax Assessment Act 1936* (Cth) (**1936 Act**); but

b) if the gain is of a capital nature it will give rise to a taxable 'capital gain' under Subdivision 115-C.

As TD 2019/D7 notes at paragraph 21, section 99D of the 1936 Act provides that where a trust's capital gain from a non-Australian source has been subject to tax under section 99A of the 1936 Act and a non-resident beneficiary receives an amount attributable to that capital gain, the non-resident beneficiary can obtain a refund of the section 99A tax. It is clearly anomalous that a beneficiary should be subject to Australian tax on such a gain if it is distributed to the beneficiary directly on the one hand, but on the other hand not subject to Australian tax on the gain (effectively) if the gain is first accumulated and subsequently distributed.

In short, the effect of the combined views in TD 2019/D6 and TD 2019/D7 are that:

**a) capital gains are taxed in circumstances where a corresponding revenue amount would not be; and**
**b) distributed capital gains are taxed where accumulated capital gains paid out later would not be.**

This is not a suitable outcome from a policy perspective.

## 2. Technical Matters

Our submission addresses a specific technical issue, namely whether, as a matter of proper statutory interpretation, Subdivision 115-C of the 1997 Act is subject to source-based restrictions imposed by section 6-10 in the 1997 Act.

However, we commend the ATO for the administrative approach described in paragraphs 10 and 11 of TD 2019/D7, which we believe is a sound and proper exercise of administrative powers to promote confidence among existing and potential taxpaying investors.

In summary, we submit that Subdivision 115-C should be subject to section 6-10 to the extent section 115-220 applies in relation to a non-resident beneficiary of a resident non-fixed trust, with the effect that, by operation of paragraph 6-10(5)(a), the beneficiary's share of a capital gain of the trust should not be subject to Australian tax unless the gain has an Australian source. This interpretation gives effect to the literal words of section 6-10(5), and is also preferable from a policy perspective because it addresses the anomalies referred to above.

Given that TD 2019/D7 has unquestionably been the subject of considerable analysis within the ATO, we have set out our reasoning for this submission in some detail below.

### a) General operation of section 6-10

Section 6-10(5) states:

> If you are a foreign resident, your assessable income includes:
> (a) your statutory income from all Australian sources; and
> (b) other statutory income that a provision includes in your assessable income on some basis other than having an Australian source.'

'Statutory income' is, broadly speaking, an amount which is not ordinary income but which is included in assessable income by a statutory provision.

As a matter of statutory interpretation, where a provision includes an amount as assessable income, that is statutory income, and does not include that amount 'on some basis other than having an Australian source', that provision must be interpreted as including the amount in the assessable income of a foreign resident only to the extent that it has an Australian source.

For example:

a) section 15-10 includes in assessable income 'a bounty or subsidy that … you receive in relation to carrying on a business; and … is not assessable as ordinary income …';
b) section 15-10 contains no other reference to any 'basis' for including such amounts in assessable income;
c) unless section 15-10, in relation to a foreign resident, was interpreted as applying only to such bounties or subsidies from Australian sources, paragraph 6-10(5)(a) would be superfluous, since:

    i) every 'statutory income' provision would either prescribe a 'basis', or not prescribe a basis;
    ii) if the provision prescribed a 'basis', paragraph (b) would apply; and
    iii) if the provision did not prescribe a 'basis' and the provision were not restricted to Australian sources (to the extent related to non-residents) paragraph (5)(a) would have no application.

For completeness, the references in section 15-10 to a 'bounty or subsidy' or to a 'business' should not be regarded as a 'basis' relevant to the operation of section 6-10(5). They are *only the criteria that define which amounts* are 'included in your assessable income' for the purposes of section 6-10(2). If instead those types of criteria were regarded as, relevantly, a 'basis', again paragraph (5)(a) could never have any operation.

**b) Capital gains tax in general, section 6-10 and Subdivision 115-C**

*Capital Gains Tax (**CGT**) and section 6-10*

Section 102-5 of the 1997 Act includes a 'net capital gain' in the assessable income of a taxpayer. That is, section 102-5 prescribes a 'net capital gain' (calculated in accordance with Parts 3-1 and 3-5) as a form of 'statutory income'.

Section 102-5 does not, in and of itself, prescribe any 'basis' for inclusion of the entire net capital gain in the assessable income of a non-resident. On its face, that invites a question as to whether:

a) section 6-10(5) applies by reference to the entire 'net capital gain' calculated under section 102-5 – in which case, a non-resident would be subject to tax on the net capital gain only if the net capital gain had an Australian source; or
b) section 6-10(5) has no application to capital gains tax at all; or
c) section 6-10(5) applies on the basis that the net capital gain is comprised of a number of different amounts, and each such amount is included in the assessable income of the taxpayer as 'statutory income' (after deduction of applicable capital losses).

Interpretation (a) appears untenable.

The net capital gain, being an artificial construct calculated by reference to an amalgam of sub-parts, would not in and of itself have a 'source'. Thus, looked at in isolation, the net capital gain would not be included in the assessable income of a non-resident, on the basis that it did not have an Australian source, and that no basis was prescribed for including it in the assessable income of a non-resident.

The problem with interpretation (b), as a matter of statutory interpretation, is that there is nothing in the wording of section 6-10 to justify such a conclusion. A net capital gain is clearly 'statutory income' as defined in section 6-10, and section 6-10(5) is not qualified in any way which would preclude it applying to section 102-5.

There might be justification for a policy-oriented adoption of interpretation (b) if it were clear that the CGT rules contained a universal prescription as to the circumstances in which a non-resident was required to recognise capital gains (and could recognise capital losses). However, even in that case, there would actually be no readily apparent reason to adopt interpretation (b), because interpretation (c) would appear to operate in precisely the same way, and interpretation (c) does not require a strained reading down of section 6-10.

However, TD 2019/D7 asserts that the CGT rules prescribe amounts (i.e. Subdivision 115-C capital gains) to be included in calculating statutory income (i.e. the net capital gains) without reference to source or TAP rules. If (as is discussed further below) that has the effect that there is no prescribed 'basis' (within the meaning of section 6-10) for their inclusion in the statutory income of a non-resident, then it is difficult to see

why the literal words of section 6-10 should be ignored in relation to capital gains tax so as to prevent those literal words applying in accordance with their terms.

Thus, the applicability of paragraphs 6-10(5)(a) and (b) may depend in part on whether the capital gains tax rules do contain a comprehensive regime for the 'basis' of imposing capital gains tax on non-residents – in particular, whether such a regime is imposed by Subdivision 855-A of the 1997 Act.

*Do the CGT rules provide a comprehensive 'basis' for Subdivision 115-C gains?*

Subdivision 855-A has the effect, broadly, that in calculating the net capital gain of a non-resident, CGT events are disregarded if 'the CGT event happens in relation to a CGT asset that is not taxable Australian property'. Thus, it is possible to calculate a net capital gain comprised by the outcomes of CGT events, and include it in the assessable income of a non-resident consistently with section 6-10(5), on the basis that Subdivision 855-A prescribes the 'basis' for inclusion in the assessable income of the non-resident each capital gain from a CGT event in relation to TAP (less the prescribed capital losses).[1]

TD 2019/D6 expresses the view that capital gains of a beneficiary arising under Subdivision 115-C do not arise from 'CGT events' happening to the beneficiary and that accordingly section 855-10 does not apply to exclude any of those capital gains from the assessable income of the beneficiary.

This submission does not address the correctness or otherwise of TD 2019/D6. This submission addresses the applicability of section 6-10 to Subdivision 115-C gains if TD 2019/D6 is correct.

Section 855-40 prescribes limits on the inclusion of capital gains in the net capital gain of a non-resident, to the extent that those capital gains are derived as a beneficiary of a resident fixed trust. The impact of section 855-40 is dealt with further below. We note, though, that section 855-40 is clearly not a comprehensive 'basis' within the meaning of section 6-10, because it does not relate to non-fixed trusts.

The only other provisions under which a 'basis' may exist are the provisions of Subdivision 115-C itself.

*Non-residence of beneficiary as a 'basis'?*

It might be argued that section 115-220 chooses as a 'basis' the mere fact that the beneficiary is a non-resident (since section 115-220 applies only by reference to section 98 of the 1936 Act, which applies only where the relevant beneficiary is a non-resident). However:

a) that does not fit neatly with the wording of section 6-10 – that is, it seems strange to say that the basis prescribed for including an amount in the assessable income of a non-resident taxpayer is that the taxpayer is a non-resident; and

b) it perpetuates the policy problems referred to above, that capital gains are taxed in circumstances where a corresponding revenue amount would not be, and that distributed capital gains are taxed where accumulated capital gains paid out later would not be.

[1] Semantically, Subdivision 855-A does not directly 'include' amounts in assessable income, but rather excludes capital gains (and capital losses) from non-taxable Australian property. However, it is submitted that Subdivision 855-A should be regarded as prescribing a 'basis' for inclusion, for the purposes of section 6-10.

Accordingly, the mere fact that section 115-220 of the 1997 Act applies to a non-resident, via operation of section 98 of the 1936 Act, should not be treated as a 'basis' for deciding what amounts are to be included in the non-resident's calculation of a net capital gain.

*Residence of trust as a 'basis'?*

In a practical sense, section 115-220 applies differently to capital gains of a resident trust and a non-resident trust, since:

a) section 855-10 restricts taxable capital gains of a non-resident trust to gains from TAP; but

b) section 855-10 does not impose such a restriction in respect of a resident trust (on the view which we understand that the ATO holds), and section 115-220 is not expressed to contain any such qualification.

It might be argued, therefore, that in respect of capital gains derived by a non-resident beneficiary through a resident non-fixed trust, the resident status of the trust is the relevant 'basis'. That is, it would in theory be possible to draw the distinction between resident trusts (treating the resident status of the trust as the 'basis') and foreign trusts (treating, indirectly, section 855-10 as the relevant 'basis'), and thus to argue that paragraph 6-10(5)(a) should not be applied to Subdivision 115-C gains even where no other 'basis' is evident.

However, in our view, that is an unnatural reading of section 6-10(5). Section 115-220 does not 'include' amounts on the basis of the residence of the trust. Section 855-10 has the incidental effect of limiting the non-resident trust gains to which section 115-220 applies, but section 115-220 still does apply to gains derived via a non-resident trust. In this regard, residence of the trust should not be treated as a 'basis' for section 6-10 purposes. Treating trust residence as a 'basis' also perpetuates the policy problems referred to above. In addition, the considerations in statutory interpretation of section 115-220 should include the following:

a) status as a resident trust or otherwise was clearly not the relevant 'basis' under Subdivision 115-C prior to *Tax Laws Amendment (2011 Measures No 5) Bill 2011* (Cth) (**the Bill**) amending Subdivision 115-C**;**

b) prior to the Bill, the relevant 'basis' was clearly the source rule contained in section 97 of the 1936 Act and other relevant provisions, via former section 115-215(2);[2]

[2] At that time, the operative provision of Subdivision 115-C, so far as is relevant here, was section 115-215. Section 115-215(2) stated as follows:

'This section treats you as having certain extra capital gains, and gives you a deduction, if:

(a) you are the beneficiary of the trust estate; and

(b) your assessable income for the income year includes an amount (the ***trust amount***);

(i) under paragraph 97(1)(a) of the *Income Tax Assessment Act 1936*; or

(ii) under subsection 98A(1) or (3) of that Act; or

(iii) under section 100 of that Act.'

c) even assuming that section 97 and similar provisions no longer relevantly expressly modify Subdivision 115-C, by virtue of the deletion of section 115-215(2), that invites the question what 'basis' if any should take the place of section 115-215(2);

d) neither the Bill nor any relevant explanatory material evidences any intended change to the basis for inclusion or non-inclusion of such capital gains in the net capital gain of a non-resident beneficiary (and in fact in the Second Reading Speech for the Bill the Assistant Treasurer at the time acknowledged that '… due to the short timeframe involved in developing these amendments, there may be scope for unintended consequences') – we note that footnote 8 in TD 2019D6 states, as an argument in support of the conclusions expressed in TD 2019/D6, that there was 'no evidence that any change to this outcome was intended to have been made' by relevant legislative amendments;

e) accordingly, an interpretation that preserves source as a limitation on Subdivision 115-C is to be preferred to one which does not.

We submit that the residency status of the trust should be interpreted as being irrelevant, in conformity with the general scheme of the tax legislation concerning investment vehicles generally, including trusts generally (Division 6 of the 1936 Act, for example section 97), partnerships generally (Division 5 of the 1936 Act, for example section 92) and dividends paid by companies (section 44 of the 1936 Act), except in so far as it creates a distinction between capital gains in respect of which there is a 'basis' (section 855-10 of the 1997 Act) and capital gains in respect of which there is no basis – and to which paragraph 6-10(5)(a) should therefore apply.

*No other basis*

Subdivision 115-C does not prescribe any other 'basis' for distinguishing between capital gains of a trust that are to be included in the non-resident beneficiary's net capital gain calculation.

Accordingly, we submit that if the ATO considers that Subdivision 115-C capital gains do not arise from 'CGT events' (and are therefore not covered by Subdivision 855-A), the ATO ought to accept that paragraph 6-10(5)(a) applies so that only Australian-source Subdivision 115-C capital gains of a resident non-fixed trust need be included in calculating a non-resident beneficiary's net capital gain.

**c) Interaction between Subdivision 115-C and Subdivision 855-A**

Our submission is based primarily on a reading of the plain words and operation of section 6-10(5). However, we have cited policy reasons in support of a literal interpretation of that section, in particular the desirability of achieving a consistent operation of the provisions. Accordingly, for completeness, we discuss below the interaction between our submitted interpretation of the provisions, and the relevant provisions in Subdivision 855-A.

*Section 855-10*

Our comments above contain an analysis of why paragraph 6-10(5)(a) ought to apply to Subdivision 115-C capital gains derived by a non-resident, where no other 'basis' exists in relation to that non-resident in respect of those capital gains.

Section 855-10 has the effect, broadly speaking, that the net capital gain of a foreign resident or a foreign trust includes only capital gains (and losses) from taxable Australian property.

If, in respect of foreign trusts, Subdivision 115-C operated as a further filter, to restrict the foreign trust's non-resident beneficiaries' capital gains derived through the trust to Australian source gains, that would place such beneficiaries (at least in theory) in a better position than foreign residents generally.

However, that need not be the way that the provisions operate.

To the extent that Subdivision 115-C operates in respect of a beneficiary of a foreign trust, section 855-10 has already prescribed a relevant 'basis' in relation to the capital gains derived through that trust. On that basis, paragraph 6-10(5)(a) would not apply to limit the Subdivision 115-C capital gains of the beneficiaries any further, because a relevant 'basis' did exist.

By contrast, there is no corresponding 'basis' in relation to the capital gains derived by a non-resident beneficiary through a resident trust (on the ATO view expressed in TD 2019/D6), so it is appropriate that paragraph 6-10(5)(a) should apply in relation to those capital gains.

Under this interpretation, trust capital gains derived by a non-resident beneficiary are not treated identically as between trust gains of resident trusts and trust gains of non-resident trusts. However, the lack of identity of treatment under this interpretation is far less anomalous than would be the case if this interpretation were not adopted (see above).

*Section 855-40*

Section 855-40 has the effect, very broadly, that a non-resident beneficiary of a 'fixed trust' is subject to tax on capital gains of the trust only to the extent that they relate to taxable Australian property. Given the existence of section 855-10, section 855-40 appears necessary only in relation to Australian resident fixed trusts. It might be thought that if non-resident beneficiaries in general are subject to Subdivision 115-C only in relation to Australian source capital gains of a trust, that section 855-40 creates in effect a double filter, that is, two layers of exclusion of capital gains for a non-resident beneficiary of an Australian resident fixed trust. That is not necessarily inconsistent with the intention of section 855-40. It was apparently intended precisely to ensure that there was no tax disadvantage to an investor in a fixed trust of having (and paying for) the activities of that trust conducted in Australia. (TD 2019/D6 corroborates this, noting at paragraph 15 that the rule reflected in section 855-40 was intended to 'improve the international competitiveness of Australia's managed funds industry'. However, we do not agree with the comment made in paragraph 16 that it is evident from the quotation in the preceding paragraph 15 that objects of non-fixed trusts were not intended to benefit from Div 855 outside of section 855-40. The reference is merely limited to section 855-40.)

In any event, it is perfectly feasible that section 855-40 gains should not be subject to a further 'Australian source' filter via section 115-220, by means of interpretation that is still perfectly consistent with the interpretation outlined in this submission. That is, the interpretation would be, simply, that section 855-40 prescribed the relevant 'basis' referred to in section 6-10(5)(b), so far as resident fixed trusts are concerned, but paragraph 6-10(5)(a) applied in respect of resident non-fixed trusts.

That is, the existence of section 855-40 does not indicate any general principle that non-Australian source gains derived by a non-resident beneficiary through an Australian trust should necessarily be subject to Australian tax.

One further note, we do not agree with the statement in paragraph 13 of TD 2019/D6 that it is 'apparent from the enactment' that comparable treatment was 'not thought to be warranted' in the case of a non-fixed trust. Similarly, paragraph 20 refers to a "strong indicator". It is altogether possible that no rule was enacted because it was already sufficiently dealt with under section 115-215 which deems the beneficiary to make the gain.

**3. Specific comments on the Taxation Determinations**

**a) TD 2019/D6**

- Paragraph 16 - We have already noted our disagreement with this paragraph. In our view, the statement in paragraph 16 that 'investing' does not occur with non-fixed trusts is incorrect. The meaning of 'fixed trust' for tax purposes is a very high bar to satisfy. A unit trust with different classes of units and a broad amendment power will not be 'fixed' for tax purposes. To say that a major unitholder of a non-fixed trust does not bring funds into Australia is simply incorrect. The same point could be made with a discretionary trust. It would be useful if the Commissioner could provide an explanation for the position taken in this paragraph.

- Paragraph 21 - We query whether the references to paragraphs 7 and 8 in paragraph 21 is correct.

**b) TD 2019/D7**

- Paragraph 11 – we note the administrative approach captured in paragraph 11. However, members have advised of their experience in practice whereby the views captured in TD 2019/D7 have been applied to current and earlier income years.

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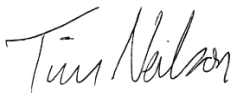
If you would like to discuss any of the above, please contact either myself or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours faithfully,



**Tim Neilson**
President