

SENATE STANDING COMMITTEE ON ECONOMICS QUESTION
(Supplementary Budget Estimates 20 October – 21 October)

Question: SBT 79**Topic: Tax Ruling – Unpaid Present Entitlements**

Senator Bushby asked:

The Commissioner's ruling on Unpaid Present Entitlements (TR 2010/3) has caused significant controversy due to its significant shift from earlier ATO views. Taxpayers have structures in place that now fall foul of the Commissioner's ruling and will face significant costs to restructure and increased costs.

1. Is the Commissioner aware of the impact such an unexpected application of his views has caused?
2. Did the Commissioner consult with Treasury on the intended scope of operation of Division 7A prior to the issue of the Commissioner's draft ruling on unpaid present entitlements in late 2009?
3. Why did the government decide to change the way this tax law is applied, resulting in an increased tax burden on small business?
4. Has any modelling been done to determine how much extra tax revenue this will extract from small business over the budget cycle?

Answer:

1. The Commissioner is aware of the potential impact of the position adopted in Taxation Ruling TR 2010/3 *Income tax: Division 7A loans: trust entitlements*, although it is not correct to say that the position adopted by the Commissioner is unexpected.

In late 2008, ATO audit activities identified the aggressive use by some taxpayers of a tax planning arrangement, whereby large amounts of unpaid trust entitlements of a corporate beneficiary remained unpaid for a long time, with the funds being used to benefit different beneficiaries. In direct response to this, in February 2009, the ATO flagged that it would reassess its view regarding how these outstanding trust entitlements of corporate beneficiaries were treated for tax purposes.

This was followed by a considerable amount of consultation and feedback from tax professionals and the professional accounting and legal bodies. Consultation continued up until the time of publication of draft taxation ruling TR 2009/D8 in December 2009, which was then subject to further public consultation prior to being finalised as TR 2010/3 in June 2010. This ruling had a prospective effect in relation to the question of whether unpaid present entitlements could constitute a financial accommodation. Subsequently, the ATO has been working with members of various professional bodies to identify a suitable test case as a way of providing judicial certainty as to the views expressed by the Commissioner in the ruling.

In recognition of the impact of the view adopted in Taxation Ruling TR 2010/3, the Commissioner recently issued practice statement PS LA 2010/4. This practice statement provides administrative concessions and practical solutions to the issues relating to the provision of finance for small

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businesses that operate through trusts. This practice statement has been welcomed by tax professionals. In effect the practice statement gives taxpayers two self corrective options and outlines three methodologies that the ATO believe are examples of a commercial return on the investment the private company is taken to have made in the trust.

2. Yes, the ATO did consult with Treasury prior to releasing draft Taxation Ruling TR 2009/D8.

3. The Commissioner identified a serious abuse of the tax law, which resulted in the change in the ATO view of the application to Division 7A to unpaid present entitlements. The revised ATO view will apply to unpaid present entitlements created on or after to 16 December 2009, the date of issue of our draft ruling.

As this is a matter of the administration of the Act, the proper application of the law is a matter for the Commissioner. A review of the administrative practice initiated as a result of the discovery of significant abuse, resulted in the views outlined in the ruling as to the proper application of the law. The process for development of these views included consideration by the ATO's public rulings panel, which includes private sector tax experts.

The practice statement PS LA 2010/4 mitigates the adverse impacts on small business, at least for the short term. However, it is the considered view of the Commissioner that Division 7A can apply to unpaid present entitlements as outlined in the ruling.

4. No modelling has been done to determine how much (if any) extra tax revenue will be collected from small businesses over the budget cycle. The ruling represents the Commissioner's considered view of the law.