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Ms Karen Rooke
Assistant Commissioner
Law Design and Practice
Tax Counsel Network
Australian Taxation Office
GPO Box 9977
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By Email: *Karen.Rooke@ato.gov.au*

Dear Karen

DRAFT TAXATION DETERMINATIONS TD 2019/D6 AND TD 2019/D7

1. Thank you for the opportunity to provide comments to the Commissioner of Taxation (‘**the Commissioner**’) in relation to Draft Taxation Determination TD 2019/D6 (‘**TD 2019/D6**’) and Draft Taxation Determination TD 2019/D7 (‘**TD 2019/D7**’) which address the following questions:

   1.1. *TD 2019/D6 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?*

   1.2. *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)?*

2. Pitcher Partners Advisors Proprietary Limited has a strong focus in assisting closely and privately held groups that commonly include trusts. TD 2019/D6 and TD 2019/D7

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if finalised as currently drafted will have a material effect on such groups and as such we have provided detailed comments in respect of the draft TDs.

SUMMARY

3. The position taken by the Commissioner in TD 2019/D6 and TD 2019/D7 is not consistent with Australian tax policy.

4. In finalising TD 2019/D6 and TD 2019/D7 the Commissioner should apply the source limitation in section 6-10(5)[1] such that non-resident beneficiaries of Australian resident trusts should not be assessed on foreign sourced capital gains distributed to them.

5. If the Commissioner does not finalise TD 2019/D6 and TD 2019/D7 in the manner suggested, he should put in place an administrative practice to allow non-resident taxpayers certainty in accessing tax refunds pursuant to Section 99D[2].

6. In finalising TD 2019/D6 and TD 2019/D7 the Commissioner should address the interaction of his view with Australia's tax treaty obligations.

7. Given the clear inconsistency with tax policy intent, if the Commissioner finalises TD 2019/D6 and TD 2019/D7 without making substantive changes to the conclusions in the drafts, the application date should not be retrospective. Indeed, the application date should be set with sufficient time for the government to consider legislative change to clarify the operation of the law, i.e. 1 July 2020 or 2021.

POLICY INTENT

8. The combined effect of TD 2019/D6 and TD 2019/D7 is that foreign sourced capital gains made by non-resident or temporary resident beneficiaries of Australian resident trusts will be assessable in Australia unless the trust is a fixed trust[3].

9. However, it would appear that such trust beneficiaries can escape Australian tax where:

    9.1. The gains distributed are revenue rather than capital in nature; or

    9.2. The gains are accumulated by the trustee of the Australian resident trust and distributed out in a later year to the beneficiary who claims a refund of the tax paid by the trustee pursuant to section 99D(1)[4] – assuming that the Commissioner does not exercise their discretion to refuse the non-resident beneficiary a refund pursuant to section 99D(2)[5].

10. This cannot be a sensible or intended policy outcome.

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1 Income Tax Assessment Act 1997 ('**ITAA97**').
2 Income Tax Assessment Act 1936 ('**ITAA36**').
3 Paragraph 1 of TD 2019/D6.
4 ITAA36.
5 ITAA36.

11. We do not agree with the Commissioner's assertion that there is a '*clear policy justification for limiting relief to capital gains where beneficiaries have interests in fixed trusts*'[6]. The Commissioner relies on wording in section 855-40 which refers to fixed trusts only. However, the Commissioner ignores a myriad of important contextual matters, in particular:

    11.1. At the time Division 855 was introduced, the assessable income of trust beneficiaries was largely governed by Division 6[7] with the result that it was clear that non-resident beneficiaries were not subject to tax on foreign source capital gains distributed to them from Australian resident trusts. Therefore, in drafting Division 855, there was no need to include provisions which specifically provided that non-residents would not be subject to tax on foreign sourced capital gains from trusts (whether fixed or non-fixed); and

    11.2. The Explanatory Memorandum of Tax Laws Amendment (2006 Measures No. 4) Act 2006 (the legislation introducing Division 855) described the intended effect of the changes as follows (emphasis added):

    " The changes ***narrow*** *the range of assets on which a foreign resident will be liable to Australian capital gains tax (CGT) to Australian real property and the business assets (other than Australian real property) of a foreign resident's Australian permanent establishment."*[8]

12. In addition, the Commissioner relies on his interpretation of section 115-215 as amended in 2011 to support his assertion that capital gains are statutory income that can be taxed even if foreign sourced. However *Explanatory Memorandum to Tax Laws Amendment (2011 Measures No.5) Act 2011* (which introduced the 2011 changes to section 115-215) makes the policy intent of the changes very clear, as the following excerpt illustrates:

    2.25 The primary purpose of these amendments is to ensure that, where permitted by a trust deed, the 'streaming' of capital gains and franked distributions to beneficiaries (by making them specifically entitled to those amounts) is effective for tax purposes.

    2.26 To achieve this goal, the taxation of a trust's capital gains and franked distributions (including attached franking credits) is effectively taken out of Division 6 and dealt with under Subdivisions 115-C and 207-B.

    2.27 These amendments do not apply to a MIT unless the MIT opts in to the amendments (see paragraphs 2.208 to 2.212).

    2.28 For trusts with no capital gains and no franked distributions, the streaming amendments have no effect. However, the specific anti-avoidance rules may still apply. [Schedule 2, item 7, section 102UW of the ITAA 1936]

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6 Paragraph 14 of TD 2019/D6

7 Part III, ITAA36.

8 See paragraph 4.1.

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> *2.29 For trusts that have capital gains or franked distributions but do not stream them to specific beneficiaries, the amendments apply but they will generally produce the same outcome as the current law.*

13. There is absolutely no reference to the taxation of non-residents in these policy comments and no suggestion that the intent of these changes is to significantly broaden the scope of Australia's taxing rights in respect of capital gains.

14. Any assertion that TD 2019/D6 and TD 2019/D7 are consistent with intended policy outcomes is clearly misconceived.

SOURCE RESTRICTION IN SECTION 6-10[9]

15. Subdivision 115-C[10] should be read as being subject to section 6-10[11]. Section 6-10(5)[12] relevantly provides that 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.'

16. The source restriction in 6-10(5)[13] is necessary as there are many provisions in Australia's tax legislation that do not include any specific territorial limitation.

17. For example, the receipt of bonuses and other amounts in respect of certain short-term life assurance policies[14] simply describes such amounts as being assessable subject to certain criteria being met[15]. The criteria make no reference to tax residency status. Therefore, the application of section 6-10(5)[16] means that recipients will only be assessed on these amounts if they are Australian residents or the bonus/other amount has an Australian source.

18. Similarly, section 102-5[17], which provides that assessable income includes capital gains, does not contain any territorial limitation. However, the assessment of capital gains is subject to many exemptions, exceptions and modifications as provided elsewhere in Australia's tax legislation. In the context of territorial limitations, the following provisions limit section 102-5[18]:

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9 ITAA97.
10 ITAA97.
11 ITAA97.
12 ITAA97.
13 ITAA97.
14 See section 26AH ITAA36.
15 Section 26AH ITAA36.
16 ITAA97.
17 ITAA97.
18 ITAA97.

18.1. Section 6-10(5)[19] – to ensure that capital gains without an Australian source are not included; and

18.2. Division 855[20] – to ensure that Australian sourced gains which are not TAP are not included.

19. In TD 2019/D7 the Commissioner takes the view that since Division 855[21] does not specifically state that non-resident beneficiaries of Australian resident (non-fixed) trusts are not assessable on foreign sourced gains, such gains are included in the statutory income of non-resident taxpayers on a basis other than source and thus section 6-10(5)(b)[22] operates to include even foreign sourced amounts in the assessable income of non-resident beneficiaries. However, Division 855[23] was introduced to narrow the classes of CGT assets to which non-residents would be taxed[24] and in fact operates not as an assessment division but a division that provides specific carve-outs from Australian taxation. Therefore it is difficult to see how it could be seen as providing a positive basis for enlivening section 6-10(5)(b)[25] in the context of any capital gains which are not Australian sourced.

20. Now, it may be contended that this interpretation is untenable because it could result in TAP gains without an Australian source escaping Australian taxation, a result that is clearly inconsistent with Australian tax policy. However, in our view this can be resolved in one of two ways:

20.1. Firstly, TAP assets could be seen as having an Australian source, at least for statutory income calculation purposes. The whole reason that assets are treated as being TAP is because they are considered to have a strong connection with Australia, therefore this interpretation is not unreasonable; or

20.2. Alternatively, Division 855[26] could be seen, perhaps by implication, as specifying a basis upon which non-residents can be taxed on a class of assets, being TAP assets, even though they may not be Australian sourced.

21. In summary, as a foundational provision in Australia's tax legislation, the provisions of section 6-10[27], cannot reasonably be seen to be overcome by an absence of a specific exemption in Division 855[28] which:

21.1. Is only focused the taxation of a very specific class of capital gains, being TAP;

21.2. Operates not as an assessment provision, but a provision which sets out a series of amounts that are disregarded in calculating assessable income; and

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19 ITAA97.
20 ITAA97.
21 ITAA97.
22 ITAA97.
23 ITAA97.
24 Paragraph 4.1 of the Explanatory Memorandum for Tax Laws Amendment (2006 Measures No. 4) Act 2006.
25 ITAA97.
26 ITAA97.
27 ITAA97.
28 ITAA97.

21.3. Was introduced at a time when foreign sourced capital gains, other than TAP, would not have been expected to be assessable to non-residents (i.e. there was no need to include further provisions to allow non-resident to disregard foreign sourced non-TAP gains derived from Australian resident trusts).

ADMINISTRATIVE PRACTICE

22. If the Commissioner remains of the view that the current legislative framework requires that non-resident and temporary resident beneficiaries be assessed on distributions of current year foreign sourced gains from Australian resident trusts, but acknowledges that this is not consistent with the intended policy of Australia's tax legislation, then the Commissioner could put in place administrative processes to allow trusts and trust beneficiaries to get to a more appropriate outcome. For example, processes to allow:

22.1. A reasonably high level of certainty to beneficiaries that the Commissioner would not seek to exercise his discretion to disallow beneficiary refunds pursuant to section 99D[29] or otherwise apply integrity measures if planning had been undertaken to accumulate in the hands of a trustee in one year and distribute to non-resident beneficiaries in a later year; and

22.2. Amounts refundable to a beneficiary pursuant to Section 99D[30] to be offset against any liability owing in respect of the same amount from the trustee to the Commissioner (i.e. to assist with cash flow issues for trustees).

LEGISLATIVE CHANGE

23. In our view an interpretative position can be reached which is consistent with the overarching policy of Australia's trust and capital gains rules. However, should the Commissioner choose to persist with the view espoused in TD 2019/D6 and TD 2019/D7, we believe that he must work with the government to have this issue rectified as a matter of urgency.

24. The reference to section 97[31] in the previous 115-215(2)[32] (which was a pre-condition to the provision) was removed in the 2011 amendments referred to above to deal with a trust deed that did not allow capital gains to be defined as income. Thus streaming could occur to a capital beneficiary irrespective of there being income of the trust estate. This was the only intention of the removal and it was not intended to have other consequences. Unfortunately, that amendment appears to have prompted the view of the Commissioner in TD 2019/D6.

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29 ITAA36.

30 ITAA36.

31 ITAA36.

32 ITAA97.

25. The *Explanatory Memorandum to Tax Laws Amendment (2011 Measures No.5) Act 2011* (which introduced the 2011 changes to section 115-215) made it clear that if there were unintended outcomes associated with the amendments made in the bill, that these would be addressed. This is evidenced by the following excerpt:

2.213 Consequential amendments are necessary to reflect the changes to Subdivisions 115-C and 207-B. These Subdivisions now effectively assess capital gains and franked distributions included in a trust's taxable income (rather than these amounts being assessed under Division 6).

2.214 Broadly, these consequential amendments ensure that existing provisions in the tax laws that look to whether a taxpayer is assessed on part of a trust's taxable income take into account amounts assessed as a result of Subdivisions 115-C and 207-B. Previously, these provisions generally only referred to Division 6 concepts or assessable amounts.

2.215 The Government is aware that, because of complex interactions in the current law, the general consequential amendments may not operate as intended in all cases. However, the application of the general rules to other provisions of the income tax laws is subject to a contrary intention in the law.

2.216 The Government is committed to the introduction of technical corrections on a regular basis to ensure that the tax legislation works and interacts appropriately. Any further consequential amendments will be considered as part of this regular maintenance process.

26. Therefore, to the extent that the Commissioner holds the view that the 2011 amendments have the effect of taxing non-resident beneficiaries on foreign sourced capital gains distributed from Australian resident trusts, then this outcome is simply due to a drafting error and the Commissioner must work with the government and industry to have this error corrected.

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AUSTRALIA'S TREATY OBLIGATIONS

27. TD 2019/D6 and TD 2019/D7 both state that they do not deal with Australia's double taxation agreements ('**DTAs**')[33]. This is an extremely important interpretation issue that must be addressed in the final TDs.

If you would like to discuss any aspect of this submission, please contact me on (03) 8610 5401.

Yours sincerely

D J HONEY
Executive Director

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[33] See paragraph 2 of TD 2019/D6 and paragraph 3 of TD 2019/D7.