30 August 2024

Ms Karen Rooke
Ms Amy James-Velagic
Assistant Commissioner
Australian Taxation Office

By email: *Amy.James-Velagic@ato.gov.au, Karen.Rooke@ato.gov.au*

Dear Ms Velagic and Ms Rooke

DRAFT TAXATION DETERMINATION TD 2024/D2 AND DRAFT PCG 2024/D1 - SECTION 99B

1. Chartered Accountants Australia and New Zealand, CPA Australia, Institute of Public Accountants, and The Tax Institute (together, the **Joint Bodies**) write to you as the peak professional accounting and tax practitioner bodies in Australia representing the tax profession.

2. The Joint Bodies make this submission to the Australian Taxation Office (**ATO**) in relation to

   - the draft Taxation Determination (TD 2024/D2) *Income tax: factors taken into account in applying the exceptions to section 99B of the Income Tax Assessment Act 1936 contained in paragraphs 99B(2)(a) and 99B(2)(b)* (**Draft TD**) and

   - the draft Practical Compliance Guideline (PCG 2024/D1) *Section 99B of the Income Tax Assessment Act 1936 (Cth) – ATO compliance approach* (**Draft PCG**).

3. We welcome the ATO publishing guidance to help clarify when section 99B may need to be considered by Australian resident beneficiaries of non-resident trusts, and the expectations regarding record-keeping and substantiation, including the compliance approach for certain low-risk arrangements.

4. Based on the statement contained in paragraph 7 of the Draft PCG, we understand that the ATO intends to only allocate compliance resources to the application of section 99B to trusts that at some time have been a non-resident trust. We note that all 27 examples in the Draft PCG and all six examples in the Draft TD expressly state that a reference to a trust is a reference to a non-resident trust, or only to a resident trust that has accumulated amounts during a period while the trust was a non-resident trust.

5. We welcome this approach by the ATO and support the proposition that section 99B should only be applied in cases involving trusts that are or have been non-resident trusts, as outlined in paragraph 7 of the Draft PCG.

6. We believe the compliance saving measures contained in the Draft PCG will assist many taxpayers in complying with section 99B. We have provided some comments in Appendix **A** requesting some further clarity in the Draft TD and Draft PCG in relation to a number of the examples.

7. If you would like to discuss any of the above, please contact The Tax Institute's Senior Counsel – Tax & Legal , Julie Abdalla at julieabdalla@taxinstitute.com.au, CA ANZ Senior Tax Advocate, Karen Liew at Karen.Liew@charteredaccountantsanz.com or CPA Australia's Tax Lead – Policy and Advocacy, Jenny Wong at jenny.wong@cpaaustralia.com.au.

Yours faithfully,

Susan Franks
Australian Leader – Tax and Financial Services
Chartered Accountants Australia and New Zealand

Ram Subramanian
Interim Head of Policy & Advocacy
CPA Australia

Tony Greco
General Manager Technical Policy
Institute of Public Accountants

Scott Treatt
Chief Executive Officer
The Tax Institute

APPENDIX A

Division 7A terms - compliance approach

8. We support the guidance contained in paragraphs 100 – 107 of the Draft PCG, which provide a sensible compliance approach where a resident beneficiary borrows funds from a non-resident trust estate.

9. However, the current wording in Example 21 of the Draft PCG could be interpreted by taxpayers to mean that they must enter into a Division 7A complying loan agreement when borrowing funds from a non-resident trust estate of which they are a beneficiary.

10. Paragraph 104 of the Draft PCG is very clear in respect of what the ATO are requesting for a loan to be considered to be made on commercial terms. That is, the agreement can be verbal, the agreement requires interest to be charged at or above the Division 7A interest rate and the length of the loan should conform with up to the maximum length of the loan as required by Division 7A.

11. However, Example 21 of the Draft PCG (**Example 21**) uses the words 'a repayment schedule confirming the agreement is consistent with the terms prescribed for Division 7A.' This could be (mis)interpreted as meaning that minimum loan repayments are required in each year and that no interest is required to be charged in the first year.

12. Further clarification could be added to Example 21 for the avoidance of doubt. For example, Example 21 could simply state that Anthony is charged interest each year (as outlined in paragraph 104 of the Draft PCG) and repays the whole of the principal at the end of the 5-year term (as outlined in paragraph 104 of the Draft PCG). These two small additions may help to ensure that taxpayers and their advisers do not misinterpret the requirements after reading Example 21.

Comparable interest rates in foreign jurisdictions

13. In addition to the compliance approach contained in paragraph 104 (i.e., using the Division 7A interest rate), we request that the ATO consider making a statement in the Draft PCG that outlines that it would also be acceptable that is applicable to use a comparable interest rate in the relevant foreign jurisdiction.

14. That is, the Division 7A rate under section 109N(2) is based on the 'Indicator Lending Rates - Bank variable housing loans interest rate last published by the Reserve Bank of Australia before the start of the year of income'.

15. To the extent that there is a similar rate published or accessible in a foreign jurisdiction, and to the extent that the loan is provided by the foreign trust in that foreign jurisdiction in the same respective foreign currency, we believe that it should also be acceptable to use the comparable foreign interest rate from a compliance perspective.

Physical payment of interest to the trustee

16. Paragraph 102 of the Draft PCG requires that there be 'physical payment to the trustee'. We note that this could be construed as being an amount of cash paid to the Trustee only.

17. We recommend that the final guidance make it clear that the requirement for 'physical payment to the trustee' includes a payment at law and is not limited to a transfer of cash to the trustee's

bank account. For example, this could be by way of set-off against debts owing by the trustee to the beneficiary.[1]

18. We note that the relevant cases (*Spargo* and *East Finchley*) support that an offset of mutual obligations constitutes a physical payment by the beneficiary. Accordingly, to avoid doubt, we recommend that an appropriate footnote be provided in relation to this statement.

Determining corpus in a foreign currency

19. We interpret the Draft PCG to suggest that corpus equates to the value of an asset when it is acquired by the trust, rather than the value of the asset as at the date of disposal. This is supported by paragraphs 48-49 of the Draft TD, which state that 'the cost base of the land and residential property…will be the market value of those assets on the date of their acquisition by the trust estate'.

20. For the purpose of the corpus exception in paragraph 99B(2)(a), taxpayers can rely on the currency in which the financial statements were prepared.

21. Paragraph 44 of the Draft PCG provides a non-exhaustive list of further documentation and information that can be used to support that the corpus exception applies, such as general ledgers. This suggests that if the financial statements of the non-resident trust are prepared in a foreign currency, it is that currency that should be used for calculating the value of the asset sourced from corpus.

22. It is suggested that a further example calculates corpus when dealing with an asset originally valued in a foreign currency would help to remove uncertainty regarding this issue.

Calculating 'benefit' when not on commercial terms

23. The examples contained in the Draft PCG that deal with non-commercial arrangements such as interest-free loans (example 24), as well as granting access to assets such as artworks and yachts (examples 23 and 25) or real estate at below market value, do not provide details on how the 'benefit' of a resident beneficiary should be calculated under agreements not made on commercial terms.

24. In these examples, where there is a non-contrived arrangement to repay the loan, or return the property, our view is that the 'benefit' obtained by the resident beneficiary would be the 'discount' or difference between the market value and actual payments made by the resident beneficiary for the period of use in the relevant income year.

25. Section 99B can apply to either an amount that is paid to or applied for the benefit of the beneficiary. While we understand that it may not be possible to quantify an amount for the purpose of the Draft PCG, we recommend that the examples state that 'provided that there is a non-contrived requirement to repay the property back to the trust, the beneficiary should be assessed on the benefit, being the amount of the discount.'

26. This is effectively similar to the approach taken in Example 27 of the Draft PCG, which holds that the arrangement is contrived. Where the arrangement is not seen to be contrived, we request that a further (clarificatory) statement be made to provide appropriate guidance to taxpayers.

Substantiating the corpus exception and the *Archer Brothers* principle

27. We welcome the ATO's guidance on the record-keeping requirements for substantiating the corpus exception, as reflected in Examples 9 and 10 of the Draft PCG.

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[1] See *Re Harmony and Montague Tin and Copper Mining Co Ltd* (1873) LR 8 Ch App 407 (**Spargo**); *East Finchley Pty Limited v FCT* [1989] FCA 481 at [49] (***East Finchley***).

28. In addition to those examples, we suggest that taxpayers should be able to evidence the source of amounts received in an approach analogous to a liquidator applying the *Archer Brothers* principle when appropriating a particular fund of profit or income in making a distribution.[2] In particular, both sections 47 and 99B of the ITAA 1936 use the key linking word 'represent' to determine the necessary connection between a payment/distribution and its underlying source.

29. Similar to the view adopted in *Taxation Determination (TD 95/10) Income tax: what is the significance of the Archer Brothers principle in the context of liquidation distributions?*, we suggest that an *Archer Brothers*-type approach to considering the corpus exception should be followed if:

    29.1. the non-resident trust's financial accounts have been kept so that a resident beneficiary can clearly identify a specific amount or property as belonging to trust corpus; and

    29.2. it is clear from either the accounts or statement of distribution that the resident beneficiary has sourced the specific amount or property received from the trust corpus.

30. If the non-resident trust has multiple reserves, (i.e. settlement sums, accumulated income, pre-CGT profits, revaluation reserves, etc.), then so long as this is reflected in separate accounts for each specific fund, the resident beneficiary should be able to apply the *Archer Brothers* principle to determine the character of the trust income received, i.e. whether it is sourced from trust corpus or not.

31. To the extent that a distribution results in a negative reserve being created, the distribution may be considered to be corpus to the extent that it is funded by borrowings rather than accumulated income.

32. We do not consider that this suggested approach is different to the approach accepted in the Draft PCG. However, having a broad statement or an additional example that outlines the principles in *Archer Brothers* would be helpful. We would be happy to assist in providing an example for ATO consideration if this would be helpful.

Additional guidance recommended – International tax implications

33. We recommend that the ATO consider providing some further guidance (outside of the Draft TD and Draft PCG) which considers the interaction with international treaties, the interaction where the trust is a hybrid, and Foreign Income Tax Offset interactions. We acknowledge these issues are outside of the scope of these documents. We would be pleased to work with the ATO on such guidance materials.

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[2] See *Archer Bros Pty Ltd (In Vol Liq) v FCT* (1952-53) 90 CLR 140 at 155; 10 ATD 192 at 201.