

## EXPOSURE DRAFT

### EXPLANATORY MATERIAL

*Taxation Administration Act 1953*  
*Taxation Administration Amendment Regulations 2010 (No. )*

Section 18 of the *Taxation Administration Act 1953* (TAA 1953) provides that the Governor-General may make regulations prescribing matters required or permitted to be prescribed, or which are necessary or convenient to be prescribed for giving effect to the TAA 1953.

These Regulations will amend the *Taxation Administration Regulations 1976* (TAR 1976) to prescribe matters related to amendments to be made to Subdivision 12-E in Schedule 1 to the TAA 1953 by Schedule 2 to the Tax Laws Amendment (2010 Measures No. 2) Bill 2010. The specific provisions relied upon in the TAA 1953 for the purpose of these regulations are subsection 15-10(2), proposed section 12-185 and proposed subparagraph 12-175(1)(c)(iii) in Schedule 1 to the TAA 1953.

These amendments to the TAA 1953 extend Tax File Number (TFN) withholding to closely held trusts, including family trusts. By extending TFN withholding to these types of trusts, the amendments are intended to encourage eligible beneficiaries to quote their TFN to the trustee of the trust. This will in turn enable the Australian Taxation Office (Tax Office) to use the TFN information to data match between the amounts received by beneficiaries from these trusts and the amounts reported on the beneficiaries' income tax return.

The objective of the Regulations is to prescribe information necessary for the operation of the amendments to Subdivision 12-E in Schedule 1 to the TAA 1953. They will prescribe the:

- TFN withholding rate to be used for working out how much of a distribution or present entitlement amount is to be withheld;
- threshold for determining whether a distribution or present entitlement amount will be subject to a withholding obligation; and
- classes of trusts to be excluded from the operation of TFN withholding .

Further details of the Regulations are set out in the Attachment.

The Regulations will be a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

The Regulations are intended to commence on 1 July 2010, at the same time as the legislative amendments to be made by Schedule 2 of the Tax Laws Amendment (2010 Measures No. 2) Bill 2010.

Authority: Section 18 of the *Taxation Administration Act 1953*

Details of the proposed *Taxation Administration Amendment Regulations 2010* (No. )

Regulation 1 – Name of Regulations

This regulation provides that the title of the Regulations be the *Taxation Administration Amendment Regulations 2010* (No. )

Regulation 2 – Commencement

This regulation provides for the Regulations to commence on the commencement of Part 1 of Schedule 2 of the *Tax Laws Amendment (2010 Measures No. 2) Act 2010*.

Regulation 3 – Amendment of *Taxation Administration Regulations 1976*

**SCHEDULE 1 – AMENDMENTS**

**Item [1] Regulation 2, definition of top rate**

Item [1] will insert a definition of *top rate* into Regulation 2. The term ‘top rate’ is used in a various withholding regulations across the *Taxation Administration Regulations 1976* (TAR 1976). By inserting ‘top rate’ as a defined term in Regulation 2, it will provide a stand alone definition that can apply consistently to the various regulations.

The ‘top rate’ is the sum of the highest rate specified in the table in Part 1 of Schedule 7 to the *Income Tax Rates Act 1986* and the rate of levy specified in subsection 6(1) of the *Medicare Levy Act 1986*.

**Items [2] to [7], amendments to references or use of top rate in existing regulations**

Items [2] to [7] will amend the existing regulations of the TAR 1976 that refer to, or provide a separate definition of ‘top rate’. The individual references to ‘top rate’ will be omitted and these amendments will insert a note referring readers to the definition of *top rate* in Regulation 2.

**Item [8] – Division 3A**

Item [8] will insert the new Division 3A into the *Taxation Administration Regulations 1976*. Division 3A will provide for regulations in respect of TFN withholding arrangements for closely held trusts.

**Regulation 38A – Prescribed Trusts**

This regulation will prescribe, and in some cases define, certain classes of trusts. These prescribed trusts will be excluded from the operation of TFN withholding in respect of closely held trusts, including family trusts, by virtue of proposed section 12-175(1)(c)(iii) in Schedule 1 to the TAA 1953.

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### Discretionary mutual fund

A trust that is a ‘discretionary mutual fund’ according to the meaning given by subsections 5(5) and 5(6) of the *Financial Sector (Collection of Data) Act 2001*, or that is a ‘statutory scheme’ discretionary mutual fund, will be a prescribed trust.

Discretionary mutual funds (DMFs) operate to provide an insurance-like product to a niche market as an alternative means of risk management. One of the distinguishing features of DMFs is that a fund has no contractual obligation to make payments in respect of eligible claims. Payment is at the discretion of the fund operator. Contributors to the fund only have a right to have their claim properly considered.

A DMF may be structured as an unincorporated association that holds its financial pool in a discretionary trust. Where a DMF is structured in this way, it will fall within the scope of the TFN withholding in respect of closely held trusts provisions. These regulations operate to exclude such structures.

‘Statutory scheme’ DMFs formed by state and territory law societies are not within the meaning of a DMF under subsections 5(5) and 5(6) of the *Financial Sector (Collection of Data) Act 2001*. They are, however, prescribed trusts for the purpose of the TFN withholding in respect of closely held trusts provisions. These statutory scheme DMFs are established under state or territory statute to provide Australian legal practitioners with professional indemnity insurance or like cover.

To the extent that they are structured as closely held trusts, DMFs are within the scope of these proposed withholding provisions. However, there was no intention to capture these types of trusts, given their unique nature and the potential large number of beneficiaries of these trusts.

### Employee share trusts

An ‘employee share trust’ that meets the definition of *employee share trust* under subsection 130-85(4) of the *Income Tax Assessment Act 1997* will be a prescribed trust.

An employee share trust (EST) has the sole purpose of obtaining shares or rights in a company and ensuring that employee share scheme (ESS) interests in the company that are beneficial interests in those shares or rights, are provided under the employee share scheme to employees, or to associates of employees.

ESTs can be structured as either fixed or discretionary trusts. Where they hold the employee shares for the benefit of the employees, the income of these trusts consists of the dividends streaming from the company. As ESTs may be structured as discretionary trusts they have the potential to constitute a closely held trust for the purposes of the TFN withholding for closely held trusts measure.

Information on the share holdings of EST beneficiaries is already reported to the Commissioner under the ESS rules. The ESS rules and the employee share trust’s role in the employer/employee relationship jointly provide sufficient tax integrity in relation to ESTs.

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### Solicitor Trusts

A solicitor trust is a prescribed trust. A ‘solicitor trust’ for these purposes is a trust formed when a client entrusts money to their solicitor either in the course of, or in connection with, the provision of legal services by the solicitor; or for the purpose of being invested or being lent under an agreement to be arranged by or on behalf of the solicitor.

This regulation is designed to have broad scope to cover purely formal trusts formed between solicitors and their clients where a client entrusts money to their solicitor in the course of, or in connection with, the provision of legal or investment services. A solicitor trust may form for a variety of purposes, including where:

- money is received by a solicitor on account of legal costs in advance of providing legal services;
- money is held by a solicitor such as amounts in dispute or deposits in relations to a proposed sale;
- money is received by a solicitor for the purpose of being invested by the solicitor or being lent under an agreement to be arranged by or on behalf of the solicitor; and
- money is entrusted or held by a solicitor for investment purposes in connection with the provision of legal services and for the ancillary purpose of keeping or enhancing the value of the money pending completion of the matter.

Those solicitor trusts which are ‘investment bodies’ under the existing framework in Division 4 of Part VA of the *Income Tax Assessment Act 1936* will still be subject to the TFN withholding arrangements in respect of investments.

This regulation will not exclude trusts formed where a trustee or beneficiary happens to be a solicitor. It is integral that the trust is a purely formal trust and is formed in connection with, or in the course of, the provision of legal or investment services.

### **Regulation 38B – Threshold amounts for exceptions**

This regulation provides the threshold amount for which withholding is required. Where a payment is less than this threshold, a trustee is not required to withhold an amount from that distribution or share. In accordance with the operation of proposed subsections 12-175(3) and 12-180(3) of the TAA 1953, a ‘payment’ includes a distribution of trust income, or a share of the net income of the trust to which a beneficiary is presently entitled, regardless of whether the distribution or the share of the net income is actually paid. Where a payment is made for part of the financial year, these Regulations apply a formula to determine a proportion of the threshold amount to be calculated.

The proposed threshold is largely consistent with the existing threshold for TFN withholding in respect of investments under Division 3 of the TAR 1976. Whilst the existing framework for investments provides separate thresholds for persons aged

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under 16 years and all other persons, separate treatment is not necessary under these Regulations. This is because the legislative amendments already exclude beneficiaries who are under a legal disability for the purpose of section 98 of the *Income Tax Assessment Act 1936*, which includes persons under 18 years of age.

### **Regulation 38C – Amount to be withheld from distribution of income of a closely held trust**

This regulation establishes the withholding rate for a distribution of an amount some or all of which is ordinary or statutory income of a closely held trust. This withholding rate applies where a trustee will be liable to withhold under subsection 12-175(2) in Schedule 1 to the TAA 1953. The operation of subsection 12-175(4) means that the withholding rate established by this regulation will apply to a distribution only to the extent that the income has not been subject to a previous withholding obligation.

The withholding rate to be applied to distributions of income of a closely held trust is the ‘top rate’, as defined in the Regulation 2 (as amended). This concept of ‘top rate’ is commonly used in the existing TFN withholding framework. The withholding rate is designed to encourage beneficiaries to quote their TFNs by providing a valuable incentive to avoid a withholding event.

### **Regulation 38D – Amount to be withheld if beneficiary is presently entitled to income of closely held trust**

This regulation establishes the withholding rate where a beneficiary is presently entitled to income of a closely held trust. This withholding rate applies where a trustee will be liable to withhold under proposed subsection 12-180(2) of the TAA 1953. The operation of proposed subsection 12-180(4) means that the withholding rate established by this regulation applies to a share of the net income of the trust only to the extent that the income has not been subject to a previous withholding obligation.

The withholding rate to be applied where a beneficiary is presently entitled to income of a closely held trust is the ‘top rate’. The reason for using the ‘top rate’ as the withholding rate is consistent with the explanation provided for Regulation 38C.