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TAXATION (UNPAID COMPANY TAX) ASSESSMENT BILL 1982

TAXATION (UNPAID COMPANY TAX) BILL 1982

TAXATION (UNPAID COMPANY TAX) (CONSEQUENTIAL AMENDMENTS) BILL 1982

INCOME TAX ASSESSMENT AMENDMENT (ADDITIONAL TAX) BILL 1982

EXPLANATORY MEMORANDUM - PART I

(Circulated by authority of the Treasurer,
the Hon. John Howard, M.P.)

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Introductory note

Part I of this memorandum contains explanations designed to provide a broad guide to the legislation that has been introduced to give effect to the company tax recoupment measures foreshadowed in Ministerial statements of 25 July 1982 and 17 August 1982, and to an associated Bill. Part II of the memorandum will contain a clause by clause explanation of the Bills.

There are three Bills for the purpose of recouping evaded company tax:

- The Taxation (Unpaid Company Tax) Assessment Bill 1982 which sets out the basic conditions of liability and contains necessary machinery measures.
- The Taxation (Unpaid Company Tax) Bill 1982 is a "Rates" Bill which formally imposes a tax of the amount established by the first Bill.
- The Taxation (Unpaid Company Tax) (Consequential Amendments) Bill 1982 which makes changes to several other Acts consequent upon the first Bill.

An associated Bill - the Income Tax Assessment Amendment (Additional Tax) Bill 1982 - provides for an increase from 10% per annum to 20% per annum in additional tax for late payment of income tax and limits the Commissioner of Taxation's powers to remit that additional tax to certain specified circumstances.

TAXATION (UNPAID COMPANY TAX) ASSESSMENT BILL 1982

General outline

This Bill will (as announced on 25 July 1982 and 17 August 1982):

- define the parameters of liability to recoupment tax of vendor-shareholders and other former owners of shares in companies that were stripped of pre-taxed profits and thus evaded company tax (including undistributed profits tax) on those profits;
- provide the mechanism for determining which former-owners are to be liable for recoupment tax and the measure of that liability;
- provide a right of election so that shareholders in a company that has been stripped of its pre-tax profits will be (if the election is made) able to be assessed on sufficient dividend income to eliminate the liability of the company to undistributed profits tax and thus to recoupment tax on that undistributed profits tax;
- require payment of additional tax for late payment of recoupment tax at the rate of 20% per annum where the recoupment tax is not paid within 30 days of service of a notice of assessment for that recoupment tax, or such extended time as the Commissioner of Taxation allows;
- require the Commissioner to re-issue notices of assessment on a stripped company to a former owner and allow that former owner to exercise those rights of objection and appeal against the assessment that the company could have exercised;
- render void arrangements entered into after 25 July 1982 which have the dominant purpose and the effect of directly or indirectly defeating, evading or avoiding a person's liability to pay recoupment tax.

Broad outline

As indicated above, the Taxation (Unpaid Company Tax) Assessment Bill is the main Bill in a package of 3 Bills, designed to recover from vendor-shareholders and other former owners of companies stripped of pre-tax profits the tax evaded by those companies. This Bill contains provisions delineating the liability to a recoupment tax of persons who, directly or indirectly, owned shares in companies that were subject to stripping procedures that rendered them unable to meet a company tax liability that was actual or contingent at the date these persons ceased to so own their shares. Included in the company tax that will be the subject of the recoupment will be tax on taxable income of the company, undistributed profits tax payable by the company and unpaid penalty tax imposed on the company for late payment of these taxes, measured only from 30 days after the date on which a former owner is notified of the company's tax liability.

The Bill will also impose additional penalty tax at the rate of 20 per cent per annum on any tax assessed under the proposed law that is not paid by the due date for payment of the tax. That penalty tax will be capable of remission by the Commissioner of Taxation only in restricted circumstances.

In addition, the Bill contains provisions to render void any arrangement, or transfer of property, occurring after the date of the Ministerial announcement foreshadowing this legislation - 25 July 1982 - that has the dominant purpose and the effect of enabling a person who will be liable to tax under the Bill to escape payment of that tax.

In order to recover from former owners of shares in stripped companies the tax evaded by those companies it is necessary for constitutional reasons for the Bills to impose on the former owners of the shares a tax - to be known as recoupment tax - of an amount equal to the tax evaded.

The legislation will apply to evasion schemes entered into before 4 December 1980, that being the date that is the commencement date of the Crimes (Taxation Offences) Act 1980. In order to make the legislation apply only from a time shortly before these schemes came to be practised on a wide scale, the Bill is expressed to apply to schemes entered into on or after 1 January 1972.

A typical scheme of pre-tax company profit stripping would ordinarily involve a sale of all (in isolated cases practically all) of the shares in a company (the "target company") which had successfully traded for a substantial part of the income year and which had, up until the implementation of the scheme, current year profits on which a contingent company tax liability existed. In addition, if the target company concerned was a private company for income tax purposes it would in due course become liable to pay undistributed profits tax in the event that it failed to pay a dividend of a specified proportion of its profits within 10 months after the end of the income year.

The trading activities of the target company would first have been transferred to another entity (company or trust) controlled by the former owners of the company and the target company's assets reduced to cash or other liquid form. It would be a condition of the scheme promoter that all liabilities of the company <u>except</u> its actual or contingent tax liabilities be paid or indemnified by the vendor-shareholders.

The former owners of the company would be paid a price for their shares that was fixed on the basis of the value of the company's assets, not taking into account the contingent tax liability on company profits. This capital sum would however have been reduced to reflect the fee charged by the promoter or other stripper.

By further processes the target company would be stripped of its liquid assets (e.g., by the making of a loan that could not be repaid) and thus rendered incapable of meeting the company tax liability in due course assessed to it. It is this unpaid company tax that is the subject of the Bill.

There were yet other situations in which the ownership of companies was sold and the companies rendered incapable of paying their income tax.

In some of these the sale of shares in a holding company would carry the ownership of one or more subsidiary companies, one or more of which was stripped of funds and rendered incapable of paying legally payable company tax. In situations involving more complex company structures, the entire ownership of a company that was later stripped was transferred by selling shares either in it and in other companies through which the company to be stripped was owned or in other companies which through various inter-company shareholdings owned the target company.

Some companies that were stripped of untaxed current year profits were also stripped of profits of a prior year that had not borne the company tax legally payable on those profits.

Yet again, some companies that had current year profits were, after the sale of their shares, put into a tax avoidance scheme which was unsuccessful in creating deductions that would eliminate the company tax liability that had accrued to the date of sale. Once the scheme is found not to be effective, so that company tax is payable, a position is reached where any stripping of funds from the company had the effect of making the company incapable of paying its tax.

For all these situations, the Bill proposes the creation of a series of levels of liability to recoupment tax - a liability at primary level on each person (other than a bare trustee) who was a vendor-shareholder of shares in a stripped company or, where the vendor was a bare trustee, the owner of them under the trust, and to the extent necessary a series of further levels for persons who were at the time of sale of the stripped company beneficially entitled directly or indirectly to capital rights in a primary level company or trust. A liability at a level below the primary level will not arise unless for some reason (e.g., the primary level liability falls on a company that has been wound up) a primary level liability to the recoupment tax will not be met or it would be inappropriate in the particular circumstances to expect it to be paid.

By clause 5 a liability for recoupment tax at the first level - primary level - will arise where (to take the simple case):

- shares in a company carrying more than 90 per cent of the voting power in the company were sold, whether in Australia or outside Australia, on or after 1 January 1972 and before 4 December 1980 (i.e., before the commencement of the Crimes (Taxation Offences) Act 1980);
- the total consideration for the sale of the shares in the company exceeded the net assets of the company after taking into consideration any actual or contingent company tax liability (but not penalty taxes) covering periods up to the time of sale of the shares;
- an assessment has been made of the company tax payable by the target company, any objection against that assessment has been finalised and there is no outstanding dispute in relation to the company tax;
- the company tax (including late payment penalty) remains unpaid as a result of an arrangement or transaction; and
- the company did not after the sale carry on the same business it had carried on before the sale.

Where these conditions are all met each direct shareholder in the target company, or a shareowner holding shares via a nominee who sold his or her shares, will, by clause 7, become liable to pay a recoupment tax equal to a proportion of the unpaid company tax ascertained by reference to the proportion of his or her consideration for the sale of the shares to the total consideration for all the shares.

The measures, suitably adapted, will also apply where shares in a holding company or holding companies were sold so that not only the holding company(ies) but also its subsidiaries were stripped of pre-tax profits, and in this case the tests outlined above will apply after aggregating the net assets and tax liabilities of the holding company(ies) and the subsidiary companies. Similarly, they will apply where a target company had been owned through a more complex series of shareholdings and the sale of the company was accomplished by selling shares in a number of companies, including the target company.

If a company had traded for a period and a provision for the company tax for the period had been raised in the company's accounts it sometimes happened that the vendor-shareholders received a price for their shares that was diminished by the amount of the provision and by an additional fee for the promoter. In that simple case, the legislation will not apply - the consideration for the shares did not exceed the company's net assets after taking into consideration the company tax liability (paragraph 5(1)(d)).

If, however, the case was one where the promoter took from the vendors the amount of the tax provision for a completed year, but left the vendors to enjoy the bulk of the benefits of the unpaid company tax for the next year, the test in paragraph 5(1)(d) could be satisfied in relation to the entire scheme, and in relation to the unpaid tax of both years. In line with the outcome in the given simple case, sub-clause 5(4) will permit the Commissioner to free the vendors from the recoupment liability in relation to the first of these two years.

Sub-clause 5(4) and its counterpart sub-clause 6(1B) will also authorise the Commissioner to free a person from a liability for recoupment tax where that person's liability would be less than $100 and it would not be appropriate to seek to recover the tax.

A person who holds shares as a bare trustee (i.e., as a nominee) will not be liable for recoupment tax, but a person on whose behalf those shares are held will become liable as if that person were the holder of the shares that were sold.

Where a person has died before an assessment of recoupment tax is made in respect of that person there will be no liability for recoupment tax passed on to that person's dependants or beneficiaries under a will. However, if a person dies after a recoupment tax assessment has been made on him or her, the Commissioner will be authorised to recover that tax out of that person's estate.

Where the allocation of the unpaid company tax at the primary level is to individuals no further tracing of liability for the recoupment tax will be necessary. Liability will rest with the vendors who benefitted as vendor-shareholders (or beneficiaries under a bare trust) from the evasion of company tax.

That will also be the case where the person who is allocated a recoupment tax liability at the primary level is a company or trust that is still owned by the people who were owners at the time control of the relevant target company was sold to the promoter or other stripper - so long, of course, that the company or trust still exists and has funds to pay its share of the recoupment tax.

Where that is not so, a further process of tracing may be necessary. As soon as such further tracing reaches an individual, it will stop, but would as necessary correspondingly continue to and through successive companies and trusts.

There are three triggers for tracing from the primary to the next level and, as required, successively to further levels. These are, very broadly, that the company or trustee to which recoupment liability has been allocated or traced -

(a) no longer exists (sub-clause 6(1));

(b) now has different shareholders or beneficiaries as a consequence of sales of shares or beneficial interests (sub-clause 6(2));

(c) is unlikely to pay all of its share of the evaded tax (sub-clause 6(3)).

Once the need to trace liability from a company or trust has thus been established, the fundamental rule for tracing to shareholders and beneficiaries is on the basis of respective firm rights to a capital distribution from the company, or to a distribution of trust corpus, normally as viewed at the time of sale of the target company concerned.

In some cases, e.g., in the case of a discretionary trust, persons will have received capital distributions in situations where it could not be said that at the time of sale they had a firm right to that distribution. For such cases the legislation treats the actual receipt of capital or of corpus as having been received pursuant to right.

There are yet again further situations where persons have received moneys as a consequence of a sale of shares in a target company (stripped of its pre-tax profits), but have not done so either in pursuance of <u>rights</u> to capital or corpus or in the form of a formal distribution of capital. For example, a recipient trust may have been stripped of funds by the making of loans so structured that they are not intended to be, and in a practical sense are not capable of being, repaid. The Bill treats persons who have thus effectively received moneys originating in a target company as having received, pursuant to right, a distribution of capital or corpus.

Should the application of these tracing rules result in the allocation to a person of a recoupment tax liability that is so far removed from practical realities that it would not be appropriate to pursue the person for the recoupment tax amount the Commissioner will be empowered (sub-clause 6(18)) to refrain from action accordingly.

If, after an assessment for recoupment tax is made, the whole or a part of the underlying basic company tax (tax on taxable income and undistributed profits tax) is paid, the payment of that company tax will reduce any recoupment tax that is payable (clause 8). Similarly, if an amount of recoupment tax is paid at the primary level that payment will be reflected through reduction of the recoupment tax payable at a later level and vice-versa.

Reflecting the fact that penalty taxes payable by companies for late or no or incorrect returns are not within the scope of the recoupment legislation, any payment of a stripped company's overall tax liability will be applied first against such penalty taxes if made by persons other than the pre-strip owners of the companies.

If an amount of recoupment tax remains unpaid after the due date for payment (i.e., 30 days after issue of an assessment), additional penalty tax at the rate of 20 per cent per annum will become payable. This additional tax will be capable of remission only in restricted circumstances such as where late payment of the recoupment tax is due to factors beyond the control of the taxpayer. If any payments of recoupment tax are made these will be applied in the first instance against this penalty tax (sub-clause 9(1)).

The legislation (clause 12) will enable the Commissioner to make an assessment of company tax against a company that has ceased to exist, e.g., where a company has been dissolved or deregistered, in which case the assessment notice is to be served on one of the pre-strip owners of the company.

By clause 15 of the Bill a copy of a notice of assessment previously served on a stripped company under the Income Tax Assessment Act will be served on a pre-strip owner.

Where clause 15 applies, a former owner on whom a notice of assessment (or a copy thereof) in relation to company tax is served will be entitled to exercise the same rights of objection and appeal against that assessment as the company had, or would have had, if it had been served with the notice of assessment.

As announced on 17 August 1982, a right of election will be available to shareholders in a company who would be liable to be assessed to recoupment tax based on unpaid undistributed profits (Division 7) tax of the company. The election would, if practicable, be made by the former directors of the company or, failing that, the vendor-shareholders. They will be able to elect that the former owners be assessed on an amount of income equal to the dividend that the company would have needed to pay to eliminate the liability to undistributed profits tax (clause 13).

Where such an election is made and the Commissioner is satisfied that the persons concerned will pay tax on the amount to be included in their assessable income, the company's liability to Division 7 tax, and thus the shareholders' liability to recoupment tax in connection with that Division 7 liability, will be eliminated. Where a shareholder is a trustee of a trust estate, a further election will be available to treat the imputed dividend income of the trust estate under the earlier election as a distribution to the beneficiaries in the trust, which will be assessed to tax at the marginal rate applicable to those beneficiaries (clause 14). A similar effect in relation to shareholders in a company will be able to be achieved by the application of existing provisions of the income tax law (sections 46(3) and 105AA).

In a practical sense persons who make elections under these provisions will do so only where a lower rate of tax is applicable to any imputed dividend and thus where elections would operate to the financial benefit of the former owners or beneficiaries in a trust that formerly owned shares in a company.

The proposed legislation also contains (clause 16) provisions - foreshadowed on 25 July 1982 - to render void arrangements entered into after that date which have the dominant purpose and the effect of directly or indirectly defeating, evading or avoiding a person's liability to pay recoupment tax. Where a scheme involves a transfer of, or diminution in the value of, any property of a person liable to pay recoupment tax, that scheme will be void in any proceedings commenced by the Commissioner or by a liquidator or trustee in bankruptcy which are designed to recover the recoupment tax. A scheme of this nature entered into for the purpose of rendering a person unable to meet a potential liability to recoupment tax will also be void if, at a later time, that person is assessed to pay recoupment tax and fails to pay that tax.

Finally, the legislation will mean that a vendor-shareholder who receives a notice of assessment to recoupment tax will not be entitled to go behind the company tax liability unless there have been exercised, in the circumstances allowed, rights of objection and appeal against the company assessment (clause 17). Once a company's liability to company tax is finalised, either by a failure to exercise rights of objection or by a determination of any objection and subsequent appeal against the company, that liability will be conclusive insofar as an assessment to recoupment tax is concerned.

TAXATION (UNPAID COMPANY TAX) BILL 1982

General outline

This Bill will formally impose a tax on the eligible taxable amount (broadly the person's share of the unpaid company tax) ascertained under the Taxation (Unpaid Company Tax) Assessment Bill 1982. The tax will be an amount equal to that eligible taxable amount.

TAXATION (UNPAID COMPANY TAX) (CONSEQUENTIAL AMENDMENTS) BILL 1982

General outline

This Bill will:

- amend the Administrative Decisions (Judicial Review) Act 1977 to exclude from review under that Act decisions relating to the assessment of recoupment tax (which will be reviewable instead under the objection and appeal provisions of the income tax law.
- amend several other taxation Acts to provide that a liquidator or receiver of a company that has a liability to recoupment tax is required in setting aside assets of the company to pay tax to take into account the liability to recoupment tax.

INCOME TAX ASSESSMENT AMENDMENT (ADDITIONAL TAX) BILL 1982

General outline

The Bill will amend the income tax law:

- to increase the rate of additional tax payable for late payment of income tax and for underestimating instalments of company tax from 10 per cent per annum to 20 per cent per annum with effect from a date 2 months after the Bill becomes law;
- to re-express the power given to the Commissioner of Taxation to remit late payment penalty, so that remission will only be permitted in special circumstances, such as adverse business or other factors beyond the control of the taxpayer - this more limited power of remission will mean that the existing administrative practice of the Commissioner of agreeing to remit late payment penalty on tax in genuine dispute, provided half the tax in dispute is paid, will not be available in future;
- to preserve existing arrangements whereby the Commissioner has permitted an amount of disputed tax to remain unpaid, free of late payment penalty, pending resolution of an objection or appeal.

Part II of this explanatory memorandum - a clause by clause explanation of the Bills - is in course of preparation.

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