TD 2010/11EC - Compendium

Ruling Compendium – TD 2010/11

This is a compendium of responses to the issues raised by external parties to draft TD 2009/D6 – Income tax: can Part IVA of the *Income Tax Assessment Act 1936* apply to a salary deferral arrangement as described in Taxpayer Alert TA 2008/14?

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1.	The Tax Office needs to explain when Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) (Part IVA) will not apply to a salary sacrifice arrangement (SSA) which includes a loan as part of the arrangement. If Part IVA applies to such arrangements it would also potentially apply to other SSA for example arrangements which includes superannuation and packaged motor vehicles. Part IVA could potentially apply to a superannuation scenario due to the permanent reduction in an employee's assessable income. The TD should discuss why Part IVA would not apply where superannuation was an option under the scheme, and what is the difference between the two investment strategies considering that the super option could be said to create a tax savings (15%) rather than just a deferral of tax. A genuine loan arrangement can be provided under an effective SSA, whereby a potential entitlement to future income is foregone and instead a loan is provided to the employee where the loan is interest bearing and full recourse. We note that the loan should not otherwise be income of the taxpayer (according to section 59-30 of the *Income Tax Assessment Act 1997* (ITAA 1997)). Should the ATO seek to apply Part IVA in such circumstances, this would undermine the tax treatment of effective SSAs contained in TR 2001/10.	The arrangement as described in the Determination is not a salary sacrifice arrangement as described in Taxation Ruling TR 2001/10: Income tax: fringe benefits tax and superannuation guarantee: salary sacrifice arrangements. The ATO view is that under a salary sacrifice arrangement, the rights to salary or wages income are permanently sacrificed in return for the provision of benefits of an equivalent amount, and it is assumed that the income 'sacrificed' is dealt with at that time under other taxing provisions. Where a SSA involves contributions to a superannuation fund by an employer, the Commissioner's view in TR 2001/10 is that the amounts contributed are not assessable income of the employee under Division 6 of the ITAA 1997 or paragraph 26(e) of the ITAA 1936. The sums contributed have not been allowed, given or granted to the employee, but are paid to the administrators of the fund. The scheme of superannuation and taxation law is such that the employee is unable to get immediate access to the funds. The arrangement as described in the Determination involves merely the deferral of the derivation of employment income to a later date, and not the permanent sacrifice of such income under a SSA. The Determination is not the appropriate place to consider any issues in relation to SSAs.

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2.	The Determination is inconsistent with Taxation Determination TD 93/242 Income tax: what is the income tax treatment of a deferred salary payment agreement? TD 93/242 makes no reference to the potential application of Part IVA and has not been withdrawn. That TD does refer to and distinguish a situation where the salary has been 'constructively' received (and applied for the benefit or at the direction of the employee). We agree with the comment that section 19 of the ITAA 1936 (the former 'constructive receipt' deeming provision, now contained in section 6-5(4) of the ITAA 1997) would not apply to assess the deferred amount, provided the amount is not applied, accumulated or invested for the benefit of the taxpayer. Accordingly, salary deferral arrangements which do not otherwise suggest or give rise to a constructive receipt of income appear to have been accepted by the Commissioner and should not attract Part IVA.	Taxation Determination TD 93/242 is still current and provides the ATO view on arrangements that include a deferred salary payment agreement, where a portion of the employee's annual salary is deferred in return for paid leave in a later period. However, TD 93/242 deals with an arrangement where the employee does not benefit by having immediate access to the deferred income by way of a loan that funds the acquisition of assets, unlike the arrangement described in the Determination.
3.	The draft TD does not adequately consider the potential non-tax considerations and all elements of Part IVA for example: • an employer making a loan to the employee forgoes a deduction and improves its financial position by reducing expenses and increasing assets (loan to employee), • the restriction that the amount can only be spent on income producing asset shows a dominant purpose to use the funds for investment • the manner the scheme is entered into might be in accordance with usually accepted salary packaging arrangements – that is, a formal process resulting in an effective salary sacrifice agreement per TR 2001/10;	Paragraph 13 of the Determination has included a further consideration of the eight factors referred to in paragraph 177D(b) of the ITAA 1936. The ATO acknowledges that salary packaging arrangements operating with one or more of the features described in the submissions might not attract the operation of Part IVA. However where the salary deferral arrangement exhibits all the features described in paragraph 4 of the Determination, the Commissioner's view is that Part IVA is likely to apply to the arrangement.

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3. cont	• On issues of form and substance, we note the following: - the form and substance of the scheme might be consistent and in accordance with usually accepted salary packaging arrangements; - Employees will not typically get the full economic benefit of income because their use of the funds is quite restricted. They will not be able to freely spend and enjoy the income, given the common requirement that funds be used for income producing investment purposes only; - Employers are also in a different position consistent with the substance of these arrangements. Firstly employers have made a loan rather than incurring an expense as discussed above. Secondly, employers will not be entitled to an income tax deduction when the loan is made, where a deduction would otherwise arise for salary; - It is anticipated that arrangements will be appropriately documented, consistent with the terms and substance of the arrangement; - A range of potential commercial (non tax) benefits arise for both the employer and the employee as discussed above; and - Employees will have obligations to repay the loans, consistent with the substance of the arrangements. Given these factors, in our view there is no divergence of form and substance in these arrangements, properly structured, and there are clear commercial (non tax) reasons for entering into them.	

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3. cont	• the timing of the scheme might coincide with an employee's period of employment, being consistent with most usually accepted forms of remuneration; • the results achieved under the scheme might be in accordance with the results expected when remunerating employees via other salary packaging arrangements – that is, increased morale and productivity, staff retention and a way of being seen as an employer of choice. The results might also be seen as similar to the results achieved by employees salary sacrificing for superannuation; • the change in financial position of the employee might be similar to that caused by a salary sacrifice for superannuation, especially when considering the requirement to invest the loan moneys, rather than having the freedom to spend salary or wages. So, similarly to salary sacrificed superannuation contributions, the main financial effect is an increase in investments held by the employee; • the change in financial position of the employer would be as outlined above, that is, reduced expense, increased assets, reduced/deferred tax deduction; • any other consequences of the arrangement might be very specific to individual scenarios; and • the nature of connection between the employer and employee might be a 'plain vanilla' arm's length employment relationship. In the absence of the 'constructive receipt' considerations, we submit that Part IVA should not apply to loans made in circumstances where the employee has an expectation that the loan would be repaid from future income which the employee does not have a current entitlement to receive, the loan was limited recourse, or at a low or nil interest rate.	

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4.	The provision of an interest free loan is specifically dealt with under the FBT legislation and section 23L of the ITAA 1936. In particular we consider that Part IVA should not apply where: (a) a loan arrangement having a low or zero interest rate, but which is otherwise identical to the loan arrangement in (a). We note that the interest rate considerations are specifically dealt with under the FBT provisions; (b) a loan arrangement having limited recourse, but otherwise identical to the loan arrangement in (a), given: (i) the interest rate considerations are specifically dealt with under the FBT provisions; and (ii) the Commissioner has ruled previously that limited recourse features would not give rise to a debt waiver fringe benefit; and (iii) the Commissioner has stated in ATO ID 2003/315 that the ‘downside risk protection’ is not taxable as a separate fringe benefit from the provision of the loan itself (which is, in respect of the interest rate applicable to the loan, and subject to reduction by application of the ‘otherwise deductible’ concession in section 19 of the *Fringe Benefits Tax Assessment Act 1986*). That is, where a loan is repayable in the ordinary course and in accordance with its terms, then Part IVA should not apply to ‘deem’ the loan to be assessable income, merely because there is an expectation that the borrower will repay the loan funds from the proceeds of sale of the investments and/or any future income.	In the arrangement as described in the Determination, the loans form part of the mechanism for the employee to get the immediate benefit of the income deferred. Where the Commissioner cancels the tax benefit obtained, and determines that amount was derived by the employee under section 6-5 of the ITAA 1997 as salary or wages or bonus income during the income in which it was deferred, then the employee has not obtained a fringe benefit (salary or wage income is specifically excluded from the definition of a ‘fringe benefit’). The Commissioner has not changed the view as described in ATOIDs 2003/315, 2003/316 and 2003/317. The Determination is specific to the arrangement described in the Determination, which is different to that set out in the ATOIDs.

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4. cont	Accordingly, we submit that the draft determination should be amended to clarify that it is not intended to affect effective SSAs but rather would apply only to situations which clearly have the effect of constructive receipt of an equivalent amount of guaranteed future income. That is, where a bonus is not 'sacrificed' but its receipt is deferred in consideration of an equivalent amount being paid over to the employee by way of a loan that is, in effect or in substance, not repayable unless and until the employee receives the guaranteed future income. There are a number of specific anti-avoidance provisions that deal with limited recourse loan arrangements (such as Division 243 and Division 247 of the ITAA 1997). We note that the Commissioner has previously accepted (in the context of employee share plan arrangements) that arms length limited recourse loan arrangements with employees should not qualify as a debt waiver fringe benefit or other taxable benefit – refer ATO ID 2003/316 and ATO ID 2003/317. It is also noted that the loans the basis of CR 2007/48 were not limited recourse, and yet the Commissioner cited Part IVA concerns.	