TR 2012/4EC - Compendium

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Ruling Compendium – TR 2012/4

This is a compendium of responses to the issues raised by external parties to draft Taxation Ruling TR 2011/D4 – Income tax: the operation of subsection 230-55(4) in determining what is an 'arrangement' for the purposes of the taxation of financial arrangements under Division 230 of the *Income Tax Assessment Act 1997* (ITAA 1997).

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	Further detail should be provided regarding how a taxpayer determines what are normal commercial understandings and practices. What are the relevant benchmarks and experts? It is submitted that the ruling should address: • Differing interpretations or applications of accounting standards; • Differing views where accounting standards are emerging; • Differing commercial understandings over time; • There might be more than one normal commercial understanding and practice; and • The role of expert opinions, accounting and commercial technical journals and papers, materials produced by accounting academics and professional firms.	What is normal is a fact that can be established by probative evidence. The explanation seeks to emphasise that this is a broad practical substantive enquiry. It is not an esoteric or highly technical enquiry. The focus is not on expertise if that expertise be arcane, but rather what is understood and practised by what might be called the commercial person on the Clapham omnibus. The explanation also notes that contextually, the focus of looking at normal commercial understandings and practices is in terms of the question of aggregation. To the extent that commercial understandings and practices are not concerned with aggregation, they may be less significant. Accounting treatment will be a relevant consideration, but, where accounting is indifferent to aggregation or disaggregation, may be less significant. It might be expected to be the case that often the normal understandings and practices in relation to the rights and obligations of things (in terms of their aggregation) will be obvious. Where such normal understandings and practices may not be obvious, the ruling suggests that the rights and obligations in question need to be clearly seen, and the analysis should not rely on a mere label. Rather, in order to see clearly such rights and obligations, it will often be helpful to compare, with a legal analysis, an understanding of cash flows, of economic risks and rewards, of accounting

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		treatment, of regulatory treatment, and of other commercial drivers. The ruling states, at the level of principle, that having seen the rights and obligations clearly, it is necessary to ask the practical substantive question of what those who normally engage in commerce would normally understand to be the way in which those rights and obligations are understood (in terms of their aggregation), and what practices those engaged in commerce normally followed.
2	The ruling and discussion should note that there is not necessarily only one commercial understanding or practice in each case.	It is certainly hypothetically possible for there to be more than one normal commercial understanding, but no actual example of this has been demonstrated, and it may be misleading to assert a hypothetical that does not in fact exist. If in fact there are different normal commercial understandings, the ruling (and the legislation) covers this. It can be established positively that there was a particular normal commercial understanding and practice
3	Paragraphs 25[1] [24 in the final ruling] and 183 [183] indicate that accounting classification is not the relevant understanding or practice or only part of the relevant understanding or practice.	Paragraph 25 [24] is not addressing normal commercial understanding in paragraph 230-55(4)(e) of the ITAA 1997 but rather paragraph 230-55(4)(f), and in particular the object in paragraph 230-10(c) of the ITAA 1997. The point being made is that taking account of and minimising compliance costs is a goal that does not override or ignore the choices that the legislation makes to not have a direct link with accounting. That is, where the legislation expressly requires a treatment different from that in accounting, the compliance costs object cannot result in the express legislative requirement being ignored.

[1] Paragraph references with no brackets are to the issued draft ruling TR 2011/D4; paragraph references in square brackets are to the final Ruling.

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4	A comment should be added to paragraph 25 [24] to show that accounting will often be a very significant if not primary factor in determining the normal commercial understanding.	Paragraph 25 [24] is not addressing normal commercial understanding in paragraph 230-55(4)(e) of the ITAA 1997 but rather paragraph 230-55(4)(f), and in particular the object in paragraph 230-10(c) of the ITAA 1997. The importance of accounting in establishing normal commercial aggregation can be overstated, given that accounting often does not care about aggregation – see paragraph [188]. The ruling is accurate in saying that accounting is relevant but not determinative as to normal commercial understandings and practices.
5	Remove references to 'economic income' and 'economic gains and losses'.	Agree. It is possible that these references could be misunderstood as referring to a 'Haig-Simons' concept. Therefore the relevant references have been reworded.
6	Include in the discussion the consequences of very common *ERA-case* style commercial bill/note facility agreements that is of the type addressed by section 775-185 of the ITAA 1997.	The ATO considered the ERA case to see if it gave sufficient facts to enable the fact pattern to be ruled on, but came to the view that a (blank) document or documents which would be used to effect such a transaction would be necessary in order for the ATO to be able to rule. The professional associations representatives were asked to provide such document or documents, but were unable to do so. At the 20 March 2012 meeting of the NTLG TOFA Working Group, the ATO was asked if such documentation were subsequently able to be provided, could an ERA example be included in the ruling. The ATO said that it would not delay the ruling in order to include such an example, but would certainly consider ruling on such example in some way (for example by means of adding to the ruling, or doing a tax determination.)
7	Include in the discussion the application of section 230-55(4) of the ITAA 1997 to securitisations and the case study provided in the explanatory memorandum.	There is a process underway to address this issue in relation to securitisation. Technical discussion paper 2011/1 is currently awaiting a response from industry.

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8	Include in the discussion the consequences of various (more complicated) 'structured finance' style transactions (hinted at in paragraph 146).	There are eleven examples in the ruling, drawn from fact patterns arising in private rulings and/or the explanatory memorandum. It is not considered that further examples will materially add to the value of the ruling. Further, in order to rule on particular complex products (rather than labels); it would be necessary to have actual documentation.
9	Include the examples provided in the Explanatory Memorandum to the Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2008 (explanatory memorandum)	A repurchase agreement example has been drafted but given that it is a substantive new example, it has been circulated as a draft to the NTLG TOFA Working Group, seeking industry comments prior to being added to the ruling. The securitisation example is discussed above. The only other examples in the Explanatory Memorandum but not in the ruling are Example 2.4 and Example 2.6. To add an example based on Example 2.4 as to the separate purchase of a building and office furniture would add to the ruling's length but is not considered to provide significant guidance. Similarly, an example based on Example 2.6 dealing with an interest bearing account is not considered to provide significant guidance.
10	The examples should set out the practical consequences of the decision to aggregate or disaggregate rights and obligations.	Potential practical consequences are stated at paragraph 7 [7]. The examples are drafted to provide guidance on the application of subsection 230-55(4) of the ITAA 1997.
11	Explanation/demonstration required of the statements in a number of the examples that the conclusion reached does not 'distort' the tax outcome. Consider issuing the examples in separate TDs, should the examples make the ruling too long.	Further explanation included at paragraph [193].

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12	In paragraph 139 [138], reword the reference to one criterion being 'particularly telling' to read 'more significant having regard to the need for a determination under section 230-55'.(of the ITAA 1997).	The phrase 'particularly telling' is replaced with 'more significant than others'.
13	The ruling should also clearly note (and in the discussion section at paragraphs 140 [139] to 151 [150]) that there is not necessarily always one clear answer or obvious 'silver bullet' interpretation.	The ruling states at paragraph [137] As noted, on its terms, subsection 230-55(4) states that the question as to one or more arrangements is a question of fact and degree. That is, the provision recognises that, at the margin, it may be a finely balanced question as to whether there is one or more arrangements.
14	Change 'chemically' to 'commercially' in paragraph 142 [141].	The word 'chemically' is deleted. The word 'commercially' not added as it is not clear what the phrase 'commercially pure' means.
15	In paragraph 165 [164] it is unclear why under and over pricing of different rights and obligations suggests the need to aggregate such rights/obligations.	Explanation is added to what is now paragraph [164].

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16	The discussion in paragraph 192 [195] should refer to the fact that, in the circumstances of Division 230, any outcome permitted under Division 230 is presumed to be 'reasonable'.	Text added in paragraph [193]. Paragraph 230-55(4)(f) incorporates the objects at paragraphs 230-10(a) and (b). When read with paragraphs 230-55(4)(a) to (e) which focus on the substance of the rights and obligations, the terms and conditions, the circumstances of creation and proposed exercise (including what can reasonably be see as the purposes of entities involved), and normal commercial understandings and practices, it can be reasonably inferred that, in partnership with other paragraphs in subsection 230-55(4), these objects could play their part in an overall decision to aggregate in certain circumstances. For example, where a common arrangement that is ordinarily achieved by one legal contract, and commercially operates as one arrangement, and is understood commercially to do so, is synthetically replicated as being a number of contracts in a quite elaborate and artificial way, such that the accruals part of it brings deductions to tax along the way and a realisation part of it postpones a gain significantly, when the economics of the arrangement (that is, cashflows and risks) is that postponing income until late in the day would tend to distort decisions by promoting inappropriate stimulation. The explanation makes clear that there is no suggestion that a default-method taxpayer should not use the realisation method to calculate gains and losses on, for example, a common financial arrangement where gains and or losses are not reasonably expected. But the language of subsection 230-55(4), and the structure of the Division, whereby there is substantive legislative machinery put in place to identify the arrangement, precludes the notion that any result produced by Division 230 on any aggregation or disaggregation of rights and obligations is necessarily such as to produce a tax treatment that would not distort commercial decision-making.