



# ***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?***

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This document has been finalised by [TD 2010/11](#).

 There is a Compendium for this document: [TD 2010/11EC](#) .



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## Draft Taxation Determination

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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?

**① This publication provides you with the following level of protection:**

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation provision applies, or would apply to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the following way. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

### Ruling

1. Yes. If the employee does not derive salary or wages or bonus income at:
  - the time of the agreement to defer the salary or wages or bonus income; or
  - the time of receiving the loan; or
  - the time of acquiring the assets,

then consideration would be given to the application of Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936)<sup>1</sup>. The application of Part IVA to any particular scheme depends on a careful weighing of all the relevant circumstances of the scheme and the relative weight that should be attached to each of those circumstances. Therefore, in the absence of all relevant information, it is not possible to state definitively whether Part IVA will apply to a particular scheme. However, it is the Commissioner's view that Part IVA is likely to apply to salary deferral arrangements as described at paragraph 4 of this draft Determination.

2. If the employee derives the salary or wages or bonus income at the time of the agreement to defer it or at the time of receiving the loan or at the time of acquiring the assets, to that extent the salary deferral arrangements would not give rise to a tax benefit within the meaning of section 177C, and Part IVA would not apply.

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<sup>1</sup> All subsequent legislative references are to the ITAA 1936 unless otherwise indicated.

3. Taxpayer Alert TA 2008/14 issued on 25 June 2008. It describes a remuneration arrangement (the arrangement) entered into by an employee and an employer whereby the parties agree that the employee will defer receipt of an amount of salary or wages or bonus income and be provided with a loan of an equivalent or greater amount in lieu. The deferred income will be paid to the employee in a later income year and the payment is applied or credited against the outstanding loan balance.

4. The arrangement exhibits the following features:

- the employee and employer agree to defer the payment of salary or wages or bonus income. For example, where an entitlement to a bonus arises on a 'determination date', the arrangement enables the employee to choose to defer receipt of the bonus at any time prior to the determination date. The deferred component of the salary or wages or bonus income is determined by the employee on a voluntary basis with no minimum or maximum level of deferral;
- the employer provides a loan to the employee, ordinarily of an amount equal in value to the income deferred. The loan may or may not be on arm's length terms and may possess features that are uncommercial in nature. For example, the loan may be provided interest-free to the employee and have limited recourse features. In addition, the employee may not be required to make repayments on the loan until the deferred income is credited to the employee;
- the employee uses the loan to acquire an income producing asset. Ordinarily, the arrangement prescribes the types of assets that may be acquired. For the purposes of this draft Determination it is assumed that the consideration paid by the employee for the acquisition of any such asset is the asset's market value;
- the asset may be offered as security for the loan and may be held within a trust structure;
- after a fixed period, or after certain conditions are met, the right to payment of the deferred income will crystallise. Generally, the deferred income (less a PAYG withholding component) is applied against the outstanding value of the loan. Where the deferred income (less the PAYG withholding component) is not sufficient to discharge the balance of the loan, the employee will be required to make a payment equal to the balance. The employee then takes full legal and beneficial ownership of the now-unencumbered asset;
- conditions that trigger the payment of the deferred income may include the expiry of the stipulated fixed period, full repayment of the loan balance, employment ceasing, default on the loan agreement, or a request by the employer;
- if the loan is limited recourse in nature and the value of the asset acquired drops below the loan amount, the employee can exercise the limited recourse feature and surrender the asset in full satisfaction of the loan amount. The employee would therefore receive his or her deferred salary or wages or bonus amount in full, less the PAYG withholding component; and
- payment of the deferred income may occur after the employee has terminated employment with the employer.

5. For the purposes of this draft Determination, it is assumed that the employee does not derive the income until it is received by them or applied against their outstanding loan balance. Whether an employee has effectively deferred income for the purposes of subsection 6-5(4) of the *Income Tax Assessment Act 1997* (ITAA 1997) will be decided on a case by case basis with careful examination of the relevant facts. In certain circumstances, there is a question as to whether the employee is taken to have derived the salary or wages or bonus income at the time of the agreement to defer it, or upon receiving the loan, or acquiring assets with the loan proceeds.

6. **This Determination does not apply to circumstances where the loan is a deemed dividend for the purposes of Division 7A of Part III.**

#### **Date of effect**

7. Subject to paragraph 8 of this draft Determination, when the final Determination is issued it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10).

8. Class Ruling CR 2007/48 was withdrawn on 19 November 2008. CR 2007/48 will continue to bind the Commissioner in relation to the class of entities who entered into the particular scheme as described in that ruling prior to the date of its withdrawal. Although CR 2007/48 does not bind the Commissioner with regard to the application of Part IVA, the Commissioner will not seek to apply Part IVA to the class of entities where they entered into the scheme prior to the withdrawal of the ruling.

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**Commissioner of Taxation**

26 August 2009

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## Appendix 1 – Explanation

**ⓘ** *This Appendix is provided as information to help you understand how the Commissioner’s preliminary view has been reached. It does not form part of the proposed binding public ruling.*

### Explanation

9. Part IVA gives the Commissioner the discretion to cancel all or part of a tax benefit that has been obtained, or would, but for section 177F, be obtained, by a taxpayer in connection with a scheme to which Part IVA applies. Part IVA applies if:

- a tax benefit, as identified in section 177C, was or would, but for subsection 177F(1), have been obtained;
- the tax benefit was or would have been obtained in connection with a scheme as defined in section 177A; and
- having regard to section 177D, the scheme is one to which Part IVA applies.

10. The scheme under section 177A would consist of the steps taken to establish and conduct the salary deferral scheme. If it is assumed that the income is not derived until it is received by the employee or applied against the employee’s outstanding loan balance, it is considered that the scheme would give rise to a tax benefit under paragraph 177C(1)(a). The objective circumstances of the scheme indicate that if the scheme had not been entered into it might reasonably be expected that the amount of deferred income would have been received by the employee during the income year in which it was agreed to be deferred and those monies used by the employee to acquire the relevant income producing assets. The tax benefit therefore is the amount of deferred salary or wages or bonus income that was not included in the assessable income of the employee in the year of deferment.

11. Section 177D provides that Part IVA applies to a scheme in connection with which the taxpayer has obtained a tax benefit if, after having regard to eight specified matters, it would be concluded that a person who entered into or carried out the scheme, or any part of it, did so for the purpose of enabling the taxpayer to obtain the tax benefit.

12. Whether the section 177D purpose test is satisfied depends on all the facts and circumstances. However, it would be reasonable to conclude, having regard to the matters set out in section 177D, that the sole or dominant purpose of the employee (and/or the promoter and/or the employer) in entering into or carrying out the scheme was for the employee to obtain a tax benefit. In this context the following general observations can be made:

- the manner in which the scheme was entered into or carried out, including the steps taken to defer income and obtain a loan in lieu, includes a number of contrived elements. The employee is able to defer derivation of income whilst obtaining the economic benefit of the deferred income by way of a loan. Rather than receiving the after-tax deferred income in cash, an employee receives a loan and acquires investments with a value equal to the pre-tax amount of deferred income. The employee is therefore able to utilise the funds representing the tax that would otherwise have been paid to acquire an asset (subparagraph 177D(b)(i));

- the form of the scheme includes an agreement by which an employee agrees to defer part of their income to be received at some later time and obtains a loan for a similar amount from the employer. The substance of the scheme is that the employee obtains access to their deferred salary by way of a loan and utilises the loan to acquire an income-producing asset, without having to pay tax on the amount received until some time in the future. This divergence of the form and substance of the scheme exists whether the loan is made on commercial terms or otherwise (subparagraph 177D(b)(ii));
- but for the operation of Part IVA, the deferred income would be derived at the deferral time. The result would therefore be that the employee is able to defer taxation on income whilst obtaining the full economic benefit of the income by way of a loan (subparagraph 177D(b)(iv));
- apart from the tax benefit, the arrangement makes no commercial sense. All of the commercial advantages that an employee obtains from entering into the scheme are attributable to the tax saved through the tax benefit (subparagraph 177D(b)(vii)).

13. The Commissioner is therefore likely in these circumstances to exercise his powers under subsection 177F(1) of the ITAA 1936 to cancel the tax benefit and determine that the whole or part of the deferred amount was derived by the employee under section 6-5 of the ITAA 1997 as salary or wages or bonus income during the income year in which it was deferred.

## Appendix 2 – Your comments

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14. You are invited to comment on this draft Determination. Please forward your comments to the contact officer by the due date.

15. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Tax Office website at [www.ato.gov.au](http://www.ato.gov.au)

Please advise if you do not want your comments included in the edited version of the compendium.

**Due date:** 9 October 2009  
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Moonee Ponds VIC 3039

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## References

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 2006/10; CR 2007/48

*Subject references:*

- anti avoidance
- arrangement
- employee bonuses
- fringe benefits tax
- Part IVA
- salary & wages income
- salary deferral
- salary sacrifice

*Legislative references:*

- ITAA 1936 Pt III Div 7A
- ITAA 1936 Pt IVA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177C(1)(a)
- ITAA 1936 177D
- ITAA 1936 177D(b)(i)
- ITAA 1936 177D(b)(ii)
- ITAA 1936 177D(b)(iv)
- ITAA 1936 177D(b)(vii)
- ITAA 1936 177F
- ITAA 1936 177F(1)
- ITAA 1997 6-5
- ITAA 1997 6-5(4)

*Other references:*

- Taxpayer Alert TA 2008/14
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ATO references

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Income Tax ~~ Assessable income ~~ employee benefits  
Income Tax ~~ Tax integrity measures ~~ schemes