

6 June 2014



**Institute of  
Chartered Accountants  
Australia**

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By email: [MiscTaxAmends@treasury.gov.au](mailto:MiscTaxAmends@treasury.gov.au)

Dear Jesse

**Tax and Superannuation Laws Amendment (2014 Measures No. 3) Bill 2014:  
Winter miscellaneous amendments**

The Institute of Chartered Accountants Australia (the **Institute**) welcomes the opportunity to comment on the abovementioned Exposure Draft legislation (**ED**) and accompanying Explanatory Material (**EM**)

Our comments, which are set out below, are limited to the proposed amendments to clarify the continuity of ownership test (**COT**) following the death of a beneficial owner of shares.

**About the Institute**

The Institute represents accounting and business professionals in Australia and around the globe. Members strive to uphold financial integrity through a commitment to ethics and acting in the public interest.

We focus on educating candidates through the Chartered Accountants Program and engage in advocacy and thought leadership underpinned by our members' knowledge and experience. We influence a range of policy areas impacting the Australian economy and domestic and international capital markets.

A watershed member vote in 2013 set the course for the Institute to amalgamate with the New Zealand Institute of Chartered Accountants, subject to obtaining formal government approvals and effecting amendments to constituent documents. The proposed new institute – Chartered Accountants Australia and New Zealand – is expected to have more than 90,000 members in total with over 17,000 candidates, giving us greater scale and influence on the world stage.

**Item 132 - Proposed amendments to clarify the operation of the COT following the death of a beneficial owner**

We are pleased that the ED includes amendments to clarify the operation of the COT. The issue which the proposed amendment seeks to clarify was first raised at the November 2010 meeting of the now defunct NTLG Losses & CGT Subcommittee – see attached agenda item and ATO response. This prompted the submission of this matter as a TIES issue.

In relation to the proposed amendments we have two observations:

1. It is not clear whether the reference to "the trustee of the deceased's estate" in proposed subsection 165-205(1) includes the trustee of a testamentary trust that is established under the will of the deceased. Given the increasing number of testamentary trusts being established it would be unfortunate if they 'fell through the cracks' in terms of COT testing.

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We note that the ATO has a long-standing administrative practice of treating the trustee of a testamentary trust in the same way that a legal personal representative is treated for the purposes of the capital gains provisions dealing with deceased persons in Division 128 of the Income Tax Assessment Act 1997. Accordingly, any capital gain or capital loss that arises when an asset owned by a deceased person passes to the ultimate beneficiary of a testamentary trust created under the deceased's will is disregarded for taxation purposes – refer Practice Statement PS LA 2003/12<sup>1</sup>.

We recommend that, in order of preference:

- proposed subsection 165-205(1) be amended so that it applies if and while shares are owned by the trustee of the deceased estate or the trustee of a testamentary trust established under the will of the deceased, or
  - the EM confirm that a trustee of a testamentary trust be treated in the same way as the trustee of the deceased's estate (in a similar fashion to that adopted by the ATO in PS LA 2003/12).
2. We do not consider that paragraph 1.39 of the EM correctly reflects the current position and suggest that paragraphs 1.39 and 1.40 be reworded along the following lines:

*"1.39 This concessional treatment for deceased estates ~~only applies in respect of ownership, not voting power and control.~~ operates appropriately where the primary test applies as the focus is on beneficial ownership of the shares in a loss company. ~~Therefore, However, it is not clear that the concession does not~~ currently operates effectively for the purpose of applying the ~~alternate~~ alternative continuity of ownership test.*

*1.40 The amendments ensure that the concessional treatment applies appropriately, for the purposes of applying both the primary test and the alternative test, ~~the deceased individual is considered to retain all voting power, dividend entitlements and capital distributions so long as the shares are owned by either the trustee of the deceased person's estate or by a beneficiary of the estate.~~"*

The suggested wording explains the issue with the current concessional treatment more accurately and also that the amendment is for clarification purposes only (rather than because the current provision does not work in relation to the alternative test).

We have not attempted to incorporate into paragraphs 1.39 and 1.40 reference to the trustee of a testamentary trust established under the will of the deceased.

If you would like to discuss our comments please call Susan Cantamessa on 02 99290 5625.

Yours sincerely



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**Institute of Chartered Accountants Australia**

<sup>1</sup> <http://law.ato.gov.au/atolaw/view.htm?docid=PSR/PS200312/NAT/ATO/00001>

## Extract from NTLG Losses & CGT Subcommittee meeting minutes – November 2010

### 7. Continuity of ownership and death

Section 165-205 of the ITAA 1997 states that:

For the purposes of a test, after a person dies, shares that the person owned beneficially at the time of death are taken to continue to be owned beneficially by the person so long as:

- they are owned by the trustee of the person's estate; or
- they are owned beneficially by someone who received them as a beneficiary of the estate.

Assume an individual, Mr A, directly holds 100% of the shares in Lossco, a company with tax losses. If Mr A dies, the effect of section 165-205 is that Mr A would be treated as continuing to beneficially own the shares in Lossco for the purposes of applying the continuity of ownership test provided those shares are owned by a trustee of Mr A's estate or a beneficiary of that estate. Section 165-205 appears to apply appropriately where the primary test applies. The primary test is contained in subsections 165-150(1), 165-155(1) and 165-160(1). For example, the primary test for voting power in subsection 165-150(1) reads:

Applying the primary test: if there are persons who, at a particular time, beneficially own (between them) shares that carry (between them) the right to exercise more than 50% of the voting power in the company, those persons have more than 50% of the voting power in the company at that time.

Hence, the focus of the primary test is on beneficial ownership of the shares in a loss company, and this ties in neatly with the wording of section 165-205 which treats the deceased as continuing to have beneficial ownership of the shares.

The difficulty arises where the alternative test applies. Consider a slight modification to the example above whereby Mr A instead owns 100% of the shares in Bco which in turn owns 100% of the shares in Lossco. The alternative test - contained in subsections 165-150(2), 165-155(2) and 165-160(2) does not focus on beneficial ownership. For example, subsection 165-150(2), which contains the alternative test for voting power states:

Applying the alternative test: if it is the case, or it is reasonable to assume, that there are persons (none of them companies or trustees) who (between them) at a particular time control, or are able to control (whether directly, or indirectly through one or more interposed entities) the voting power in the company, those persons have more than 50% of the voting power in the company at that time.

Accordingly, the focus of the alternative test is not on beneficial ownership of Lossco but on control of voting power in Lossco or on who has the right to receive for their own benefit dividends and distributions of capital of Lossco. One view might be that the section 165-205 would deem Mr A to continue as the beneficial owner of the shares in Bco, which effectively would represent continuity in the right to control the voting power of Lossco or the right to receive for dividends or capital distributions from Lossco.

It would clearly be an anomalous outcome if section 165-205 could only operate to prevent a failure of the continuity of the ownership test where Mr A directly holds the shares in Lossco. Could the ATO please advise its views on the operation of section 165-205 in the context of the alternative test and whether a purposive approach could be adopted to allow its application if the ATO sees any difficulties with a literal reading?

**Response**

The ATO agrees that section 165-205 can apply in the application of the alternative tests as contained in sections 165-150(2), 165-155(2) and 165-160(2) of the loss recoupment tests. The member who raised the issue agreed to raise the matter as a TIES issue.

**Update**

This was submitted as a TIES issue on 21 December 2010 and has been given TIES issue number 0031-2010.