Hi

We raised a minor consequential tax law change required in the Indirect Value Shifting provisions on 1 September 2020. Please refer to the e-mail below for more details. The e-mail was initially addressed to department@treasury.gov.au. Later we also used the Board of Taxation Sounding Board to log the issue, as we were not able to establish whether the issue raised was progressing through the Treasury escalation process.

We became aware of miscamendments@treasury.gov.au email address only when we reviewed *Treasury Laws Amendment (Measures for a later sitting) Bill 2020: Minor and Technical Amendments.*

In response, we submit that the following minor amendment to Indirect Value Shifting recovery provisions in Division 727 of ITAA 1997 be included in *Treasury Laws Amendment (Measures for a later sitting) Bill 2020: Minor and Technical Amendments.* The recovery provision in section 727-250 is designed to prevent the operation of the indirect value shifting rules when the gaining entity receives assessable income or a dividend. The issue identified relates to the change of dividends being ***exempt income*** to ***non-assessable non-exempt income*** in 2004 without a consequential amendment in section 727-250(2).

> 727-250(2) This subsection covers an amount that the assessable income or ~~exempt~~ (should read "non-assessable non-exempt") income of the gaining entity for any income year includes because of the distribution or right.

The technical background is outlined below and a more detailed explanation can be provided upon request. Please do not hesitate to contact me on 0421 611 955.

Kind regards
Rolf Drohn

Rolf Drohn | Director Tax Policy Centre

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From: Rolf Drohn
Sent: Tuesday, September 1, 2020 12:01 PM
To: department@treasury.gov.au
Cc: Tony Merlo <Tony.Merlo@au.ey.com>; Alfonso J Capito <alf.capito@au.ey.com>
Subject: Minor tax law change: Indirect Value Shifting provisions - Consequential amendment required

To whom it may concern

The EY Tax Policy Team would like to raise a minor drafting error in the general value shifting regime (GVSR) via this central escalation process within Treasury.

Would you please pass the required tax law consequential amendment identified below on to the appropriate department.

Indirect Value Shifting Provisions - Consequential Amendment Required

The recovery provision in section 727-250 (all references are to ITAA97 unless stated otherwise) is designed to prevent the operation of the indirect value shifting rules when the gaining entity receives assessable income or a dividend.

The issue identified relates to the change of dividends being ***exempt income*** to ***non-assessable non-exempt income*** in 2004 without a consequential amendment in section 727-250(2).

In summary, the law as currently drafted has an unintended consequence pursuant to section 23AJ ITAA36 /section 768-5 dividends changing from exempt income to non-assessable non-exempt *(NANE) income in 2004 without a consequential amendment in section 727-250. To read section 727-250(2) as currently drafted as not also including dividends which are non-assessable, and non-exempt income for Australian income tax purposes would give rise to an unintended, and egregious, outcome whereby any section 768-5 dividend paid by a foreign resident entity to either its Australian parent, or foreign parent, would trigger an indirect value shift in relation to the shares in the entity paying the dividend.

The issue also occurs where Australia pays dividend to a foreign parent and the dividend is NANE in the hands of the foreign parent due to application of section 128D ITAA36 or section 802-15 and therefore dividend doesn't fall within 727-250(2) ITAA97 and seemingly triggers an indirect value shift.

The change required in section 727-250:

727-250(1) An * indirect value shift does not have consequences under this Division if:

…….

Conditions

727-250(2) This subsection covers an amount that the assessable income or ~~exempt~~ (should read "non-assessable non-exempt") income of the gaining entity for any income year includes because of the distribution or right.

(Section 6-23: An amount of * ordinary income or * statutory income is non-assessable non-exempt income if a provision of this Act or of another * Commonwealth law states that it is not assessable income and is not * exempt income.)

To discuss this matter please contact either Tony Merlo (+61 3 8575 6412), Alf Capito (+61 2 8295 6473) or me (+61 3 8650 7618).

Kind regards

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