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client alert | explanatory memorandum

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Tax Laws Amendment (2008 Measure No 6) Bill

On 3 December 2008, the Federal Government introduced Tax Laws Amendment (2008 Measures No. 6) Bill 2008 into the House of Representatives. The Bill seeks to amend the:

- CGT provisions relating to roll-overs for corporate restructures in Subdivision 124–M of ITAA 1997;
- collection provisions in Division 263 of Schedule 1 to the *Taxation Administration Act 1953* (the TAA);
- late payment offset for superannuation guarantee contributions in section 23A of the *Superannuation Guarantee (Administration) Act 1992* (the SGAA); and
- taxation laws, which include the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act) and the *Fringe Benefits Tax Assessment Act 1986* (the FBTAA) for technical corrections and other minor amendments.

A brief discussion of the amendments follows.

Rollovers for corporate restructures

The Bill will modify the CGT provisions to prevent a market value cost base from arising when shares and certain other interests in an entity are acquired by another entity following a scrip-for-scrip CGT rollover (Subdivision 124–M of ITAA 1997) under an arrangement that is taken to be a 'restructure'.

Meaning of 'restructure'

An arrangement will be taken to be a restructure if, just after the arrangement was completed (the completion time), the market value of the replacement interests issued by the acquiring entity under the arrangement in exchange for qualifying interests in the original entity is more than 80% of the market value of all the shares (including options, rights and similar interests to acquire shares) issued by the replacement entity.

Other matters to note about the operation of this rule include the following:

- if a replacement entity is listed on an approved stock exchange at the completion time, then the market value of the replacement interests is taken to be the officially quoted price of the interests at that time;
- if qualifying interests in more than one original entity are acquired, then the qualifying interests of each of the original entities are taken to be acquired under separate arrangements, and these are taken to have happened in the order that the original entities were acquired; and
- an arrangement will be taken to be a restructure only if the replacement entity knows, or could reasonably be expected to know, that a scrip-for-scrip CGT rollover has been, or will be, obtained in relation to the arrangement.

Note that a replacement entity can make a choice to prevent taxpayers from being able to choose to obtain a scrip-for-scrip CGT rollover in relation to an arrangement. In this case, the replacement entity or the original entity must notify affected taxpayers of the choice before the exchange of shares.

Cost base of interests in original entity

If an arrangement that qualifies for scrip-for-scrip rollover is taken to be a restructure, then the cost base for the qualifying interests that the acquiring entity acquires in the original entity will reflect the cost bases of the underlying net assets of the original entity (rather than the market value of the original entity), in terms of the complex formula in the proposed subsection 124-784B(2) of ITAA 1997. Note that if the original entity becomes a member of a consolidated group or multiple-entry consolidated group (MEC group) under the arrangement, then the head company of the group can elect to retain the tax costs of the original entity's assets.

Furthermore, for a downstream acquisition where the acquiring subsidiary issues debt or equity to the ultimate holding company, the acquisition cost for the ultimate holding company for that debt or equity will be based on the cost base for the qualifying interests that the subsidiary acquires.

Application of Part IVA

The Explanatory Memorandum to the Bill explains that arrangements that are structured in an artificial or contrived way so as to avoid being treated as a restructure could, depending on the circumstances, attract the application of Part IVA of ITAA 1936. For example, some transactions involving the changing of the market value of the replacement interests or the interests on issue (or shifting value between them), or the issuing of interests before the completion time of the transaction, may contain features which could lead to the application of Part IVA.

Date of effect

These amendments will apply to arrangements entered into after 7.30pm, by legal time in the ACT, on 13 May 2008.

Tax debt collection provisions

The Bill will amend the collection provisions in Division 263 of Schedule 1 to the TAA dealing with mutual assistance in collection of foreign tax debts. The amendments will overcome legal and administrative problems associated with deeming debts ‘never to have been payable’ in the event that claims are removed from the foreign claims register (Register) or otherwise reduced.

Specifically, the amendments provide that:

- any foreign tax debts that are removed from the Register or otherwise reduced with the agreement of a foreign country are treated as a credit for the purposes of Part IIB of the TAA (as opposed to being deemed ‘never to have been payable’);
- where foreign tax debts are removed from the Register, a debtor's liability for any GIC referable to a foreign tax debt is also removed;
- where foreign tax debts are reduced and applied as a credit in accordance with Part IIB, a debtor remains liable for any GIC referable to the amount by which the debt has been reduced (as opposed to the GIC being deemed ‘never to have been payable’); and
- any principal amount of a foreign tax debt (and any GIC associated with that debt) that the Commissioner collects can be remitted to a foreign country in addition to any judgment interest and any costs funded by the foreign country that the Commissioner recovers in the course of legal proceedings (whereas previously the Commissioner could only remit the principal amount and any GIC associated with that amount that he collected).

The amendments also clarify that the role of the Register is to transform foreign tax debts into Australian tax debts, rather than acting as a day-to-day record of a debtor's liability.

Date of effect

These amendments will apply from the day after the Bill receives Royal Assent.

Late payment offset for superannuation guarantee

The Bill will amend the SGAA to vary the period within which employers can make a superannuation guarantee (SG) contribution to an employee’s superannuation fund after the due date for a quarter and still be able to use the late payment offset to reduce their superannuation guarantee charge (SGC) liability for the quarter. This amendment seeks to encourage employers to make a contribution on behalf of their employee (albeit late) closer to the original due date.

The SGAA will also be amended in relation to the calculation of the GIC on an unpaid amount of the SGC where an employer elects to use the offset. The offset takes effect from the original SG assessment date. The GIC accrues from the original SG assessment date on the remaining shortfall component of the unpaid SGC amount after the offset has been applied.

Claiming the offset

Specifically, the Bill will amend section 23A of the SGAA to provide that an employer will be eligible to use the offset to reduce their SGC liability, where:

- the employer has made a contribution for a quarter into an employee's fund after the due date for the quarter;
- the contribution in respect of the employee is made before the employer's original assessment for the SGC for the quarter (the original SG assessment date);
- the employer has given an election, in the approved form, to the Commissioner to use the offset in respect of the employee to reduce their SGC liability for the quarter; and
- the election is made within four years after the original SG assessment date for the quarter.

Original SG assessment

An employer's 'original assessment' date for a quarter is when either of the following first occurs:

- the Commissioner receives an SG statement from the employer for the quarter and the employer has not previously lodged an SG statement for that quarter which has been assessed by the Commissioner; or
- a default SG assessment is raised on the employer for the quarter.

Note that employers are required to assess their own liability to the SGC. If an employer is liable, a SG statement must be lodged and is to be accompanied by a payment for the amount outstanding. However, if the employer makes sufficient quarterly superannuation contributions for each employee by the due date for the relevant quarter, no statement is required.

The SGC statement is a prescribed form, which is available on the Tax Office's website at <www.ato.gov.au/content/downloads/nat9599.pdf.>. (Accessed 16 January 2009.)

If an employer does not lodge an SGC statement and the Commissioner considers that the employer has an SGC liability for a quarter, the Commissioner may make an assessment of the employer's SG shortfall for the quarter and the SGC payable on the shortfall. (Practice Statement PS LA 2007/10 outlines when a default assessment can be made and the factors the Commissioner will consider in making the default assessment.)

Examples from Explanatory Memorandum

Example 3.5 of Explanatory Memorandum

> Catherine is required to make a $1,000 contribution for the September 2009 quarter on behalf of Jay. Catherine fails to make the contribution by the due date of 28 October 2009, but makes a late contribution into Jay's superannuation fund on 1 December 2009.
>
> Catherine is assessed on 31 January 2010 with an SGC liability for the September 2009 quarter for Jay. Catherine is eligible to use the late contribution made to Jay's fund to offset against her unpaid SGC liability for Jay for the September 2009 quarter. If Catherine wishes to use the offset she must give her election in the approved form to the Commissioner by 31 January 2014.

Example 3.6 of Explanatory Memorandum

> Jeremy does not make super contributions for Phil, Peter and Michael for the quarter ended 30 September 2009. He pays a late contribution for all three on 15 December 2009. On 11 January 2010

Jeremy lodges an SG statement with the Commissioner including his liability for only Phil and Peter. In that statement, he also elects a late payment offset for Phil and Peter.

On 27 June 2010 Jeremy realises that he did not include details for Michael in the SG statement or elect the offset for him and lodges both an amended SG statement and an offset election for Michael. Jeremy will be entitled to claim the offset for Michael as it has been received within four years of the original SG assessment date (i.e. within four years of 11 January 2010).

Date of effect

These amendments commence from the date the Bill receives Royal Assent.

Current law

If an employer makes a contribution for an employee any time after the due date for a quarter, the contribution can be used to offset against the SGC for the quarter for the employee.

If an employer elects to use the offset, the GIC accrues on the full shortfall component of the unpaid SGC amount (before the offset is applied) from the SGC payable date to the date of the election. The GIC then accrues on the remaining shortfall component of the unpaid SGC amount (after the offset is applied) from the date of the election.

Late payment offset for SG contributions

An employer is liable for a non-deductable SGC which is imposed by the SGAA if the employer does not make sufficient quarterly superannuation contributions or misses the cut-off payment date for each employee by the due date.

Since 1 January 2006, an employer can elect to use late contributions to offset the portion of any shortfall for a quarter that relates to the relevant employee under section 23A of the SGAA. The late contribution must be made before the end of the 28th day of the second month after the end of the quarter. The election, which must be in the approved form, has to be made within four years of the superannuation guarantee charge becoming payable. The election is irrevocable.

Effective from 24 June 2008, employers who make a late superannuation contribution are able to elect (using an approved form) to use the late payment offset to reduce their SGC liability for a year rather than a quarter. This becomes payable after that date. However, the late contribution can only be offset against an SGC that relates to the same quarter and to the same employee. Importantly, late contributions used to offset a resulting SGC are not tax deductible to the employer in the same way that SGC payments are not deductible to the employer. Therefore, employers still have a strong incentive to continue making their SG quarterly payments on time.

To be eligible for the superannuation guarantee late payment offset:

- the contributions for an employee must have been made after the cut-off date for the quarter,
- the employer has an outstanding SGC for the employee for that quarter; and
- the employer elects that the contribution be offset.

Where an employer has been assessed on its SGC for a quarter, the employer can seek an amendment of the assessment to elect to use the offset. However, the amendment must be made within four years after the employer’s SGC for the quarter became payable.

The offset can only be used to reduce the nominal interest component, the superannuation guarantee shortfall and the choice liability. The administration component cannot be reduced. The offset will be applied in the following order:

- the nominal interest component; then
- the SG shortfall; then
- the choice liability.

Technical corrections and minor amendments

The Bill will make various minor amendments to the taxation laws dealing with matters such as incorrect terminology, grammatical or punctuation errors, missing asterisks from defined terms, inoperative material, ambiguities in the law and correction of examples. The amendments also include more significant technical amendments, as follows:

FBT and remote area property benefits — Subsections 5C(3) and (4) of the FBTAA

The FBT calculation of an employer's aggregate fringe benefits amount will be amended to restore the pre-GST concessional treatment of remote area property benefits. The amendments also clarify how remote area housing fringe benefits are allocated between Type 1 and Type 2 aggregate fringe benefits amounts, according to whether the amortised fringe benefit to which it relates is a GST creditable benefit.

The amendments apply from the FBT year commencing 1 April 2000.

FBT and worker entitlement funds — Subsection 58PB(4)(c)(i) of the FBTAA

This amendment will allow approved worker entitlement funds to make payments to the dependants of deceased workers. They will provide that, upon the death of an employee, the fund is able to make payments to the employee's dependants or the trustee of the employee's deceased estate, without losing its status as an approved worker entitlement fund.

Capital allowance rollover — conversion of fixed trust

This amendment extends capital allowance rollover relief for depreciating assets to the case where a fixed trust is converted to a company under Subdivision 124–N of ITAA 1997 (CGT rollover relief).

The amendment applies to balancing adjustment events in the 2008/09 income year and later years.

CGT and employee share trusts

The amendment will give trustees and beneficiaries of employee share trusts a choice to backdate the recently-amended subsection 130–90(3) of ITAA 1997 which prevents the double taxation of both trustees and beneficiaries when the employee becomes absolutely entitled to shares held in the trust after exercising rights under an employee share scheme.

Subsection 130–90(3) was amended by the *Tax Laws Amendment (Budget Measures) Act 2008*, which received Royal Assent on 30 June 2008. Currently, the subsection applies to CGT events happening on or after 7.30pm (AEST) on 13 May 2008.

The proposed amendment will allow an entity to backdate the application of subsection 130–90(3) to a CGT event that happened:

a. after the start of the entity's 1998/99 income year; and

b. before 7.30pm (AEST) on 13 May 2008.

Date of effect

The amendments apply from the date of Royal Assent unless otherwise stated.

Luxury Car Tax

Amending Bill

The Tax Laws Amendment (Luxury Car Tax — Minor Amendments) Bill 2008 received Royal Assent on 11 December 2008. The Bill was introduced into Parliament on 25 November 2008 and was passed without any amendments.

The Bill contained minor and technical amendments to the *A New Tax System (Luxury Car Tax) Act 1999* (the LCT Act) and related legislation.

The amendments ensure that vehicle-financing arrangements do not affect refunds under Division 18 of the LCT Act from being claimed by eligible primary producers and tourism operators (see 'Refunds for primary producers and tourism operators' page 6). The amendments also ensure that a refund will be paid directly to a claimant. The amendments, further, ensure that the transitional provision (see below) for contracts entered into before 7.30pm (AEST) on 13 May 2008 will apply, notwithstanding that a vehicle was the subject of a financing arrangement entered into after that date.

Transitional provision

The transitional provision ensures that the LCT payable will remain at 25%, regardless of when a luxury car is delivered, if a contract to purchase the car was entered into before 7.30pm on 13 May 2008 (legal time in the ACT) but delivered after 1 July 2008.

Date of effect

In the main the changes take effect from 1 July 2008. However, the amendment for finance arrangements entered into before 7.30pm (AEST) on 13 May 2008 commenced from 3 October 2008, which is the date that these provisions began.

Amending Regulations

The Government has also amended the A New Tax System (Luxury Car Tax) Regulations 2000 (LCT Regulations) to define the terms 'tourist activity' and 'refund-eligible car' for the purposes of Division 18 of the LCT Act.

The term 'refund-eligible car' is defined in the new regulation 27–1.01 of the LCT Regulations to mean a four-wheel drive or an all-wheel drive car that is describes as:

- a 'passenger car (MA)' in clause 4.3.1 of the Vehicle Standard (Australian Design Rule — Definitions and Vehicle Categories) 2005 and has a ground clearance of not less than 175mm; or
- an 'off road passenger vehicle (MC)' for the purposes of the Vehicle Standard (Australian Design Rule — Definitions and Vehicle Categories) 2005.

The term 'tourist activity' is defined in the new regulation 27–1.02 to mean an activity that is a leisure activity of a touring nature and does not involve the transporting of passengers by taxi, limousine for fares or hire car service. The term 'leisure activity' is further defined to include an activity involving a visit by a tourist to a site of scenic beauty, cultural interest, environmental interest, historical interest or recreational interest.

Date of effect

The amendments apply from 1 July 2008.

Refunds for primary producers and tourism operators

A partial refund of the luxury car tax (LCT) may be available for primary producers or tourism operators if they purchase a refund-eligible car. The term 'refund-eligible car' is defined in section 27–1 of the LCT Act as a four-wheel drive or an all-wheel drive car of a kind as specified in regulations made for the purposes of the LCT (i.e. regulation 27–1.01).

It is a requirement that a primary producer or a tourism operator is registered for GST before an entitlement to a refund arises. In addition, specific conditions must be satisfied. For a primary producer, it must be carrying on a primary production business at the time of the supply of the car. Whereas, for a tourism operator, the car must be used solely for the purpose of carrying on a business and the principal purpose of the business is carrying tourists for tourist activities (as defined by regulation 27–1.02).

The amount of refund for primary producers and tourist operators is limited to the lesser of either 8/33 of the LCT borne or $3,000. Effectively, this means that primary producers and tourism operators are subject to a LCT rate of 25%. A primary producer is only entitled to a maximum of one refund per income year. However, a tourism operator can claim a refund for each eligible car purchased in an income year. The producer or the operator must claim the refund using an approved form within four years of becoming entitled to it.

Process for claiming refund

Eligible primary producers and tourism operators can claim the refund by completing an 'Application for luxury car tax refund — for primary producers and tourism operators' form (NAT 72601), which is available on the Tax Office website at <www.ato.gov.au/content/downloads/gst00155886nat72601.pdf>. (Accessed 16 January 2009.)

The completed form can be mailed to the Tax Office at:

Australian Taxation Office

PO Box 1032

Albury NSW 2640

Alternatively, the form can be faxed to the Tax Office: 1300 130 900.

Investment Allowance

The Government has introduced a temporary 10% investment allowance to encourage businesses to undertake capital investment. The allowance is an additional tax deduction. That is, businesses can claim the allowance and a deduction for depreciation on capital assets.

Requirements for allowance

To qualify for the allowance, a business must satisfy the following conditions:

- the business must start to hold or construct a qualifying asset (see ‘Qualifying assets’ page 8) after 12.01am (AEDT) 13 December 2008 and before 1 July 2009;
- the asset must cost $10,000 or more;
- the asset must be used in Australia; and
- the asset must be installed and ready for use by 30 June 2010.

Note that only new qualifying assets and new expenditure on existing assets will qualify for the allowance. Assets that have previously been used or held for use do not qualify for the allowance.

Calculation of allowance

The allowance is 10% of a qualifying asset’s first element of cost, to the extent that the asset will be used for a taxable purpose.

If expenditure is capitalised into an existing asset as a second element of cost, the allowance will be 10% of that expenditure.

The example below, which is from the publication *Nation Building — Rail, Road, Education & Research and Business* released by the Government, sets out how the allowance is calculated:

On February 2009 a bakery enters into a contract to purchase a new oven at a total cost of $60,000 and with an effective life of 20 years. The oven is installed ready for use on 10 August 2009.

When the business lodges its 2009/10 income tax return, the taxpayer will be able to claim a deduction of $7,500 in respect of the oven:

- the first depreciation deduction of $2,500 ($50,000 / 20) using the straight line method; and
- the investment allowance of $5,000 ($50,000 x 0.1).

Qualifying assets

The allowance applies to tangible assets used in the carrying on of a business for which a deduction is available under the core provisions of Division 40 of ITAA 1997 (i.e. Subdivision 40–B). Specifically, these assets are prescribed in section 40–30 of ITAA 1997, except for intangibles and rights that would otherwise be included by subsections 40–30(2), (5) and (6).

Broadly, the following assets will **not** qualify for the allowance:

- land;

- trading stock; and
- intangible assets, including:
  - — mining, quarrying or prospecting rights;
  - — mining, quarrying or prospecting information;
  - — items of intellectual property;
  - — in-house software;
  - — indefeasible right to use a telecommunications cable system;
  - — spectrum licences;
  - — datacasting transmitter licences; and
  - — telecommunications site access rights.

Cars will not be disqualified from the allowance merely because a business uses the 12 % method.

The Treasurer's Media Release accompanying the Government's announcement of the allowance states that 'assets for which deductions can be obtained under other Subdivisions will not qualify for the investment allowance'. Therefore, an asset that qualifies for a deduction under Subdivisions 40–E, 40–F, 40–G and 40–H potentially will not attract the allowance.

Discrepancies

The publication *Nation Building — Rail, Road, Education & Research and Business* states that:

> The investment allowance will be available to businesses who acquire new tangible depreciating assets which **cost more than $10,000** … The investment allowance will be available for new assets which are acquired, held under a contract or constructed after today and **before 30 June 2009**.' [Emphasis added.]

However, the Treasurer's Media Release (12 December 2008, Media Release No. 141) states that:

> The allowance will be applicable to most new tangible depreciating assets — which includes most items of plant and equipment — **over $10,000** which are acquired or ordered by the end of the current financial year … The investment allowance will be available for businesses who start to hold or start to construct the asset after 12.01am AEDT 13 December 2008 and **before the end of June 2009**.' [Emphasis added.]

Adding to the confusion, Attachment A accompanying the Treasurer's Media Release states that:

> The investment allowance will apply from 12.01am AEDT 13 December 2008 until **the end of 30 June 2009** … A **minimum** expenditure threshold of **$10,000 will apply**. [Emphasis added.]

Further adding to the confusion, the Tax Office's release states that:

> It [the investment allowance] is confined to new assets and new expenditure on existing assets, used in Australia, which **cost $10,000 or more**. The investment allowance will be available for new assets which are acquired, held under a contract or constructed after 12.01am AEDT 13 December 2008 and **before 30 June 2009**. [Emphasis added.]

At the time of writing, the Government has not introduced any legislation giving effect to the investment allowance, which may assist in clarifying the minimum threshold and end day for acquiring qualifying assets. Therefore, it is assumed that the intentions of the Government are that:

- the assets must cost $10,000 or more; and
- the assets must be acquired before the end of June 2009 (i.e. before 1 July 2009).

Reduction in PAYG Instalment

The Government has announced a 20% reduction for the December 2008 quarter PAYG instalment payable by small business entities (see 'Definition of a small business entity' page 10). The reduction applies to taxpayers who calculate their PAYG instalment using the GDP-adjusted notional tax method.

The reduction applies to taxpayers that report and pay their PAYG instalment either on a monthly or quarterly basis. For monthly payers, the due date is 21 January 2009. For quarterly payers, the due date is 28 February 2009, which will be extended to 2 March 2009 as 28 February falls on a weekend.

The reduction **does not apply** to taxpayers who calculate their PAYG instalments based on the instalment rate notified by the Tax Office. This is because their instalment amounts are automatically adjusted when they apply the given rate to their actual income for the quarter.

Example

The Government says the average tax liability of a small company with an annual turnover of less than $2 million was around $20,000 for the 2007/08 income year. Based on this liability, and taking into account a GDP uplift factor of 8%, the average PAYG instalment amount for the 2008/09 income year is $21,600, which is $5,400 payable quarterly. With the 20% annual reduction in the PAYG instalment occurring on 28 February 2009, the Government says average small company with a turnover of under $2 million a year will pay $1,080 less.

Definition of a small business entity

A 'small business entity' is defined in Subdivision 328–C of ITAA 1997. The term is defined as an entity that carries on a business and:

- had an 'aggregated turnover' of less than $2 million in the previous income year; or
- is likely to have an 'aggregated turnover' in the current income year of less than $2m (an objective test).

The objective test is worked out at the start of the income year or, if an entity starts to carry on a business part-way through an income year, as at the day the entity started to carry on a business. However, the entity will not be a small business entity if its aggregated turnover for each of the two income years preceding the current year was $2 million or more (unless its actual aggregated turnover for the year is less than $2 million).

An entity's 'aggregated turnover' is the sum of the relevant 'annual turnovers', but it excludes certain amounts. The relevant annual turnovers are the entity's annual turnover, any connected entity's annual turnover and any affiliate's annual turnover.

Three classes of ordinary income are excluded from aggregated turnover to avoid double-counting:

- amounts derived from dealings between the taxpayer entity and any connected entity or affiliate;
- amounts derived by a connected entity or an affiliate from their dealings with each other while connected with, or an affiliate of, the taxpayer entity; and
- amounts derived by a connected entity or an affiliate while they are not connected with, or an affiliate of, the taxpayer entity.

An entity's annual turnover for an income year is the total ordinary income that the entity derives in the income year in the ordinary course of carrying on a business. However, the following amounts are excluded:

- any GST-related amounts that are non-assessable non-exempt income under section 17–5 of ITAA 1997; and
- any income derived from the sale of retail fuel.

An 'affiliate' is an individual or company that acts, or could reasonably be expected to act, in accordance with the directions or wishes of a taxpayer or in concert with the taxpayer in relation to the affairs of the business of the individual or company.

An entity is connected with another entity if:

- one of the entities 'controls' the other entity; or
- if the two entities are 'controlled' by the same third entity, in which case all three entities will be connected.

(See section 328–125 of ITAA 1997 for when control will exist.)

Managed Investment Schemes and Deductions

In a test case decision, the Full Federal Court has found that two taxpayers' investments in an almond managed investment scheme (MIS) constituted the carrying on of a business and the outgoings incurred on the schemes were allowable deductions. *Hance v. FCT* [2008] FCAFC 196 (Full Federal Court, Finn, Dowsett and Edmonds JJ, 19 December 2008).

Background

The taxpayers sought private rulings from the Commissioner concerning the tax treatment of income to be received, and outgoings to be incurred, in connection with the Scheme. In effect, the Commissioner ruled that the net proceeds of the sale of almonds (proceeds of sale less direct costs and expenses of marketing and selling) would be assessable income under section 6–5 of ITAA 1997, and that the various outgoings (other than interest) were not allowable deductions pursuant to section 8–1 of ITAA 1997. However, he did not consider the application of Part IVA of ITAA 1936 to the MIS.

The Commissioner claimed that, while the relevant outgoings will be incurred in gaining or producing assessable income, neither taxpayer would be carrying on a business. He also claimed that the taxpayers' interest in the MIS would be a right to share in the profits to be generated from the scheme, either contractually or as beneficiary of a trust.

Decision

The Court said that the continuation of the operation over an extended period of time, the repetitive nature of the work involved in farming each almond lot (to be paid for on a regular basis) and the return in the form of almond crops (to be received from year to year) 'all suggest an ongoing business'. It considered that the Commissioner focused too much upon what the taxpayers would not be doing and paid too little attention to what they would be doing. It said that such an approach failed to give sufficient weight to the judgment in *Sun Newspapers Ltd and Associated Newspaper Ltd v. FCT* (1938) 61 CLR 337 regarding the variety of forms which a business might take. It also said that such an approach placed an 'artificial limit upon the proposition … that a person who conducts a business may delegate functions to another'.

The Court was of the view that each taxpayer would be carrying on an individual business on their almond lots with the purpose of producing almonds for sale at a profit. It also noted that the Commissioner effectively conceded that, on the face of the documentation, the outgoings fall into categories which have traditionally been treated as on revenue account, being either rent or management fees (including responsible entity fees).

The Court found that there would be no relevant trust interest acquired by the taxpayers in exchange for payment of the relevant deductions. In doing so, it rejected the Commissioner's contention that the income to be derived by the taxpayers should be taxed as trust income.

The Court concluded that the relevant outgoings would be incurred as operating expenses in carrying on each taxpayer's business and that they are deductible pursuant to s 8–1 of the ITAA 1997.

Commissioner's response to judgment

In a Media Release, the Commissioner has indicated that the Tax Office does not expect to lodge a request for special leave to appeal against the decision of the Full Federal Court. He said that the decision accepts that investments in MIS arrangements which are broadly similar to the test case are deductible. He said the arrangements did not involve features like non-recourse or round-robin funding in mass-marketed schemes that were disallowed by the courts in cases such as *Howland-Rose & Ors v. FCT* (2002) 49 ATR 206 and *Vincent v. FCT* (2002) 51 ATR 18.

In light of the Court's decision, the Commissioner said the Tax Office will withdraw its current income tax ruling (TR 2007/8) and draft GST ruling (Draft GSTR 2008/D1) on managed investment schemes and will work with industry to finalise 2009 product rulings as soon as possible. 'We offered arrangements to stockpile these product ruling applications so that they could be finalised quickly after the decision is handed down. We will now work to finalise the five applications on hand,' the Commissioner said.

The Commissioner said a new income tax ruling will be published in 2009 and the Tax Office expects to release a decision impact statement shortly. He said the Tax Office does not expect to lodge a request for special leave to appeal the case.

One-off Sale of Land and GST

The Administrative Appeals Tribunal (AAT) has held that the acquisition of a vacant block of land by a taxpayer was a taxable supply within the meaning of section 9–5 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act). *AAT Case [2008] AATA 1167, Re Touram Pty Ltd ATF The GKA Family Trust and FCT* (AAT, Ref No: 2008/0365, McCabe SM, 23 December 2008).

Background

On 18 May 2006, the taxpayer entered into a contract to purchase the land for $226,737, which was GST inclusive. The settlement date was 30 June 2006. In its June 2006 BAS, the taxpayer claimed an input tax credit (ITC) of $20,612.

While the refund was paid to the taxpayer, the Commissioner subsequently formed the view that the acquisition did not satisfy the definition of a taxable supply as contained in section 9-5. He contended that the supply of the land was not made in the course or furtherance of an enterprise being carried on by the vendors. Therefore, he argued that the claim for the ITC must be disallowed.

The vendors, who carried on a primary production business through a partnership, acquired the land in October 1994 with the intention to hold it as an investment. The purchase was secured against a partnership asset. The land was initially zoned as 'Village Residential'. Subsequently, the vendors engaged a town planner to prepare an application to re-zone the land to 'Village Business', which included a commercial development plan.

The land was listed in the partnership accounts as a partnership asset, albeit that the vendors had regarded it as a 'personal asset'. In oral testimony to the Tribunal, the vendors stated that they never contemplated developing the land.

Decision

In reaching its decision, the Tribunal considered whether factors indicative of a business being carried on existed.

While the acquisition and sale of the land was distinguishable from the vendors' primary production business and a one-off, the Tribunal said that it did not mean the vendors were not also in the business of buying and selling of property. The Tribunal was satisfied that the vendors dealt with the land in a business-like way. It said that the commissioning of a town planner to prepare plans for a commercial development and to seek a re-zone was indicative of how a business person would behave.

The Tribunal rejected that the land was a 'personal asset' of the vendors because the record-keeping for the land was done with system and regularity, which was expected from a business. It was satisfied that the land was acquired by the vendors with a profit-making motive.

In conclusion, the Tribunal held that the vendors were conducting a property investment enterprise. Therefore, the taxpayer was entitled to the ITC on the acquisition of the land.

Enterprise and GST

The term 'enterprise' is exhaustively defined by section 9–20 of the GST Act where it states that an enterprise is an activity or series of activities, done:

- in the form of a business;
- in the form of an adventure or concern in the nature of trade; or
- on a regular or continuous basis, in the form of a lease, licence or other grant of an interest in property.

Miscellaneous Taxation Ruling MT 2006/1

In the Ruling, the Commissioner states that whether or not an activity or series of activities amounts to an enterprise is a question of fact and degree having regard to all of the circumstances of a case. It is important to note that each activity of an entity could amount to an enterprise, albeit the activity may not directly relate to the 'core' activity of the entity.

The question of whether the entity is carrying on an enterprise often arises where there are ‘one-offs’ or isolated real-property transactions. The Commissioner states that the salient issue to be decided in such transactions is whether the activity is an enterprise in that it is of a revenue nature as it is considered to be an activity of carrying on a business or an adventure or concern in the nature of trade (a profit-making undertaking or scheme) as opposed to the mere realisation of a capital asset.

The Commissioner considers that in an isolated property transaction, where land is sold that was purchased with the intention of resale at a profit, an enterprise exists. This is because the activity is an activity in the conduct of a profit making undertaking or scheme and therefore an adventure or concern in the nature of trade as contained in subsection 9-20(1)(b) of the GST Act.

Note that it is the Commissioner’s view that an adventure or concern in the nature of trade (i.e. subsection 9–20(1)(b)) includes a commercial activity that does not amount to a business but which has the characteristics of a business deal. That is, such transactions are of a revenue nature.

FBT and Exempt Benefits

ATO ID 2008/158 states that any cost of upgrades involving built-in internal components made at the time of purchase of a portable electronic device will form part of the cost base of the device.

Facts surrounding the ID

At the time of purchasing a laptop, an employee requested additional memory to be included in it. The laptop and the additional memory were itemised on one invoice.

The employer agreed to reimburse the employee for the cost of the laptop and the additional memory, that is, the total invoiced amount.

The laptop was a portable electronic device for the purposes of subsection 58X(2)(a). The employer’s reimbursement was an expense payment benefit for the purposes of subsection 20(b) of the FBTAA.

Exempt benefits — work-related items

An exemption from FBT for the provision of certain work related items is available under section 58X of the FBTAA 1986. In particular, subsection 58X(2)(a) states that a portable electronic device is an eligible work related item if it is primarily use in an employee’s employment.

The Tax Office’s view of whether a device qualifies as a ‘portable electronic device’ is contained in ATO ID 2008/133: see November 2008 Client Alert. In ATO ID 2008/127, the Tax Office confirms that a laptop qualifies as a portable electronic device for the purpose of subsection 58X(2)(a): see the November 2008 edition of this publication.

Subsection 58X(2)(a) does not state whether upgrades to a portable electronic device made at the time of purchase will form part of the cost base of the device. In ATO ID 2008/158, the Tax Office states that if the upgrades are clearly not peripheral items in relation to the device and form part of the device, they will form part of the cost base. This is because there is no difference, in effect, ‘from simply purchasing a laptop computer model with better specifications at an increased cost’.

In ATO ID 2008/158, the Tax Office also states that the exemption in subsection 58X(2)(a) will not extend to peripheral items which are purchased at an additional cost. These items include:

- cables;
- modems;
- cradles; and
- extended warranty.

Note that while upgrades can form part of the cost base of a device, consideration must also be given to the other requirements stipulated in section 58X before arriving at a conclusion whether a portable electronic device is exempt from FBT.

Deductibility of Compound Interest

The Tax Office has released Taxation Determination TD 2008/27 in which the Commissioner states that the principles governing the deductibility of compound interest are the same as those governing the deductibility of ordinary interest (see ‘Deductibility of interest’ page 15). The Commissioner says that he accepts that this is the law following the Full Federal Court’s decision in *Hart v. FCT* (2002) 50 ATR 369. However, the Determination does not address the question of the application of Part IVA of ITAA 1936 to arrangements involving compound interest.

The Tax Office noted that the *Hart* case proceeded to the High Court (*FCT v. Hart* (2004) 55 ATR 712) but the Court did not have to deal with the question of the deductibility of the compound interest in that case because it found that Part IVA applied to the arrangement in question. In the Commissioner’s view, the decision of the High Court does not detract from the Full Federal Court’s decision on the question of deductibility of compound interest.

(Compound interest is interest that accrues on interest that is unpaid.)

Use of borrowed funds

The Determination says it has been suggested that the deductibility of compound interest is always determined by the use to which the funds originally borrowed were put and so differs from the deductibility of other interest. This, it is suggested, flows from the following statement of Hill J in the *Hart* case at 50 ATR 378:

> 30. There is no reason in principle why there should be any difference between ordinary interest and compound interest. Both are simply the cost of the funds which are borrowed. It is artificial to treat compound interest as the cost of some new fund divorced from the original borrowing. The compounding of interest is no more than a formula for computing the interest to be paid on the funds originally borrowed. Accordingly, as the learned primary Judge held, the compound interest, like the ordinary interest, will take its character from the use to which the original funds borrowed are put…

The Commissioner considers this is not the correct reading of Hill J’s statement. Rather, the Commissioner says the statement needs to be read in light of what His Honour said earlier in his reasons for judgment at 50 ATR 376:

> 25. Two tests have been proposed to determine the deductibility of interest on monies borrowed to acquire income producing assets. The first looks to the purpose of the borrowing; the second, looks to the use to which the borrowed funds are put. Generally, where interest is borrowed to finance the acquisition of an income producing asset it will make no difference which formulation is used. The result will be the same. The interest will be deductible. This is because the purpose of the borrowing will usually be readily seen from examining the use to which the borrowed funds are put. It is unnecessary, therefore, in the normal case to distinguish between the two tests.

When the judgment is read as a whole, the Tax Office considers it is clear that Hill J did not intend by his statement at paragraph 30 to reject the principles he had just set out at paragraph 25 (whether generally or in the case of compound interest particularly). The Commissioner’s view is that Hill J was merely indicating that, on the particular facts of *Hart*, the use to which the funds borrowed were put gave the answer. That is, this was a ‘normal case’ in which it was unnecessary to distinguish between the two tests.

Citing the judgment of Edmonds J in *Spassked Pty Ltd v. FCT* (2007) 67 ATR 900, the Commissioner noted his Honour’s view (at paragraph [71]) that the issue of deductibility of interest on a loan ‘is essentially a question of fact in respect of the year or years of income for which it is to be determined. Moreover, it is clear that the relevant factual considerations can change over the term of the loan so that the facts relevant to the criteria for deductibility in one year will not necessarily mirror those in another year. This is perhaps best brought out by Hill J in *Kidston Goldmines Ltd v. FCT* (1991) 22 ATR 168.’

The Commissioner’s view is that nothing in *Hart* provides authority for the proposition that the principles in these cases are incorrect or that they apply any differently in the case of compound interest.

Date of effect

The Determination applies to all income years beginning both before and after its date of issue (3 December 2008).

Interest on Loan to Settle Trust

The Tax Office has released Draft Taxation Determination TD 2008/D16 in which it states the Commissioner's preliminary view on whether interest incurs on a loan when the borrowed moneys are settled by a borrower on trust to benefit the borrower and others fully-deductible under section 8–1 of ITAA 1997.

The Draft says that interest on a loan used to settle moneys on a trust to benefit the borrower and others cannot be deductible in full under section 8–1. It is the Commissioner's view that the interest can only be deductible to the extent to which a taxpayer has used the borrowings to gain or produce assessable income of the taxpayer. Accordingly, the interest incurred will not be deductible to the extent the borrowed moneys were used to benefit persons other than the taxpayer, the Draft says.

The Draft states that whether borrowed moneys have been used to benefit others will usually follow objectively from the terms upon which a taxpayer has settled the borrowed moneys on trust for the benefit of the taxpayer and others. It also states that the terms of the trust will provide an objective basis for characterising whether the taxpayer has used the borrowings to acquire an interest in the trust that is conducive to the generating of assessable income. It further states that the terms of the trust will assist in ascertaining whether the taxpayer borrowed the moneys for the purpose of gaining or producing assessable income.

Example from the Draft

> Paul arranges for his accountant to set up a trust for himself and his family. Paul and his wife control the corporate trustee. He borrows $1 million from a bank, in his own name, and settles it on the trust. The trustee issues 500,000 units to Paul and 500,000 units to his wife. The trustee uses the $1 million to purchase a rental property.
>
> The trust deed provides that unit holders are entitled to a proportionate share of the income of the trust based on their unit holdings. The units acquired by Paul and his wife are redeemable at the discretion of the trustee. The units are redeemable for an amount equal to each unit holder's proportionate share of the trust fund calculated by reference to the net asset value of the fund as at the date of redemption.
>
> Only 50% of Paul's interest expense is deductible because the borrowing was used to fund trust entitlements with distinct and severable parts. That is, the terms of the trust indicate that Paul has used the borrowed money in part to benefit his wife and in part to acquire an interest in the trust that is of a kind that is likely to be productive of assessable income.

Follow-up to Taxpayer Alerts

The Draft follows Taxpayer Alerts 2008/3 and 2008/4 (issued on 26 March 2008) which outlined the Tax Office's concerns about the types of arrangements as described in the Taxpayer Alerts.

Warning for tax agents

Following the release of the Draft, the Tax Office has advised that it is currently examining the conduct of entities involved in marketing these arrangements and that in a number of cases it is considering, or is in the process of taking, action against them under the promoter penalty laws.

According to the Tax Office, many of the trust arrangements it has examined involve cases where the taxpayer's entitlement to trust income is determined by the exercise of the trustee's discretion, rather than by the rights attaching to the units — with the result that interest is not deductible. Alternatively, they involve the case where the taxpayer's entitlement to trust income and/or capital is disproportionately small compared to their contribution to the trust — with the result that the interest is not deductible in full and some apportionment would be required.

The Tax Office further advises that tax agents wanting to provide information about people or companies who may be promoting such arrangements (including those covered by Taxpayer Alerts 2008/3 and 2008/4) should call the Tax Office's tax practitioner integrity service on 1800 639 745. The Tax Office also said that it is working through various options to help taxpayers who have been involved in these types of arrangements to comply with their tax obligations.

Deductibility of interest

Interest incurred by a taxpayer is deductible if it satisfies the positive limbs of section 8–1. For interest to be deductible, a nexus must exist between the interest and the assessable income so that the outgoing is incidental and relevant to the gaining of assessable income: see *Ronpibon Tin NL v. FCT* (1949) 78 CLR 47; (1949) 8 ATD 431. Further, it is imperative to consider the 'character of the advantage' which is sought to be gained by incurring the expenditure: see *Sun Newspapers Ltd and Associated Newspaper Ltd v. FCT* (1938) 61 CLR 337.

Generally, the deductibility of interest incurred is determined by considering the principles established by the courts and the facts of the particular situation. This is because section 8–1 does not provide any guidance to assist a taxpayer in determining the deductibility. A useful reference is Taxation Ruling TR 95/25, which provides the Tax Office's views on the various factors that were derived from principles established by the courts. Although an understanding of the *rationale* of a precedent is important, it is equally important to realise that where the economic substance of a transaction is inconsistent with its form, the incidents of taxation will follow the economic substance rather than the legal substance: *FCT v. Sth Aust Battery Makers Pty Ltd* (1978) 8 ATR 879 and *Cliffs International Inc. v. FCT* (1979) 9 ATR 507. Put simply, the establishment of whether expenditure constitutes 'interest' is a matter of fact and degree in relation to the particular situation.

In *FCT v. The Myer Emporium Ltd* (1987) 18 ATR 693 and *Riches v. Westminister Bank Ltd* [1947] AC 390, interest was defined as 'compensation to the lender for being kept out of the use and enjoyment of the principal sum'. However, the formal identification of whether expenditure amounts to 'interest' does not translate into its deductibility. It is also crucial to examine the purpose of the borrowings and the nature of the expenditure.

An important proposition derived from cases such as *Steele v. FCT* (1999) 41 ATR 139, *FCT v. Energy Resources of Australia Limited* (1996) 33 ATR 52 and *Fletcher & Ors v. FCT* (1991) 22 ATR 613 is that the deductibility of interest requires an examination of the purpose of borrowing and usage of the borrowed funds. Hill J in *FCT v. Smith* (1992) 23 ATR 494 acknowledged that 'a rigid tracing of funds will not always be necessary or appropriate'. Further, in Taxation Ruling TR 2004/4, which deals with deductions for interest incurred either prior to the commencement or following the cessation of a relevant income earning activity, the Tax Office states that outgoings of interest are of a recurrent nature.

In determining the deductibility of interest, an examination of the taxpayer's intention and usage of the borrowings is crucial.

Removal of Trust Cloning Exception

In the December 2008/January 2009 issue of this publication, it was reported that the Government will abolish the trust cloning exception to CGT events E1 and E2.

The Tax Office has released details of the administrative treatment it will apply concerning the trust-cloning exception. It said that it would continue to apply the existing law until enactment of the proposed changes. It also said that, if the legislation receives Royal Assent prior to 1 July 2009, taxpayers should ensure the enacted changes are taken into account when completing their income tax returns for the financial year ending 30 June 2009.

Racehorses and Data Matching

The Tax Office has announced that it will electronically match data relating to the sale and ownership of thoroughbred racehorses with available data-holdings to identify individuals who have a significant interest in these horses.

According to the Tax Office, the matching process will apply to approximately 10,000 sales records from the auctioneers and about 35,000 thoroughbred records from the registrar. It is anticipated that around 87,500 ownership records will be produced but because of multiple ownerships it is not known how many unique owner records will be produced.

The information will be supplied by:

- William Inglis & Son Ltd;

- Magic Millions; and
- The Registrar of Racehorses (a division of Racing Information Services Australia Pty Ltd).

The Tax Office says that the information will be used to:

- identify taxpayers whose tax affairs should be reviewed under the high-wealth individuals program when combined with additional wealth indicators; and
- ensure the correct tax treatment of taxpayers' affairs in accordance with ITAA 1936 and ITAA 1997.

Value of Goods Taken from Stock for Private Use

The Tax Office has released Taxation Determination TD 2008/32 in which it provides an update of the amounts that the Commissioner will accept for the 2008/09 income year as estimates of the value of goods taken from trading for private use by taxpayers in certain specified industries.

The Determination should be read in conjunction with Taxation Ruling IT 2659. In IT 2659, the Tax Office notes that a greater or lesser value may be appropriate in certain cases. It says where the actual amount is lower than prescribed for an income year the lower amount should be used. Conversely, where the actual amount is greater, the actual amount should be used.

It is important to note that taxpayers should be able to demonstrate that the value attributed to goods taken from stock for private use is fair and reasonable. Therefore, taxpayers should always have regard to their own circumstances when determining the appropriate value.

The amounts (which exclude GST) for the 2008/09 income year are:

Type of business	Adult / Child over 16 years[1] ($)	Child 4 – 16 years[1] ($)
Bakery	1,070	535
Butcher	720	360
Restaurant / café (licensed)	3,680	1,470
Restaurant / café (unlicensed)	2,940	1,470
Caterer	3,190	1,595
Delicatessen	2,940	1,470
Fruiterer / greengrocer	770	385
Takeaway food shop	2,780	1,390
Mixed business (includes milk bar, general store and convenience store)	3,520	1,760

1. The amounts are per adult or per child.

GIC and SIC rates Released

The Tax Office has released the GIC and SIC rates for the third quarter of the 2008/09 income year (i.e. 1 January 2009 to 31 March 2009). The rates are:

Rate	Annual (%)	Daily (%)
GIC	11.76	0.03221918
SIC	7.76	0.02126027

The Tax Office has also released the interest rate for overpayments, early payments and delays in refunds for the third quarter of the 2008/09 income year. The applicable interest rate is 4.76%.

Status of Tax Bill

It was reported in the November 2008 issue that the Government introduced Tax Laws Amendment (2008 Measures No. 5) Bill 2008 into the House of Representatives. The Bill received Royal Assent on 9 December 2008.

Broadly, the Bill amended the:

- GST provisions relating to the sale of real property;
- thin capitalisation regime in relation to the use of accounting standards for identifying and valuing an entity's assets, liabilities and equity capital;
- interest withholding tax regime by extending the eligibility for exemption to bonds issued in Australia by state and territory central borrowing authorities;
- FBT provisions to ensure that the 'otherwise deductible rule' applies to benefits provided in relation to investments that an employee holds jointly with a third party; and
- streaming and modernising of the eligible investment business rules for managed funds as contained in Division 6C of ITAA 1936.