

client alert | explanatory memorandum

July 2009

Tax Laws Amendments

On 14 May 2009, the Federal Government introduced the Tax Laws Amendment (2009 Measures No 3) Bill 2009 into the House of Representatives. The Bill seeks to:

- set the gross domestic product adjustment for the 2009/10 income year at 2% for the purposes of calculating the PAYG instalments for quarterly taxpayers;
- align the GST and PAYG obligations for taxpayers who are voluntarily registered for GST and who choose to remit GST annually;
- amend the *Petroleum Resource Rent Tax Assessment Act 1987*; and
- update the list of deductible gift recipients to include three new organisations.

A brief discussion of some of the amendments follows.

GDP adjustment for PAYG instalments

The Bill will set the gross domestic product (GDP) adjustment factor to be used by the Commissioner in calculating the PAYG instalments for quarterly taxpayers at 2% for the 2009/10 income year. This will be achieved by amending s 45-405 in Sch 1 to the *Taxation Administration Act 1953* (TAA). In the absence of this concession, the GDP adjustment factor calculated under s 45-405 would be around 9%.

Taxpayers may still vary their quarterly instalments under s 45-112 of the TAA if they consider their income is expected to be lower or higher than the amount determined by the Commissioner using the 2% GDP adjustment factor.

The GDP adjustment factor for income years after 2009/10 will continue to be based on the current methodology contained in s 45-405.

Date of effect

The amendment will commence on the day after the Bill receives Royal Assent and will apply for the purposes of working out an instalment amount that becomes due on or after the date of commencement.

PAYG instalments for the 2009/10 income year that are due before the commencement of the Bill will be calculated in accordance with the current method. That is, a GDP adjustment factor of around 9% will apply. However, under s 45-400 of the TAA, each instalment amount payable in the income year is worked out based on a set percentage of a taxpayer's GDP-adjusted factor reduced by the instalment amounts for the earlier quarters in that income year. Therefore, aggregate instalment amounts payable for the 2009/10 income year will reflect the 2% adjustment calculation.

Alignment of GST and PAYG obligations

The Bill will allow taxpayers (including a partner in a partnership) who are voluntarily registered for GST and who have made an annual tax period election under Div 151 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) to make PAYG instalments annually if they satisfy certain eligibility tests (see below).

A taxpayer who is a partner in multiple partnerships that are registered under Pt 2-5 of the GST Act will also be able to make PAYG instalments on an annual basis provided the registered partnerships in which the taxpayer is a partner have made valid annual GST tax period elections and the taxpayer satisfies the relevant eligibility tests (see below).

The example below, which is from the Explanatory Memorandum accompanying the Bill, explains how the amendments will apply to a taxpayer who is a partner in multiple partnerships.

Rebecca is a partner in three different partnerships. Two of the partnerships in which she is a partner are voluntarily registered for GST and have also made annual tax period elections under Div 151 of the GST Act for the 2009/10 income year. The third partnership is not registered for GST.

Rebecca made quarterly PAYG instalments for the 2008/09 income year but would like to choose to make PAYG instalments annually for the 2009/10 income year.

Rebecca will be eligible to make PAYG instalments annually if she meets the other eligibility tests in ss 45-140(1A)(c) to (f), as she meets the requirements set out in ss 45-140(1A)(a) and (b).

Eligibility tests

The eligibility tests that must be satisfied when a taxpayer chooses to report PAYG and GST obligations annually are contained in proposed s 45-140(1A) of the TAA.

Broadly, the eligibility tests can be divided into two categories: the general conditions and the specific conditions.

The general conditions

The general conditions will be contained in new ss 45-140(1A)(c) to 45-140(1A)(f) of the TAA. A taxpayer must satisfy **all** the conditions by the end of the relevant starting instalment quarter. These conditions are:

- the taxpayer is not a partner in a partnership that is required to be registered for GST;
- the taxpayer's most recent notional tax notified by the Commissioner is less than \$8,000; **and**
- where the taxpayer is a company, it is not part of an 'instalment group' or a participant in a GST joint venture under Div 51 of the GST Act.

The specific conditions

A taxpayer will only need to satisfy one of the specific conditions, which will be contained in new ss 45-140(1A)(a) and 45-140(1A)(b) of the TAA. The relevant specific condition must be satisfied at the time the taxpayer elects to make PAYG instalments annually. (Note that the current law requires taxpayers to make this election by notifying the Commissioner, in the approved form, on or before the day on which the relevant instalment would otherwise be due.)

The specific condition to be satisfied at the time of election is either:

- the taxpayer has an annual tax period election that is in effect. If the taxpayer is a partner in one or more partnerships that are registered for GST, an annual tax period election of each of those partnerships is in effect; **or**
- the following conditions apply to the taxpayer:
 - the taxpayer is neither registered nor required to be registered for GST,
 - the taxpayer is a partner in one or more partnerships that are registered for GST, and
 - each of the partnerships has an annual tax period election that is in effect.

Ceasing of eligibility

The current laws that prescribe when a taxpayer ceases to be an annual PAYG instalment payer will apply to taxpayers that elect to make PAYG instalments annually under the eligibility tests contained in new s 45-140(1A) of the TAA: see ss 45-150, 45-155 and 45-160. However, the relevant sections will be amended to reflect the introduction of the eligibility tests.

Broadly, a taxpayer ceases to be an annual taxpayer if:

- the taxpayer becomes required to be registered for GST;
- the taxpayer becomes a partner in a partnership that is required to be registered for GST;
- the partnership in which the taxpayer is a partner becomes required to be registered for GST;
- the Commissioner notifies the taxpayer that its notional tax is more than \$8,000;
- the annual tax period election that applies to the taxpayer or to the partnership ceases to have effect; or
- where the taxpayer is a company, it becomes a participant in a GST joint venture, part of an instalment group or becomes the head company of a consolidated group.

Date of effect

The amendments will apply to PAYG instalments for income years starting after 30 June 2009.

Current law

As the PAYG provisions currently stand, a taxpayer may elect to pay a single annual PAYG instalment if the following conditions are satisfied:

- the taxpayer is neither registered nor required to be registered for GST;
- the taxpayer is not a partner in a partnership that is registered, or required to be registered, for GST;
- the taxpayer's most recent notional tax notified by the Commissioner is less than \$8,000; and
- where the taxpayer is a company, it is not part of an 'instalment group', or a participant in a GST joint venture under Div 51 of the GST Act.

The above requirements mean that a deferred BAS payer cannot be an annual payer. The term 'deferred BAS payer' is defined in s 995-1 of ITAA 1997 to include an entity that is required to report and pay its GST quarterly, or report another BAS obligation quarterly.

Under the GST Act, a taxpayer is eligible to pay GST annually if the taxpayer voluntarily registers for GST and makes an annual tax period election under Div 151.

The misalignment between the PAYG and GST systems may prevent taxpayers from making PAYG instalments annually solely due to their voluntary GST registration, even where they may be remitting GST annually. This misalignment also imposes unnecessary compliance costs on taxpayers.

Deductible gift recipients

The Bill will amend ITAA 1997 to update the list of deductible gift recipients (DGRs) to include three new organisations. Taxpayers who make gifts of \$2 or more to these organisations will be entitled to be a tax deduction. These organisations are:

| Name of fund | Date of effect | Special conditions |
|---|-----------------------|--|
| Royal Institution of Australia Incorporated | 17 April 2009 | Gifts to this fund can be made after 16 April 2009 |
| Diplomacy Training Program Limited | 17 April 2009 | Gifts to this fund can be made after 16 April 2009 |
| Leeuwin Ocean Adventure Foundation Limited | 17 April 2009 | Gifts to this fund can be made after 16 April 2009 |

Small Business and General Business Tax Break

The *Tax Laws Amendment (Small Business and General Business Tax Break) Act 2009*, which gives effect to the one-off bonus deduction for businesses purchasing eligible assets, received Royal Assent on 22 May 2009.

The Act, as enacted, incorporates various amendments including the government's announcement in the 2009/10 Federal Budget to increase the rate of bonus deduction for small business entities to 50%. The amendments, which were introduced after the associated Bill was tabled before Parliament, are discussed below.

(Note that the one-off bonus deduction is not a tax refund and can only be used to reduce a taxpayer's assessable income at the end of an income year.)

Bonus deduction rates

The Act increases the rate of the one-off bonus deduction available to small business entities to 50% where a small business entity acquires an eligible asset between 13 December 2008 and 31 December 2009 and the asset is installed or ready for use by 31 December 2010. The new rate supersedes the previous rates as initially introduced for small business entities (see below).

Previous rates for small businesses

The bonus deduction rate, as initially introduced for small business entities, was either 30% or 10%, depending on the acquisition time of an eligible asset. If a small business entity acquires the eligible asset between 13 December 2008 and 30 June 2009 and the asset is installed or ready for use by 30 June 2010, the rate was 30%. Where the small business entity acquires the eligible asset between 1 July 2009 and 31 December 2009, and the asset is installed or ready for use by 31 December 2010, the rate was 10%.

General businesses

The relevant bonus deduction rate for general businesses remains at either 30% or 10%, depending on the acquisition time of an eligible asset. (See ***Key dates and rates*** on page 5.)

Batches and sets

The Act clarifies the relevant rate to be used on:

- multiple assets that form a batch of identical or substantially identical assets; or
- assets that are part of a set of assets,

where a taxpayer is not a small business entity (ie a general business).

For a general business to be eligible for the 30% bonus deduction, an eligible asset that is part of a batch or set must have an 'investment commitment time' between 13 December 2008 and 30 June 2009, and a first use time on or before 30 June 2010. In addition, the sum of the recognised new investment amounts in relation to the asset plus the recognised new investment amounts in relation to other assets in the batch or set (that also have an investment commitment time between 13 December 2008 and 30 June 2009, and a first use time on or before 30 June 2010) must meet the relevant investment threshold, that is a minimum of \$10,000.

A general business will be permitted to roll over its investments in a batch or set of eligible assets into future income years.

The example below is from the Supplementary Explanatory Memorandum accompanying the Bill:

Otto operates a commercial laundry that is not a small business. On 1 May 2009, he purchases eight dryers and installs them in two of his stores. Each dryer has a recognised new investment amount of \$1,000.

The assets are substantially identical. Therefore, Otto can aggregate his expenditure on the dryers for the purpose of meeting his new investment threshold.

This approach gives Otto an aggregated total recognised new investment amount for 2008/09 of \$8,000. However, Otto has not satisfied the relevant new investment threshold of \$10,000 and cannot claim the Tax Break in his 2008/09 tax return.

On 1 August 2009, Otto purchases another four dryers and installs these in another store. These dryers are substantially identical to those he purchased and installed in 2008/09. Each dryer has a recognised new investment amount of \$1,000.

As Otto has not previously claimed the Tax Break for his \$8,000 of expenditure in 2008/09, he can carry the \$8,000 forward into 2009/10.

Otto's aggregated total recognised new investment amount in relation to the dryers for 2009/10 is \$12,000 which satisfies the relevant new investment threshold.

Otto can claim the Tax Break on this amount at the rate of 10 per cent in his 2009/10 tax return. He is not eligible to claim the Tax Break at the rate of 30 per cent as the total of the recognised new investment amounts in relation to the dryers with an investment commitment time between 13 December 2008 and 30 June 2009 and a first use time on or before 30 June 2010 did not satisfy the relevant new investment threshold.

Key dates and rates

These tables summarise the applicable rates for the different classes of taxpayers:

Small business entities

| Installed by | New investment by 31 December 2009 |
|---------------------|---|
| 30 June 2009 | 50% claimable in the 2008/09 income year ¹ |
| 30 June 2010 | 50% claimable in the 2009/10 income year ¹ |
| 31 December 2010 | 50% claimable in the 2010/11 income year ¹ |

1. Assuming a taxpayer is using a standard income year (ie 1 July to 30 June).

All other taxpayers

| Investment commitment time | Installed by | Rate |
|-----------------------------------|---------------------------------|-------------|
| 13 December 2008 to 30 June 2009 | 30 June 2010 | 30% |
| 13 December 2008 to 30 June 2009 | 1 July 2010 to 31 December 2010 | 10% |
| 1 July 2009 to 31 December 2009 | 31 December 2010 | 10% |

Debt forgiveness

The Act requires that if the cost of an asset is reduced under Div 40 of ITAA 1997 because of an involuntary disposal of the asset or a forgiveness of a debt, the amount to be taken into account for the purpose of the bonus deduction is the unreduced cost of the asset.

The Act also provides that when working out if an asset will be eligible for deductions under s 40-25, for the purpose of the bonus deduction, a taxpayer can disregard any reduction in the cost/adjustable value of the asset that has arisen due to a forgiven debt or an involuntary disposal of the asset.

Self-constructed assets

The Act clarifies the operation of the bonus deduction in relation to self-constructed eligible assets. It states that a taxpayer who chooses to self-construct an eligible asset is not precluded from the bonus deduction. It also states that the construction time for the asset commences when the taxpayer first incurs expenditure in respect of the construction (or the modifications to an existing asset).

According to the Act, such an approach ensures that the test for self-constructed assets is broadly analogous to a situation where a taxpayer enters into a binding contract, while providing taxpayers with the certainty of an objective and a verifiable test.

The example is from the Supplementary Explanatory Memorandum accompanying the Bill:

Greenfield Power is a power supply company that builds its own transmission lines. During mid 2008, the company started to contemplate building a number of new transmission lines. Over the remainder of 2008, preliminary design planning and work was undertaken in anticipation of the project going ahead. On 15 January 2009, the company's directors sign off a decision to proceed with construction of the lines. While the company does not start to physically construct the transmission lines at this point, it places an order for some of the materials it will need. Upon placing the order for the materials, the company is liable to pay a deposit and, therefore, incurs expenditure in relation to the materials. On 10 February 2009 the relevant division of the company starts to finalise the specification of the lines and places further orders for materials. The investment commitment time for each of the transmission lines is 15 January 2009 as this is when the company first incurred expenditure in respect of the construction of the assets.

Date of effect

The one-off bonus deduction applies to income tax assessments for the 2008/09, 2009/10, 2010/11 and 2011/12 income years.

Tax return label

The Tax Office has said that a new tax return label entitled 'Small Business and General Business Tax Break' will be available in tax return forms relating to the 2009 and later relevant years to enable taxpayers to claim the one-off bonus deduction.

2009 Federal Budget Follow-up

On 27 May 2009, the government introduced the Tax Laws Amendment (2009 Budget Measures No 1) Bill 2009 into the House of Representatives. The Bill contains three measures announced in the 2009/10 Federal Budget and seeks to:

- amend the provisions relating to the income tax exemption on foreign employment income;
- temporarily reduce the matching rate and maximum co-contribution for the superannuation government co-contribution; and
- reduce the superannuation concessional contributions cap.

Exemption of foreign employment income

The Bill seeks to limit the circumstances in which foreign employment income derived by an Australian resident individual engaged in foreign service will be exempted from income tax under s 23AG of ITAA 1936. This will be achieved by inserting new s 23AG(1AA) into the section.

The new subsection will ensure that foreign employment income derived by an Australian resident individual engaged in continuous foreign service for not less than 91 days will only be eligible for exemption from income tax if the service is directly attributable to any of the following:

- the delivery of Australian official development assistance (ODA) by the individual's employer;
- the activities of the individual's employer in operating a developing country relief fund or a public disaster relief fund (ie international affairs deductible gift recipients under items 9.1.1 and 9.1.2 in s 30-80(1) of ITAA 1997);
- the activities of the individual's employer if the employer is a prescribed institution that is exempt from Australian income tax because of s 50-50(c) or 50-50(d) of ITAA 1997;

- the individual's deployment outside Australia by an Australian government (or an authority thereof) as a member of a disciplined force; or
- an activity of a kind specified in the regulations.

The term 'Australian government' includes the Commonwealth, a state or a territory.

The term 'disciplined force' is intended to refer to a defence force, including a peacekeeping force, and a police force. The Explanatory Memorandum accompanying the Bill states that 'in a defence force context, the exemption would apply to an individual's deployment outside Australia as part of a non-warlike operation'. It also states that 'in a police force context, the exemption would apply to Australian Federal Police employees deployed on an International Deployment Group mission who are subject to Commanders Orders to achieve operational policing outcomes'.

Continuous period of foreign service

Under the proposed amendments, the exemption from income tax will only be available if an individual's foreign service relates to one or more of the activities listed in the new s 23AG(1AA) and the service is for a continuous period of 91 days or more. Where an individual's foreign service relates to two or more activities, it is important to ensure that all the activities are listed in the new s 23AG(1AA) for the exemption to apply.

The examples below, which are from the Explanatory Memorandum accompanying the Bill, explain how the exemption applies when an individual undertakes different activities.

Example 1

Lisa is an APS employee employed by AusAID. On 1 July 2009 Lisa is posted to Tonga for 45 days, as a project advisor on an Australian ODA project.

At the end of the 45 day posting, Lisa resigns from AusAID and takes up a position as an aid worker in Tonga, employed by a prescribed charitable institution covered by s 23AG(1AA)(c). Lisa remains in her new position for another 100 days.

Lisa's continuous period of foreign service for the purpose of s 23AG(1AA) is 145 days and her foreign earnings are eligible for exemption pursuant to s 23AG, subject to the conditions contained in s 23AG(2).

Example 2

As in the above example, Lisa resigns from AusAID at the end of her 45 day posting. However, rather than commencing work as an aid worker, Lisa takes up permanent employment with a bank in Tonga.

Lisa's continuous period of foreign service in Tonga exceeds 91 days but none of her foreign earnings are eligible for exemption because she did not attain 91 days of continuous foreign service in relation to an activity covered by s 23AG(1AA).

Co-relation with current conditions for exemption

The existing conditions for exemption will continue to apply, notwithstanding foreign employment income derived by an Australian resident individual is directly attributable to one of the activities referred to in the new s 23AG(1AA). That is, the individual has been engaged in foreign service for a continuous period of not less than 91 days **and** the income is not denied the exemption because of one of the conditions contained in s 23AG(2).

Foreign employment income derived in a foreign country is not exempt from tax under s 23AG if the amount is exempted from income tax in the foreign country only because of:

- a double tax agreement (DTA) or a foreign law giving effect to a DTA;
- the foreign country not taxing employment or personal services income, at the federal or national level; or
- the application of a law or an international agreement dealing with privileges and immunities of diplomats, consuls or persons connected with international organisations.

If foreign employment income is not exempt under the new rules, the income may be subject to Australian income tax. However, a taxpayer will be eligible to claim a non-refundable foreign income tax offset (FITO) for foreign income tax paid on that income.

Employers' obligations

The proposed amendments will also impose new obligations on employers.

From 1 July 2009, employers of individuals who derive non-exempt foreign employment income will be required to withhold amounts from salaries, wages, allowances, bonuses and commissions paid to their foreign-based employees.

Employers will also need to consider their FBT obligations in respect of benefits provided to their foreign-based employees. This is because, for FBT purposes, an individual is considered to be an employee if the individual receives salary and wages, which are, in turn, defined to include a payment where an amount is withheld under the PAYG withholding rules. Therefore, fringe benefits provided to employees whose foreign employment income is not exempt under s 23AG may be subject to FBT.

Date of effect

The proposed amendments will apply to foreign earnings derived on or after 1 July 2009 from foreign employment performed on or after that date.

Foreign earnings derived on or before 30 June 2009 will remain eligible for exemption under the current rules. In determining whether the '91 days rule' has been satisfied, foreign employment performed on or after 1 July 2009 will be included in the calculation, even where the foreign earnings derived after that date are not exempt.

Foreign earnings paid to an individual taxpayer on or after 1 July 2009 for foreign services performed before 1 July 2009 will remain eligible for exemption under the current provisions.

The examples, which are from the Explanatory Memorandum accompanying the Bill, explain how the date of effect applies.

Example 1

Wallace is an Australian resident employed by a Thai company to work in Bangkok from 1 July 2009 to 30 September 2009. His foreign earnings are not directly attributable to any of the activities covered by new s 23AG(1AA).

Wallace's foreign earnings derived after 1 July 2009 will not be eligible for exemption under the new rules. However, Wallace's foreign earnings in respect of foreign service performed before 1 July 2009 will remain eligible for exemption because his total foreign service from 1 June to 30 September exceeded 91 consecutive days.

Example 2

Jennelle has been engaged in continuous foreign service since 1 February 2009. Her foreign earnings are not directly attributable to any of the activities covered by new s 23AG(1AA).

On 1 July 2009 Jennelle is paid in respect of foreign services performed during the month of June 2009. Her foreign earnings for the month of June 2009 remain eligible for exemption notwithstanding the fact that they were paid on 1 July 2009.

However, Jennelle's foreign earnings derived in respect of foreign service performed on or after 1 July 2009 are not eligible for exemption because they are not directly attributable to any of the activities covered by new s 23AG(1AA).

Temporary reduction in government co-contribution

The Bill will temporarily reduce the superannuation government co-contribution matching rate and maximum co-contribution that is payable on an individual's eligible personal superannuation contributions

made in the 2009/10, 2010/11, 2011/12, 2012/13 and 2013/14 income years. The matching rate and maximum co-contribution will revert back to 150% for the 2014/15 and later income years.

The proposed temporary reduction for the relevant income years is as follows:

- for the 2009/10, 2010/11 and 2011/12 income years, the rate is 100% (ie \$1 for each dollar of contribution), up to a maximum of \$1,000 per annum for a \$1,000 personal contribution. The amount of co-contribution will be reduced by 3.333 cents for each dollar by which an individual's total income exceeds the shade-out threshold for receiving the full co-contribution;
- for the 2012/13 and 2013/14 income years, the rate is 125% (ie \$1.25 for each dollar of contribution), up to a maximum of \$1,250 per annum for a \$1,000 personal contribution. The amount of co-contribution will be reduced by 4.167 cents for each dollar by which an individual's total income exceeds the shade-out threshold for receiving the full co-contribution; and
- for the 2014/15 and later income years, the rate will revert back to 150% (ie \$1.50 for each dollar of contribution), up to a maximum of \$1,500 per annum for a \$1,000 personal contribution. The amount of co-contribution will be reduced by 5 cents for each dollar by which an individual's total income exceeds the shade out threshold for receiving the full co-contribution.

150% matching until 30 June 2009

The 150% matching continues to apply until 30 June 2009 for eligible personal superannuation contributions made during the 2008/09 income year.

The maximum government co-contribution of \$1,500 per annum is available to all qualifying persons whose assessable income and reportable fringe benefits (if any) for the 2008/09 income year do not exceed \$30,342. For incomes exceeding \$30,342, the co-contribution tapers out at the rate of \$0.05 for each whole dollar of income. The co-contribution ceases to be available once a taxpayer's total income reaches \$60,342 for 2008/09. In addition, to be able to take advantage of the government co-contribution, a person must also:

- be aged under 71 on 30 June of the year in which the contributions are made. For persons aged 65–70, the additional work test rules (ie gainful employment for at least 40 hours in a period of not more than 30 consecutive days in the financial year in which the contribution is made) must also be satisfied for a complying superannuation fund or retirement savings account to be able to accept contributions;
- lodge an income tax return for the year; and
- not have held an eligible temporary resident visa during the year.

Note that 'reportable employer superannuation contributions' (eg salary sacrificed superannuation contributions) will be counted as part of the co-contributions total income test from 1 July 2009.

Superannuation co-contribution thresholds for 2009/10

At the time of publication, the Tax Office has not released the lower and higher income thresholds for the 2009/10 income year. However, the Bill states that the thresholds are \$31,920 and \$61,920 respectively.

Date of effect

The amendments will apply to contributions made in the 2009/10 and later income years.

Reduction in concessional contributions cap

The Bill seeks to reduce the superannuation concessional contributions cap. The Bill also seeks to make consequential amendments to the level of the superannuation non-concessional contributions cap.

Concessional contributions cap

The Bill proposes to reduce the concessional contributions cap to \$25,000 (from \$50,000) for concessional contributions made in the 2009/10 and later income years. The cap will be indexed annually to the average weekly ordinary time earnings, rounded down to the nearest multiple of \$5,000.

The current concessional contributions cap of \$50,000 continues to apply to contributions made in the 2008/09 income year.

The Bill also proposes to reduce the transitional concessional contributions cap, which applies to concessional contributions made by individuals aged 50 to 74 between the 2007/08 and 2011/12 income years, to \$50,000 (from \$100,000). The transitional cap is not indexed.

The current transitional concessional contributions cap of \$100,000 continues to apply to contributions made in the 2008/09 income year.

From 1 July 2012, the concessional contributions cap for those aged 50 and over will revert to the lower \$25,000 cap (or applicable indexed amount at that time).

Concessional contributions to defined benefit funds

Special arrangements will apply to certain members with a defined benefit interest on 12 May 2009 where notional taxed contributions for that interest exceed the concessional contributions cap in the 2009/10 or later income years. The notional taxed contributions for a member's interest will be taken to be at the maximum level of the member's cap. This arrangement will be subject to the conditions (if any) prescribed in the regulations and will only apply to notional taxed contributions reported for the 2009/10 or later income years. The arrangement will continue to apply even if a member's defined benefit interest is transferred to a successor fund that retains equivalent rights for the member.

The Bill also proposes to extend the existing 'grandfathering' arrangements in relation to the concessional contributions cap that apply to certain defined benefit interests held on 5 September 2006.

The following example, which is from the Explanatory Memorandum accompanying the Bill, explains how the proposed amendments apply to defined benefit funds.

Donna is 45 and has had an interest in a defined benefit fund since 1 July 2006. In the 2007/08 and 2008/09 financial years Donna had notional taxed contributions of \$30,000. The grandfathering provisions in these years did not need to be activated as Donna's notional contributions were below the concessional contributions cap of \$50,000.

During these financial years Donna also made salary sacrificed contributions of \$20,000 (the difference between the concessional contributions cap and her notional taxed contributions).

In the 2009/10 financial year Donna's notional taxed contributions are \$30,000 and therefore in excess of the concessional contributions cap. However, as Donna was a member of the fund on 12 May 2009 the grandfathering provisions will provide that her notional taxed contributions will be taken to be equal to the cap in that year and future financial years provided that the defined benefit interest meets and continues to meet the necessary conditions set out in the regulations. If this is the case, Donna's notional taxed contributions (\$30,000 in 2009/10) will be taken to equal \$25,000 meaning that Donna will not breach the concessional contributions cap as a result of these contributions.

Concessional contributions cap

The Bill seeks to set the non-concessional contributions cap at six times the proposed (indexed) concessional contributions cap for the 2009/10 and later income years. In effect, the non-concessional contributions cap remains at \$150,000 (\$25,000 x 6) for the 2009/10 income year.

The current provision allowing an individual to 'bring forward' two years worth of non-concessional contributions remains.

Medicare Levy Thresholds 2008/09

The government has also introduced the Tax Laws Amendment (Medicare Levy and Medicare Levy Surcharge) Bill 2009 into the House of Representatives. The Bill will increase the Medicare levy and Medicare levy surcharge low-income threshold amounts for individuals, families and pensioners below age pension age for the 2008/09 income year. It will also increase the phase-in limits as a result of the increased threshold amounts.

The proposed threshold amounts for the 2008/09 income year are:

| Category of taxpayer | No Medicare levy payable if taxable income or family income does not exceed (\$) | Reduced levy if taxable income or family income is within range (inclusive) (\$) | Ordinary rate of levy payable where taxable income or family income exceeds (\$) |
|---|---|---|---|
| Individual taxpayer | 17,794 | 17,795 – 20,933 | 20,934 |
| Pensioner under age pension age | 25,299 | 25,300 – 29,762 | 29,763 |
| Families ¹ with the following children and/or students | Family income | | |
| 0 | 30,025 | 30,026 – 35,322 | 35,323 |
| 1 | 32,782 | 32,783 – 38,566 | 38,567 |
| 2 | 35,539 | 35,540 – 41,809 | 41,810 |
| 3 | 38,296 | 38,297 – 45,053 | 45,054 |
| For each extra child and/or student add: | 2,757 | 2,757 – 3,243 | 3,243 |

1. The figures also apply to taxpayers who are entitled (or would have been entitled had the laws applicable to rebates not been amended with effect from 1 July 2000) to a sole parent, child-housekeeper or housekeeper rebate.

Date of effect

The amendments will apply to the 2008/09 and later income years.

Superannuation Guarantee Ruling

The Tax Office has issued Superannuation Guarantee Ruling SGR 2009/2, in which the Commissioner explains the meanings of ‘ordinary time earnings’ (OTE) and ‘salary or wages’ as defined in ss 6(1) and 11 of the *Superannuation Guarantee (Administration) Act 1992* (SGAA), respectively.

Substantive changes from draft

The ruling was previously released as Draft Superannuation Guarantee Ruling SGR 2008/D2 and has been modified in several important respects, most notably in respect of certain overtime payments and allowances (eg Christmas bonuses are now considered OTE). Importantly, the Tax Office has altered its position from the draft ruling to now provide that regular overtime payments (ie payments outside an employee’s ordinary hours of work) will *generally* not be included in OTE. However, the ruling notes that there are situations where items commonly referred to as ‘overtime’ may still be counted as OTE and salary or wages. For example, some payments may still be considered as OTE where no ordinary hours of work are stipulated in an employment contract or where a workplace agreement supplants an award and removes the distinction between ordinary hours of work and other hours: see table below.

The final ruling replaces the Commissioner’s previous position in Superannuation Guarantee Rulings SGR 94/4 and SGR 94/5, which will be withdrawn from 1 July 2009.

Parental leave and top-up payments

The ruling notes that the government announced on 12 May 2009 that it intends to clarify the superannuation guarantee status of certain kinds of leave payments. Accordingly, it does not deal with the status of payments made to employees who are on parental leave. The ruling also does not deal with the status of payments

made to employees who are on other ancillary kinds of leave, including 'top-up payments' (eg those made while serving on jury duty or with defence reserve forces).

Background

Since 1 July 2008, employers must use OTE as the earnings base when calculating the 9% minimum level of quarterly superannuation guarantee support for their employees. Employers may still use the notional earnings bases specified in the SGAA or industrial agreements, provided those bases are above an employee's OTE.

The term OTE is relevant to employers for the purpose of calculating the minimum level of superannuation guarantee required for their employees under the SGAA. If employers provide less than the required minimum level of contributions, they will be liable to pay a non-deductible superannuation guarantee charge on the superannuation guarantee shortfall for an employee, which is calculated using salary or wages.

The ruling states that payments included in OTE are also included in salary or wages. It also states that payments specifically excluded from OTE are not necessarily excluded from salary or wages. In other words, 'salary or wages' as defined in s 11 has a broader concept than OTE.

Ordinary time earnings

The definition of OTE prescribes a requirement that earnings be in respect of ordinary hours of work. However, the terms 'earnings' or 'ordinary hours of work' are not specifically defined in the SGAA.

In the Commissioner's view, the term 'earnings', for the purpose of superannuation guarantee, is the remuneration paid to the employee as a reward for the employee's services, which for practical purposes means 'salary or wages'.

Ordinary hours of work

The Commissioner considers that an employee's 'ordinary hours of work' are the hours specified in the relevant award or agreement (or a combination of such documents) as the employee's ordinary hours of work. The Commissioner notes that while the documents need not use the exact phrase 'ordinary hours of work', a genuine distinction must be drawn between ordinary hours and other hours (commonly described as overtime payments). In particular, the Commissioner states that he will expect the other hours are remunerated at a higher rate. The Commissioner also states that any hours worked in excess of, or outside the span of, specified ordinary hours of work do not form part of the employee's 'ordinary hours of work'.

Where the ordinary hours of work are not specified in the relevant award or agreement, the 'ordinary hours of work' are the normal, regular, usual or customary hours worked by an employee, as determined by reference to the circumstances of the case. The ruling states that if it is not possible or practicable to determine those hours, the actual hours worked by the employee should be taken to be the ordinary hours of work.

The ruling notes that 'ordinary hours of work' are not confined to hours to be worked between 9am and 5pm, Monday to Friday. It states that the ordinary hours of work can include night and weekend shifts. It also notes that the total of OTE in respect of an employee for a quarter cannot exceed the maximum contribution base for the relevant quarter. (The maximum contribution base per quarter for the 2008/09 income year is \$38,180.)

Treatment of specific payments

The Commissioner provides his view on whether certain payments received by employees are OTE. These payments include:

- **overtime** — payments for work performed during hours outside an employee's ordinary hours of work are not OTE. This is so whether the payments are calculated at an hourly rate or the employee gets a specific loading, or an annualised or lump sum component of a total salary package, that is expressly referable to overtime hours as remuneration for overtime hours worked. However, the ruling notes that some employees, particularly some managers and professionals, receive a single undissected annual salary within a remuneration package that recognises in a non-specific way that the employee may often be expected to work more than the ordinary hours of work prescribed. The whole amount of salary

payable under such a package is OTE, unless overtime amounts are distinctly identifiable and expressly referable to overtime hours;

- **commission** — payments to an employee such as a salesperson on the basis of the volume of sales they achieve or similar criteria are always OTE (except in the unusual case where they can be shown to be wholly referable to overtime hours worked);
- **on-call allowance** — a payment to an employee for making themselves available at certain times to be called in to work if needed. This entitlement is separate from the salary or wages the employee will receive if actually called in. If paid in respect of hours that the employee is not otherwise working, these payments are not OTE. However, in some cases, on-call allowances are paid as a loading on the salary of an employee received for ordinary hours of work. For example, some doctors employed by hospitals are paid an extra hourly allowance, while carrying out routine duties in ordinary hours of work, to make themselves available to perform urgent surgery if required. Payments of that kind are OTE (except of course to the extent that they are paid in respect of overtime hours);
- **allowances and loadings** — these kinds of payments to recognise or compensate employees for certain employment conditions are OTE (to the extent they are not ‘salary or wages’ or relate solely to hours of work other than ordinary hours of work). Examples include a site allowance, casual loading, dirt allowance or freezer allowance;
- **bonuses** — additional earnings received as a reward for good performance (eg performance bonuses) and other ‘bonus’ payments (eg Christmas bonuses) are, generally, OTE;
- **over-award payments** — component of a payment in excess of an award entitlement. The Commissioner’s view is that the specific inclusion of these payments does not apply to over-award payments that are specifically referable to hours worked that are not ordinary time hours. For example, an employer’s policy may be to offer a higher rate of overtime pay for some overtime hours worked than the penalty rate required by an award;
- **shift-loading** — a shift-loading is an amount paid to a worker in addition to their basic hourly rate for having to work outside the usual span of time for day workers. Shift-loadings payable on ordinary hours of work must be distinguished from overtime payments under awards and agreements. Often these are mutually exclusive under awards and agreements, but if an employee is entitled to a shift-loading in respect of hours other than ordinary hours of work, the Commissioner’s view is that the specific inclusion of shift-loadings does not apply in that circumstance;
- **piece rates** — all wage payments made on a piece-rate basis are included in an employee’s OTE, unless the employee is subject to an award or agreement that specifies their ordinary hours of work;
- **paid leave and holiday pay** — amounts received by an employee for annual leave, public holidays and rostered days off are OTE. However, lump sum arrears payments of unused leave, sick leave or long service leave are not OTE;
- **payments in lieu of notice** — an amount that an employee receives in lieu of notice concerning termination of employment is OTE;
- **workers’ compensation payments (employee required to work)** — payments made by an employer or on their behalf (eg by an insurance company) are part of an employee’s OTE only if they are ‘salary or wages’ paid in respect of ordinary hours of work; and
- **directors’ fees** — all fees paid to a company director are earnings in respect of the director’s ordinary hours of work and, therefore, OTE.

The ruling also states that the following payments, which are not salary or wages for SGAA purposes, are therefore, not OTE:

- certain private or domestic payments;
- fringe benefits and other non-cash payments;
- some workers’ compensation payments (where the employee is not required to work);
- some sign-on bonuses;
- expense allowance payments and reimbursement of expenses incurred for the employer;
- redundancy payments; and

- payments for unfair dismissal.

Salary or wages

The Commissioner notes that the SGAA defines ‘salary or wages’ inclusively in s 11. Therefore, he states that unless specifically excluded, payments are included in the definition of ‘salary or wages’ if:

- they satisfy the ordinary or common law meaning of that term; or
- they fall within the extended definition contained in s 11(1).

Payments included in OTE are also included in salary or wages.

In the Commissioner’s view, the salary or wages of an employee can be paid by the employer or by another party on behalf of the employer.

The ordinary meaning of the term salary or wages is remuneration paid to employees for their services as employees. In most practical situations, the Tax Office says it is straightforward to determine whether any given payment made in an employment context is salary or wages. However, the term is not limited to fixed payments made periodically for work performed, such as a worker’s fortnightly pay cheque. It extends to certain lump sum payments, bonuses and allowances that are part of the worker’s remuneration.

The Tax Office says payments to an employee which are not given as a reward for their services are not included in salary or wages. For example, a payment made to reimburse an employee’s out of pocket expenses is not salary or wages.

Payments to an employee are included in salary or wages if the employee is entitled to receive the money for themselves. For example, a meal allowance that the employee is free to spend as they wish. By contrast, an advance given to an employee to enable the employee to expend the money on behalf of the employer is not salary or wages.

Specific payments

The ruling examines whether certain payments received by an employee constitute salary or wages. These include:

- **allowances (not reimbursement of expenses)** — all allowances are included in salary or wages, except expense allowances and allowances that are fringe benefits under the *Fringe Benefits Tax Assessment Act 1986*;
- **bonuses (including Christmas and performance bonuses)** — where a bonus is paid to an employee by reason of their services as an employee and not on a personal basis, the bonus is salary or wages. However, the Commissioner states that there are only very limited cases in which he will accept a payment is made on a personal basis;
- **leave payments** — amounts received by an employee on any period of paid leave are salary or wages. (Note that the ruling does not discuss the status of parental leave or other kinds of ancillary leave);
- **workers’ compensation payments** — any workers’ compensation payments received by an injured employee where the employee performs work or is required to attend work will form part of salary or wages. Conversely, if the employee has terminated or is otherwise absent from employment, the payment will not be salary or wages;
- **lump sum payments on termination of employment** — where an employee receives a lump sum payment for unused annual leave, long service leave and/or sick leave on termination of employment, the payment is salary or wages;
- **payments received by way of settlement** — if unpaid salary or wages are recovered by way of a court order, out-of-court settlement or negotiated settlement, and that settlement contains an identifiable and quantifiable amount of unpaid salary and wages, that amount retains its character as ‘salary or wages’. Where the settlement amount is undissected, the whole amount is not salary or wages; and
- **sign-on bonuses** — generally, a sign-on bonus is salary or wages if it is assessable income in the hands of an employee for income tax purposes. The Commissioner says he will only accept that such a payment is not assessable income in limited situations, such as where the payment is clearly referable to a separate restrictive covenant entered into by the employee.

The ruling states that the following payments are not ‘salary or wages’:

- **expense allowances and reimbursements** — those allowances paid to an employee with a reasonable expectation that the employee will fully expend the money in the course of providing services. A reimbursement that compensates an employee for an expense they have incurred on behalf of the employer is also not salary or wages;
- **redundancy payments** — payments made on termination of employment are not a reward for services rendered by an employee, even if part of the payment is calculated by reference to the employee’s period of service with the employer. They are payments to compensate the employee for the loss of their job; not a reward for their services;
- **unfair dismissal** — payments by way of compensation for unfair dismissal are not salary or wages because they are payments for the loss of an employee’s job and not a reward for the employee’s service; and
- **workers’ compensation payments** — made by or on behalf of an employer to an employee who is not required to attend work due to incapacity, or whose employment has been terminated, are not salary or wages.

Date of effect

The ruling applies to payments made to employees in the quarter beginning on 1 July 2009 and all later quarters.

Examples

The appendixes accompanying the ruling contain a table summarising whether common payments received by employees are considered to be OTE and/or salary or wages. It also contains 24 examples setting out common scenarios that employers may encounter.

The table below, which is reproduced from the ruling, provides a general guide to the treatment of common payments.

| Payments to an employee in relation to... | Salary or wages | OTE |
|---|-----------------|-----|
| Awards and agreements | | |
| Regular overtime | Yes | No |
| Additional hours in an agreement over an award’s ordinary hours | Yes | No |
| Agreement supplanting award removes distinction between ordinary hours and other hours | Yes | Yes |
| No ordinary hours of work stipulated | Yes | Yes |
| Casual employee — shift-loadings | Yes | Yes |
| Casual employee — overtime payments | Yes | No |
| Casual employees whose hours are paid at overtime rates due to a ‘bandwidth’ clause | Yes | No |
| Piece-rates — no ordinary hours of work stipulated | Yes | Yes |
| Overtime component of earnings based on ‘hourly driving rate’ formula stipulated in award | Yes | No |
| Allowances | | |
| Allowance by way of unconditional extra payment | Yes | Yes |
| Expenses allowance expected to be fully expended | No | No |
| Danger allowance | Yes | Yes |
| Military allowance | Yes | Yes |

| Payments to an employee in relation to... | Salary or wages | OTE |
|---|------------------------|------------|
| Retention allowance | Yes | Yes |
| Hourly on-call allowance in relation to ordinary hours of work (eg doctors) | Yes | Yes |
| Hourly on-call allowance in respect of overtime hours | Yes | No |
| <i>Payment of expenses</i> | | |
| Reimbursement | No | No |
| Petty cash | No | No |
| Reimbursement of travel costs | No | No |
| Payments for unfair dismissal | No | No |
| Workers' compensation — returned to work | Yes | Yes |
| Workers' compensation — not working | No | No |
| <i>Leave payments</i> | | |
| Annual leave | Yes | Yes |
| Termination payments — in lieu of notice | Yes | Yes |
| Termination payments — unused annual leave | Yes | No |
| <i>Bonuses</i> | | |
| Performance bonus | Yes | Yes |
| Bonus labelled as ex-gratia but in respect of ordinary hours of work | Yes | Yes |
| Christmas bonus | Yes | Yes |
| Bonus in respect of overtime only | Yes | No |

Legal status of Superannuation Guarantee Ruling

A Superannuation Guarantee Ruling, whether draft or final, is not legally binding on the Commissioner. However, if the Commissioner takes the view that the superannuation law applies less favourably to a taxpayer than a ruling, the fact that the taxpayer acted in accordance with the ruling will be a relevant factor in the taxpayer's favour in the Commissioner exercising any discretion in regards to the imposition of penalties.

Taxpayer Alerts

The Tax Office has issued five Taxpayer Alerts warning taxpayers of arrangements that it currently has under review.

Non-commercial use of negotiable instruments and SMSFs

In Taxpayer Alert TA 2009/10, the Tax Office describes arrangements involving the non-commercial use of negotiable instruments to pay a benefit from or make a contribution to a self-managed superannuation fund (SMSF). The Tax Office is concerned that some SMSF trustees and members are attempting to use negotiable instruments in a non-commercial and contrived manner to artificially avoid liquidity problems, change the timing of transactions or to obtain taxation advantages.

Description of arrangements

The Tax Office states that the alert applies to arrangements with features that are substantially equivalent to the following:

1. A non-commercial use of a negotiable instrument (usually a promissory note) involves a transaction between an entity and an SMSF. This transaction includes:
 - a trustee of an SMSF giving a promissory note to a member to pay a benefit;
 - a person giving a promissory note to an SMSF as a contribution; or
 - a combination of the above two transactions, often within a very short period of time.

The same effect may be attempted through non-commercial use of cheques, such as post-dating a cheque or only presenting a cheque for payment after a significant period of time has passed.
2. Such non-commercial use of a promissory note includes where the note is:
 - never intended to be honoured;
 - immediately re-endorsed back to the issuer;
 - post-dated; or
 - while on its face immediately payable, it is only intended to be honoured after a significant period of time has passed (eg longer than would occur in a normal commercial context for arm's length parties).

Issues of concern

The Tax Office considers that arrangements of this type may give rise to the following issues relevant to the application of the *Superannuation Industry (Supervision) Act 1993* and the *Superannuation Industry (Supervision) Regulations 1994*, being whether the:

- arrangement, or some step within it, may be a sham at general law;
- benefit payment standards may not be met;
- contributions standards may not be met;
- restriction on SMSFs acquiring assets from related parties may apply;
- restriction on SMSFs providing financial assistance to a member or relative of a member may apply; and
- in-house asset provisions may not be met.

The Tax Office considers that such arrangements give rise to the following issues relevant to taxation laws:

- the arrangement, or some step within it, may be a sham at general law;
- the arrangement attempts to change the timing of a contribution to an SMSF in order to reduce or eliminate liability for excess contributions tax under Div 292 of ITAA 1997;
- any assessable income may arise to one of the parties, and if so, at what time such income may arise;
- income tax deductions may be available to one of the parties, and if so, at what time such deductions may be allowable;
- the general anti-avoidance provisions in Pt IVA of ITAA 1936 may apply to the arrangement or some part of it; and
- any entity involved in the arrangement may be a promoter of a tax exploitation scheme for the purposes of Div 290 of Sch 1 to the *Taxation Administration Act 1953* (TAA).

Possible penalties

The Tax Office also warns that such arrangements may give rise to the following penalties:

- base penalties of up to 75% of the tax avoided can apply where someone makes a false or misleading statement to the Commissioner. Reductions in base penalty will be available if the taxpayer makes a voluntary disclosure to the Tax Office;
- penalties of up to 5,000 penalty units for individuals, 25,000 penalty units for bodies corporate or up to twice the amount of consideration received or receivable may apply to promoters of tax exploitation schemes under Div 290;

- where appropriate, s 167 of ITAA 1936 may be used to determine the amount of taxable income upon which the taxpayer should be assessed.

Tax Office media release

In the media release accompanying the Taxpayer Alert, the Commissioner says that the Tax Office is concerned with the non-commercial use of promissory notes to avoid the need to liquidate assets in order to change the timing of transactions, or to obtain tax advantages that are not available in the circumstances. In particular, the Commissioner says that taxpayers may be lead into these non-commercial transactions hoping to take advantage of the existing super concessional contributions caps in view of the Government's proposed measure to reduce the concessional contributions caps from 1 July 2009 (see **2009 Federal Budget Follow-up**).

The Commissioner says that the Taxpayer Alert does not apply to the use of negotiable instruments involving real movements of funds or assets through genuine withdrawal and re-contribution strategies. However, the alert covers artificial and contrived arrangements including 'round robin' transactions.

Legal status of a superannuation-related Taxpayer Alert

A Taxpayer Alert is only intended to be an 'early warning' of a tax planning arrangement that the Tax Office has under risk assessment. However, it is expected that a ruling or determination will be issued by the Tax Office following the release of the alert.

Taxpayers who have entered into, or are contemplating entering into, an arrangement similar to that described in an alert may contact the Tax Office to seek guidance in relation to the superannuation regulatory issues covered in the Alert.

Shareholders and retail premium payments

The Tax Office has issued Taxpayer Alert TA 2009/11 which is designed to assist shareholders make informed decisions whether to take up entitlements to a share offer based on the tax treatment of retail premium payments.

The Tax Office is concerned an issuing company may be providing incorrect advice to shareholders that retail premium payments will be treated as capital gains for tax purposes. It is currently considering the correct tax treatment of retail premium payments including whether the payments should be treated as unfrankable dividends, ordinary income or a combination of both.

The Tax Office says it will be reviewing tax returns of shareholders who have received retail premium payments. It encourages shareholders to check if they have correctly accounted for the payments in their tax returns. It also says that shareholders who voluntarily disclose the incorrect treatment of payments in their returns to the Tax Office will be entitled to a reduction in any penalties which may apply.

Description of arrangements

The alert applies to arrangements with features that are substantially equivalent to those outlined below:

1. A company grants entitlements to existing shareholders that allow them to subscribe for an allotment of new shares in the company at an amount called the 'offer price', subject to their eligibility.
2. The offer price is less than the amount shareholders would have to pay to acquire the same quantity of shares on the share market. That is, the shares are acquired at a discount.
3. Some shareholders choose not to exercise some or all their entitlement to the offered allotment or, alternatively, are not eligible to receive or exercise an entitlement.
4. Entitlements for ineligible shareholders, which they did not take up or could not take up, are collectively referred to as 'unexercised entitlements'.
5. The issuing company arranges to offer a number of shares equivalent to the unexercised entitlements to other entities, such as to institutional investors, in what is referred to as a 'bookbuild process'.

6. Where the issue of shares under a bookbuild process realises an amount above the offer price, the company arranges payment of a pro rata 'retail premium' to shareholders who have unexercised entitlements after the offer period closes.
7. The retail premium paid may be all or part of the difference between the offer price under the unexercised entitlements and the price at which the buyers subscribed for the shares.
8. At the time of the initial offer or the time of payment of the retail premium, the company issuing the shares or another entity may offer advice to shareholders that retail premiums received should be treated as a capital gain, and potentially the CGT discount may apply.

Regulatory issues

The Tax Office considers that arrangements as described in the alert give rise to the following taxation issues, including whether:

- the retail premium payments should be treated as unfrankable dividends pursuant to ss 6(1), 6(4), 44(1) and 44(1B) of ITAA 1936;
- the retail premium payments and any similar payments made are also ordinary income under s 6-5 of ITAA 1997 and under the decision in *FCT v McNeil* (2007) 64 ATR 431 and the facts material to that decision; and
- the retail premium payments, as unfranked dividends and/or ordinary income, should not be treated as capital gains and, therefore, ineligible for the CGT discount.

Fact sheet on tax consequences

The Tax Office has also issued further information in the form of a Fact Sheet in which it states the tax consequences of retail premiums paid to shareholders where share entitlements were not taken up by or not available to them.

The Tax Office states in the Fact Sheet that retail premiums payments to non-participating shareholders are characterised as unfranked dividends because those payments represent a part of the share capital subscribed by other investors and are paid under the arrangement for the subscription of that share capital. It also states that if the payments are not characterised as unfranked dividends, the payments will be ordinary income under the more general principles as discussed by the High Court in *McNeil's* case. It states, further, that the payments should not be treated as capital gains, and therefore shareholders are not eligible for the CGT discount.

The Tax Office encourages taxpayers who have reported retail premium payments in their tax returns as capital gains to self-amend their returns to reduce the capital gain, and increase the amount of unfranked dividends or assessable income. For taxpayers who have received payments but have not lodged their tax returns, they should report the payments as unfranked dividends or assessable income.

Re-characterising capital losses as revenue losses

In Taxpayer Alert TA 2009/12, the Tax Office describes arrangements whereby taxpayers seek to re-characterise their shareholding status from that of a long-term capital investor to a trader in shares. It states that taxpayers involved in these arrangements have claimed the CGT discount on previous receipts, but are now realising losses which they seek to claim as tax deductions against ordinary income.

Description of arrangements

The alert applies to arrangements with features that are substantially equivalent to those outlined below:

1. The taxpayer is an individual investor who holds shares.
2. The taxpayer has previously disposed of shares and realised a profit. The taxpayer treated that profit as a capital gain and claimed the 50% CGT discount in their income tax return for the relevant income year.
3. The value of shares still held by the taxpayer decreases as a result of market conditions and an unrealised loss arises in respect of those shares.

4. The taxpayer may receive advice from a tax professional or a financial advisor concerning the deductibility of losses incurred on the sale of shares for the current income year, including the benefits of being regarded as holding shares as a share trader when making such a loss.
5. The taxpayer decides to arbitrarily re-characterise their shareholding in order to claim a revenue loss on the disposal of the shares under s 8-1 of ITAA 1997, without changing the economic substance of their shareholdings. This is done on the basis that the taxpayer is now carrying on a business of share trading.
6. To support a contention that the taxpayer is carrying on a business of share trading, they may artificially adopt specific practices to present a pretence of being a share trader, but with no objective, material change in either the nature of investments held (or sold) or their holding activities. These practices (which in the relevant circumstances a reasonable person would regard as artificial and contrived) may include:
 - a) purchasing or selling shares on a more regular basis (often with small net volumes). This is often called 'window dressing';
 - b) creating a trading plan for their share transaction activities with a newly stated goal of maximising profit — even though the shares sold will generate a loss, rather than a profit;
 - c) increasing recording of time spent per week on the investment process (without any significant change in the total value of transactions); and
 - d) maintaining additional records to evidence share transactions including additional reliance on guidance from others (without any significant change in the total value of transactions).
7. The taxpayer subsequently decides to dispose of the shares to realise the net loss.
8. The change in approach is applied on a prospective basis only, such that only future transactions are affected, even though there has been no substantive change in objective facts between the current year and previous years.

Taxation issues

The Tax Office considers that arrangements as described in the alert may give rise to the following taxation issues, including whether:

- a) any transactions from the taxpayer's activity are covered by the capital loss provisions under Pt 3-1 of ITAA 1997;
- b) any losses incurred from the disposal may be allowed as a deduction under s 8-1;
- c) any transactions from the taxpayer's activity are covered by the trading stock rules under Div 70 of ITAA 1997;
- d) any losses incurred are able to be substantiated by evidence necessary to determine/support the intention of the acquisition as explained in TD 2007/2. In particular, whether records have been retained until the later of:
 - the end of the statutory record of retention period, eg s 262A(4) of ITAA 1936, or
 - the end of the statutory period of review for an assessment for the year of income when the tax loss is fully deducted or the net capital loss is fully applied;
- e) the general anti-avoidance rule contained in Pt IVA of ITAA 1936 may be applied to cancel any tax benefit under all, or some part, of the arrangement; and
- f) any entity involved in the arrangement may be a promoter of a tax exploitation scheme for the purposes of Div 290 of Sch 1 to the TAA.

Losses from disposal of shares

If a taxpayer is genuinely carrying on a share trading business, a deduction for a loss on the disposal of shares, which are trading stock, is unavailable. However, the corollary of being a share trader is that the taxpayer is allowed a deduction for expenses incurred on acquiring the shares under s 8-1. Any proceeds from the disposal of the shares will be assessed as ordinary income under s 6-5. The net position of these two transactions is that any losses will have been accounted for.

Conversely, if the shares are not trading stock, any actual losses arising from the shares will be governed by the CGT provisions: see also ATO ID 2001/174.

It is important to note that just because a taxpayer ‘deals’ in shares in some profit-making or commercial manner, it will not be enough to make the shares trading stock. For example, in *Investment and Merchant Finance Corporation Ltd v FCT* (1971) 2 ATR 361, Walsh J stated that: ‘... I do not assert, of course, that shares are always trading stock in the hands of their owner, even where the owner is a dealer in shares, circumstances may show that particular shares are not trading stock...’

In short, the case law clearly provides that shares (and other assets) will only be considered to be ‘trading stock’ when they are acquired and disposed of in the course of carrying on a business. This is succinctly stated by the Commissioner in Taxation Determination TD 92/124 (albeit in relation to land) as follows:

‘Land is treated as trading stock for income tax purposes if:

(a) it is acquired for the purpose of resale; and

(b) a business activity which involves dealing in land has commenced.’

For a speculator, the tax treatment of losses arising from the disposal of shares is different. Generally, such losses will not be deductible. For example, in *AATA Case 6297* (1990) 21 ATR 3747, the AAT said that:

The term ‘share trader’ was used to describe a person who dealt in shares such that his transactions had the character of a continuing business enterprise, whereas a ‘speculator’ in the stock market was a person whose speculations were in the nature of individual forays in particular stocks with a view to resale ... The question of whether the taxpayer was a share trader or a speculator was essentially one of fact. The following factors were relevant:

(a) repetition and regularity in the buying and selling of shares;

(b) turnover;

(c) whether the taxpayer operated to a plan, setting budgets and targets and keeping records;

(d) maintenance of an office;

(e) accounting for the share transactions on a gross receipts basis;

(f) whether the taxpayer was engaged in another full time professional ...

It was necessary to consider not only the taxpayer’s subjective intent, but also the objective surrounding circumstances.

The Tribunal concluded that the taxpayer’s share activities did not amount to carrying on a business and that, as a result, the taxpayer was not entitled to a deduction for losses arising from the disposal of his shares.

Furthermore, in ATO ID 2002/951 the Commissioner ruled that a speculator was not entitled to a revenue deduction for losses under s 25-40 of ITAA 1997 on the sales of post-CGT shares. Interestingly, the Commissioner did not discuss the deductibility of the losses under s 8-1, nor whether the losses were capital in nature.

The deductibility of losses on shares under s 8-1 will, arguably, depend on how the shares are characterised, that is, as capital or revenue. This is because s 8-1 prescribes that a taxpayer can only deduct a loss to the extent it was incurred in gaining or producing assessable income or in the carrying on of a business for the purpose of gaining or producing assessable income. But importantly, a deduction is denied if the loss is capital or of a capital nature. Put simply, a taxpayer will be eligible to deduct a loss if one of the positive limbs of s 8-1 is satisfied, and the negative limb is not invoked — even if the shares are post-CGT assets.

The determination of whether an expense or outgoing is on capital or revenue account has been the subject of never ending litigation, with no clear cut answer. Rather, court decisions provide tests or indicators to assist the classification. It is important to note that no one test or indicator is conclusive. Equally important, the absence of an indicator does not imply an expense is capital or revenue. Instead, the classification of the expense requires an objective consideration of all the circumstances surrounding it. In the classical statement on the issue in *Sun Newspapers Ltd v FCT* (1938) 61 CLR 337, Dixon J stated that:

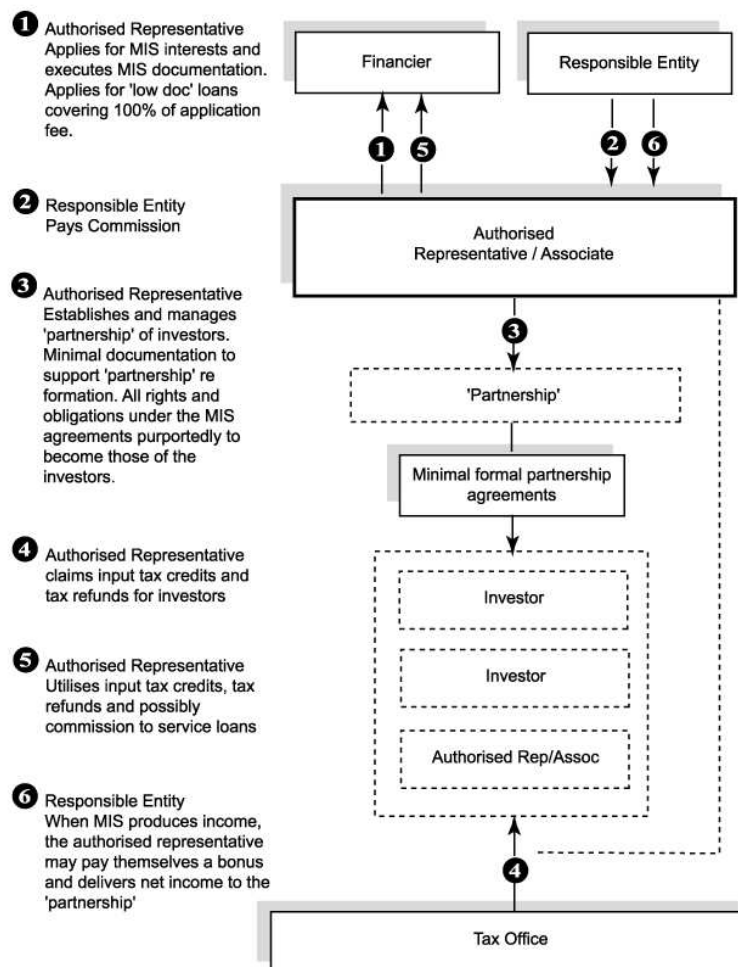
'The distinction between expenditure and outgoings on revenue account and on capital account corresponds with the distinction between the business entity, structure or organisation set up or established for the earning of profit and the process by which such an organisation operates to obtain regular returns by means of regular outlay ... In the same way expenditure and outlay upon establishing, replacing and enlarging the profit-yielding subject may in a general way appear to be of a nature entirely different from the continual flow of working expenses which are or ought to be supplied continually out of the returns or revenue.'

Managed investment schemes — purported partnership participation

In Taxpayer Alert TA 2009/13, the Tax Office advises that it has seen attempts by promoters to sell interests in managed investment schemes (MIS) to groups of individual investors on the basis that they will be 'partners' in a partnership and will be able to claim upfront deductions for their interests in the MIS. The alert also reminds taxpayers they can only rely on a product ruling if it is implemented in accordance with the arrangement in that product ruling and warns that partnerships of the type in this alert are not covered by Tax Office product rulings or other tax clearances.

Diagram of arrangement

The features of arrangements to which the alert applies can be summarised diagrammatically as below:



Source: Taxpayer Alert TA 2009/13

Taxation issues

The Tax Office considers that arrangements as described in the Alert may give rise to the following taxation issues, including whether:

- such an arrangement (or certain steps within it) is a sham to which the general anti-avoidance provisions in Pt IVA of ITAA 1936 may apply;
- there is any 'partnership' under general or taxation law, either in the first year of income or at any later time;
- the interests in the MIS have been taken up by or on behalf of any such 'partnership';
- the investors are entitled to deductions under s 8-1 of ITAA 1997 or under s 92 of ITAA 1936 in respect of losses;
- the investors are entitled to offset losses from investment in the MIS against other assessable income as governed by Div 35 of ITAA 1997;
- the investors are entitled to a share of the income from the MIS which is assessable under s 6-5 of ITAA 1997;
- the tax treatment of any disposal of an MIS interest is subject to ss 82KZMGA or 82KZMGB of ITAA 1936;
- the commission fees received by the representative are assessable under s 6-5;
- the representative is entitled to deductions under s 8-1 for amounts contributed to the 'partnership';

- the investors or their representative are entitled to input tax credits under s 11-20 of the *A New Tax System (Goods and Services Tax) Act 1999*;
- any entity involved in the arrangement is a promoter of a tax exploitation scheme for the purposes of Div 290 of Sch 1 to the TAA;
- any entity involved in the arrangement has implemented a product ruling scheme in a materially different way for the purposes of Div 290;
- any criminal offences have been committed by the investors, the representative or any associates in relation to the arrangement; and
- a registered tax agent involved in the arrangement may have their registration suspended or cancelled by the Tax Agents' Board under s 251K of ITAA 1936.

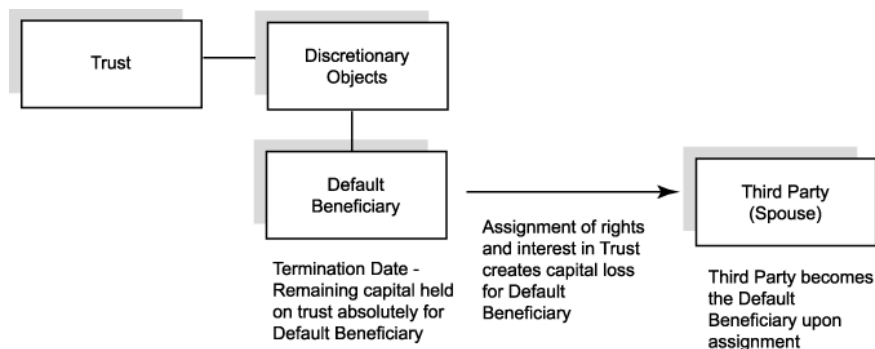
The Tax Office also states that where there appears to have been backdating of the documents criminal prosecution action may be considered against a taxpayer.

Capital losses and default beneficiary arrangements

The Tax Office has issued Taxpayer Alert TA 2009/14 in which it describes arrangements where a taxpayer with a current or future capital gain attempts to artificially create an offsetting capital loss by becoming a default beneficiary for a discretionary trust (for no consideration) and then transferring its interest in that trust (for no consideration).

Description of arrangement

The features of arrangements to which the alert applies to can summarised diagrammatically as below:



Source: Taxpayer Alert TA 2009/14

Issues under consideration

The Tax Office considers that arrangements as described in the alert may give rise to the following taxation issues, including whether:

- a valid trust has been created at general law;
- any subsequent purported assignment is valid at general law;
- the assignment of a default interest in the capital of a trust will trigger either CGT event E8 (ie disposal of capital interest by a beneficiary) or CGT event A1 (ie disposal of a CGT asset) happening to the holder of the interest and the calculations associated with such an event;
- a default interest in the capital of a trust constitutes an 'interest in the trust capital' for the purposes of CGT event E8 and the appropriate valuation of such an interest;
- the arrangement may constitute a scheme to which the general anti-avoidance rules in Pt IVA of ITAA 1936 may be applied to cancel a relevant tax benefit; and
- any entity involved in the arrangement may be a promoter of a tax exploitation scheme for the purposes of Div 290 of Sch 1 to the TAA.

Legal status of a Taxpayer Alert

A Taxpayer Alert is only intended to be an ‘early warning’ of a tax planning arrangement that the Tax Office has under risk assessment. However, it is expected that a ruling or determination will be issued by the Tax Office following the release of the alert.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in an alert can seek a formation determination of the Tax Office’s position through a private ruling.

Deductibility of Self-education Expenses

The Commissioner has lodged an appeal against the Federal Court’s decision in *Anstis v FCT* [2009] FCA 286.

The Tax Office has issued a notice in which it states that it will continue to apply the Commissioner’s established view contained in Taxation Ruling TR 98/9. That is, self-education expenses are not deductible against various Commonwealth education assistance schemes.

Note that self-education expenses deduction is one of the areas that the Tax Office has flagged in its 2008/09 Compliance Program.

WorkCover Data Matching Project

The Tax Office has announced that it will request and collect business names and addresses from each state’s and territory’s WorkCover authority for the 2007 and 2008 calendar years.

According to the Tax Office, records relating to approximately 1,573,128 entities registered with the relevant Authority will be matched. These details will be electronically matched with certain sections of its data holdings to identify non-compliance with registration, lodgment and payment obligations under the taxation law.

The Tax Office says that the data matching will enable it to:

- identify people outside the taxation system;
- verify the accuracy of information provided by taxpayers;
- address non-compliance with lodgment and debt payment; and
- be more strategic in its business activities.