

client alert | explanatory memorandum

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SMSF and financial assistance to members

The Tax Office has released Self Managed Superannuation Funds Ruling SMSFR 2008/1, which explains the prohibition on trustees of self-managed superannuation funds (SMSFs) giving financial assistance using the resources of the fund – to a member of an SMSF or relative of the member under section 65(1)(b) of the SIS Act.

(Note that the Ruling was previously released as Draft SMSFR 2007/D2.)

Financial assistance prohibition

According to the Commissioner, financial assistance given to a member of an SMSF or a relative of a member will contravene section 65(1)(b), regardless of whether or not such assistance was requested.

Financial assistance can take the form of the giving of a guarantee, indemnity, security or charge or the taking on of an obligation, or any other arrangement that, on an objective assessment, is in substance to provide financial assistance to a member or relative of a member, using the resources of the SMSF. Section 65(1)(b) can also apply if financial assistance is indirectly given to a member or relative through a third party.

Using resources of the fund

For section 65(1)(b) to apply, the assistance must be given using the resources of the fund. It is the Commissioner's view that the resources of an SMSF are used if an arrangement or transaction relies on the assets of the SMSF, whether or not there is a positive, negative or nil effect on the net assets as a result of that arrangement or transaction. Therefore, financial assistance using the resources of the SMSF can include any arrangement or transaction whereby the assets of the SMSF are converted into other assets, diverted, diminished or put at risk, or there is prejudice to the financial position of the SMSF.

Assistance given to member/relative

While the assistance given must be to "a member of the fund or a relative of a member of the fund", the Tax Office states that section 65(1)(b) can apply if the financial assistance is indirectly given to a member or relative through a third party. That is, the financial assistance can be indirectly given to a member or relative if the SMSF enters into an arrangement with some other entity whereby SMSF resources are used to give financial assistance to a member or a relative through that other entity.

Examples of contraventions

The Ruling states that the following arrangements and transactions involving a member or relative of an SMSF contravene section 65(1)(b) by their very nature:

- giving a gift of an SMSF asset to a member/relative;
- selling an SMSF asset for less than its market value;
- purchasing an asset for greater than its market value;
- acquiring services in excess of what the SMSF requires;
- paying an inflated price for services acquired;
- forgiving a debt owed to the SMSF by a member/relative;
- releasing a member/relative from a financial obligation owed to the SMSF, including where the amount is not yet due and payable;
- delaying recovery action for a debt owed to the SMSF by a member/relative;
- satisfying, or taking on, a financial obligation of a member/relative;
- giving a guarantee or an indemnity for the benefit of a member/relative;
- giving a security or charge over SMSF assets for the benefit of a member/relative.

Factors suggesting a contravention

Whether the arrangement or transaction contravenes section 65(1)(b) depends on whether the arrangement or transaction, assessed objectively in light of commercial reality and having regard to the facts of the particular case, is in substance a financing arrangement providing financial assistance to a member or relative using the resources of the SMSF.

Factors that indicate to the Commissioner that an arrangement or transaction is in substance a financing arrangement providing financial assistance to a member or a relative using the resources of an SMSF include:

- the arrangement or transaction exposes the SMSF to a credit risk, or exposes the SMSF to a financial risk, of a member/relative;
- the arrangement or transaction is on non-arm's length terms that are favourable to a member/relative;
- the arrangement or transaction is not a usual or normal commercial arrangement in the context in which SMSFs operate;
- the arrangement or transaction is not consistent with the investment strategy of the SMSF;
- under the arrangement or transaction an amount is paid by the SMSF, and later repaid to the SMSF, in amounts or in a manner that may be equated with the repayment of a loan whether with or without an interest component;
- the arrangement or transaction results in a diminution of the assets of the SMSF, whether immediately or over a period of time.

Indirect use of SMSF resources

The Commissioner states that there is a sufficient connection between the financial assistance given by another entity to a member or relative and using the resources of an SMSF to give that financial assistance if:

- the financial assistance would not have been given by the entity had the SMSF not entered into an arrangement with the entity that relies on SMSF resources;
- the entity is in effect passing on financial assistance given to it by the SMSF. This also includes money or assets flowing from the SMSF through a chain of related entities to a member or a relative of a member of the SMSF; or

- there is something else to indicate that financial assistance given by the entity relied upon, or was in some way conditional or dependent upon, SMSF resources.

For example, financial assistance is indirectly given to a member or relative of a member of an SMSF if the SMSF agrees to sell an asset (at market value) to another entity and as part of that arrangement, the other entity releases the member or relative from a financial obligation owed to it by the member or relative.

Assistance via unrelated entities

The Rulings states the section is not contravened if an SMSF invests on commercial terms in an unrelated entity and that unrelated entity, independently of the SMSF and in its own right and from its own resources, gives financial assistance to a member or relative.

Financing and leasing arrangements

In the Commissioner's view, an arrangement that is in substance a financing arrangement, although not a lending of money as prohibited by section 65(1)(a), is prohibited by section 65(1)(b). However, the Commissioner does not consider that all leasing arrangements would contravene section 65(1)(b).

Business real property

Although an SMSF may acquire business real property from a member or relative under section 66(2) of the SIS Act and lease it to a member or relative, the Commissioner warns that such arrangement must still not contravene section 65(1)(b).

Other issues

The Commissioner notes that the Ruling does not deal with the prohibition on the lending of the monies of an SMSF to a member or relative under section 65(1)(a). Nor does it provide the Commissioner's views on how other provisions in the SIS Act may apply to any of the arrangements discussed in the Ruling. For instance, an SMSF trustee must also comply with the other requirements of the SIS Act, including:

- the sole purpose test under section 62 of the SIS Act;
- the fund's investment strategy;
- the prohibition on acquiring assets from related parties: section 66 of the SIS Act;
- the prohibition on in-house assets with a market value in excess of 5% of the total market value of the SMSF's assets;
- the investments maintained on an arm's length basis: section 109 of the SIS Act;
- the trustee's duties under section 52(2) of the SIS Act; and
- the prohibition on borrowing or placing a charge over fund assets or assigning a superannuation interest.

Date of effect

The Ruling applies to SMSFs (and former SMSFs) for all income years.

Legal status

The Ruling represents the Commissioner's views about the way in which provisions of the SIS Act, or regulations under that Act, apply to SMSFs.

The Ruling is not legally binding on the Commissioner. However, if the Commissioner later takes the view that the law applies less favourably to a taxpayer than the Ruling, the fact that the taxpayer acted in accordance with the Ruling would be a relevant factor in the Commissioner exercising his discretion as to what action to take in response to the breach of that law.

SMSF and sole purpose test

The Tax Office has also released Self Managed Superannuation Funds Ruling SMSFR 2008/2, which outlines the Commissioner's approach to the application of the sole purpose test under section 62 of the SIS Act.

In particular, the Ruling sets out the factors that the Commissioner will consider in determining whether the provision of an incidental, remote or insignificant benefit by a self-managed superannuation fund (SMSF) amounts to a breach of the sole purpose test.

(Note that this Ruling was previously released as Draft SMSFT 2007/D1.)

Sole purpose test

The sole purpose test is a fundamental aspect of the regulation of superannuation funds which prohibits trustees from maintaining an SMSF for purposes other than the core or ancillary purposes specified in section 62 of SIS Act. The core purposes essentially relate to providing retirement or death benefits for, or in relation to, fund members. The SMSF can also be maintained for one or more of the core purposes and other specified ancillary purposes, which relate to the provision of benefits on the cessation of a member's employment and other death benefits not specified under the core purposes. However, a trustee who maintains an SMSF for other purposes contravenes section 62.

The Tax Office warns that a strict standard of compliance is required under the sole purpose test, requiring exclusivity of purpose, which is a higher standard than the maintenance of the SMSF for a dominant or principal purpose.

Incidental benefits

The Ruling acknowledges that the provision of incidental benefits that fall outside the scope of the core or ancillary purposes specified in section 62 (e.g. retirement, employment termination or death benefits) may occur in certain circumstances, particularly as an inherent or unavoidable consequence of otherwise legitimate activities of the SMSF.

Nevertheless, the provision of benefits other than those specified in section 62 that are incidental, remote or insignificant does not of itself displace an assessment that the trustee has not contravened the sole purpose test. Rather, the Ruling says that determining whether benefits are incidental, remote or insignificant requires the circumstances surrounding the SMSF's maintenance to be viewed holistically and objectively.

Relevant factors for consideration

The Tax Office says that determining the purpose for which an SMSF is being maintained requires a survey of all of the events and circumstances relating to the SMSF's maintenance. The Commissioner also indicates that the sole purpose test is particularly concerned with how a trustee of an SMSF came to make an investment or undertake an activity, which is likely to vary from trustee to trustee.

While all of the facts and circumstances associated with the maintenance of the SMSF are relevant in deciding if the trustee has complied with the sole purpose test, the Tax Office lists factors that commonly arise in considering whether the provision of benefits not specified in section 62 contravenes the sole purpose test.

Factors suggesting a contravention

Factors the Commissioner considers weigh in favour of a conclusion that an SMSF is not being maintained in accordance with the sole purpose test are:

- the trustee negotiated for, or sought out, the benefit (even if the additional benefit is negotiated for, or sought out, in the course of undertaking other activities that are consistent with section 62);
- the benefit has influenced the decision-making of the trustee to favour one course of action over another;

- the benefit is provided by the SMSF to a member or another party at a cost or financial detriment to the SMSF; or
- there is a pattern or preponderance of events that, when viewed in their entirety, amount to a material benefit being provided that is not specified under section 62.

Factors suggesting no contravention

Factors that weigh in favour of the Commissioner reaching a conclusion that an SMSF is being maintained in accordance with the sole purpose test, despite the provision of benefits not specified in section 62, are:

- the benefit is an inherent or unavoidable part of other activities that are consistent with the provision of benefits under section 62;
- the benefit is remote or isolated, or is insignificant (whether it is provided once only or considered cumulatively with other like benefits) when assessed in light of other activities undertaken by the trustee that are consistent with section 62;
- the benefit is provided by the SMSF on arm's length commercial terms (e.g. if the benefit is provided at market value), consistent with the financial interests of the SMSF and at no cost or financial detriment to the SMSF;
- all of the activities of the trustee are in accordance with the covenants set out in section 52 of the SIS Act (e.g. in the best interest of the beneficiaries and exercised with the same degree of care, skill and diligence as an ordinary prudent person would exercise in dealing with property of another for whom the person felt morally obliged to provide);
- all of the SMSF's investments and activities are undertaken as part of, or are consistent with, a properly considered and formulated investment strategy.

Examples

The Ruling notes that investments consisting of collectables and other boutique items such as works of art, antiques, jewellery, classic cars and wine, pose particular issues in relation to the application of the sole purpose test. The Commissioner considers that these kinds of assets lend themselves to personal enjoyment and, therefore, can involve significant "current day benefits" being derived by those using or accessing the asset. As a result, the Commissioner says trustees should be in a position to show (e.g. by reference to independent expert opinion) how acquiring assets of this kind involves a reasonable investment for the SMSF.

The Ruling sets out 16 examples demonstrating the Commissioner's approach to determining whether the provision of an incidental benefit amounts to a breach of the sole purpose test. The examples consider SMSF investments in:

- holiday apartments through a property syndicate involving incidental upgrade rights;
- shares in a golf club with assignable membership rights attached;
- the use, lease and loaning of artwork;
- shareholder discount cards (which result in reduced dividend rights);
- instalment warrant arrangements involving limited recourse borrowing from a related party at excessive rates; and
- overseas properties that come with reimbursement of travel expenses incurred on inspecting them.

Date of effect

The Ruling applies to SMSFs (and former SMSFs) for all income years.

Discussion of the sole purpose test

The objective of the sole purpose test is to limit the provision of superannuation benefits by an SMSF to a range of prescribed retirement or retirement related circumstances. Section 62 requires that a fund must be maintained for at least one core purpose, or at least one core purpose and one ancillary purpose. A trustee who maintains a fund only for one or more ancillary purposes will contravene the test. Essentially, the core purposes are:

- the provision of benefits on or after a member's retirement;
- the provision of benefits for a member upon attaining 65 years of age; or
- the provision of benefits to a deceased member's dependant or legal personal representative, provided that the death occurs before the member retires or attains 65 years of age.

Essentially, ancillary purposes are purposes that a fund may maintain in conjunction with at least one of the core purposes and are as follows:

- the provision of benefits for a member on or after termination of employment from an employer who had, or any of whose associates had, at any time contributed to the fund in relation to the member;
- the provision of benefits for a member on or after the member's temporary or permanent cessation of work because of physical or mental ill-health;
- the provision of benefits to a deceased member's dependents or legal personal representative, provided that the member dies after retiring or attaining 65 years of age; and
- the provision of other ancillary benefits as the Australian Prudential Regulation Authority (APRA) approves in writing.

The operation of the test must not be viewed in a vacuum but in conjunction with the payment standards as prescribed by Part 6 of the SIS Reg.

In Superannuation Circular No III.A.4, APRA states that a fund's governing rules, procedures and practices are the primary sources for judging whether it is maintained consistently with the sole purpose test. The fund's intentions may also be determined by its planning and corporate governance documents.

In Case No V94/447 31 ATR 1067, the AAT stated that the legislation expressly requires that a strict standard of compliance should be adhered to. This entails more than the presence of a dominant or principal purpose. Further, the test requires an exclusivity of purpose commensurate with that purpose being the "sole purpose".

The consequences of breaching the test are dire and may result in the Tax Office undertaking enforcement actions. Several options are available to the Tax Office, which includes a fund receiving non-complying status, the assets of a fund being frozen, and the trustee being suspended or removed.

A trustee can be prosecuted under the civil penalty provisions of Pt 21 of the SIS Act. If a trustee is found guilty of a civil and/or criminal offence, the maximum penalties which may apply are a fine of \$220,000 (for civil penalties) and 5 years imprisonment (for criminal proceedings).

Notwithstanding that a fund has contravened the SIS Act, the Tax Office has the discretion to allow a fund to maintain its complying status after taking into consideration:

- the taxation consequences that would arise if the fund was treated as non-complying;
- the seriousness of the contravention; and
- all other relevant circumstances.

Withdrawal of related ATO IDs

The Tax Office has withdrawn the following ATO IDs with effect from 18 July 2008, as they have been superseded by the Ruling:

- ATO ID 2004/248: Investment in art by an SMSF;
- ATO ID 2004/249: Investment in art by an SMSF and its display; and

- ATO ID 2004/250: Investment in art by an SMSF - in-house asset.

Self-education expenses

In a recent case, the AAT affirmed the Commissioner's decision to deny a taxpayer a deduction for self-education expenses: *AAT case [2008] AATA 606, Re Southwell-Keely and FCT*. The Commissioner had disallowed the taxpayer's claim for self-education expenses for the years ending 30 June 2004 and 2005. The expenses were the payment of fees to Southern Cross University for a Bachelor of Business in Hotel Management. The course initially required 500 hours of practical experience which was undertaken at the Hotel Intercontinental in Sydney.

After completing his compulsory 500 hours of industry placement, the taxpayer continued working at the Hotel Intercontinental while at the same time completing his degree. During his time at the hotel, the taxpayer's career progressed. The taxpayer claimed that his course was relevant to his progression at the Intercontinental Hotel. However, he conceded that it was not a condition of his continued employment at the Hotel that he continued his studies and that his rate of pay was determined by his job scope, not his formal qualifications.

The AAT held that the taxpayer had not shown that the expenses were incidental and relevant to the gaining of assessable income. In addition, the expenses did not have the essential character of an outgoing incurred in gaining assessable income. The Tribunal considered that the expenses were concerned with the gaining of employment in the future and, therefore, not deductible.

Legislative background

Generally, self-education expenses are deductible if there is a sufficient connection with the taxpayer's income-producing activities. Based on case law,

- expenses incurred in maintaining or improving the taxpayer's skills and knowledge in her or his present occupation should be deductible, particularly if they are likely to lead to a pay increase;
- the cost of acquiring knowledge is not of itself an outgoing of a capital nature; and
- self-education expenses incurred before employment commences or to obtain new employment are not deductible.

The Tax Office's views on the deductibility of self-education expenses are set out in Taxation Ruling TR 98/9.

Tax Office's focus

In a recent speech, Second Commissioner Jennie Granger gave an "early bird" view of some of the areas that the Tax Office's Compliance Program 2008-09 will focus on. In addition, Ms Granger provided an overview of the Tax Office's tax time focus for individuals and small business. According to Ms Granger, one of the areas that the Tax Office will be looking at is anomalous or "out of pattern" claims for self-education expenses.

Withdrawal of related ATO IDs

The Tax Office has withdrawn the following ATO IDs with effect from 25 July 2008, as they have been superseded by TR 98/9:

- ATO ID 2001/43: Self-education expenses – Postgraduate study overseas;
- ATO ID 2002/506: Self-education expenses – Receives tax-free scholarship and employed part-time in field of study; and
- ATO ID 2002/901: Self-education expenses – Deductibility of meals and accommodation.

Business establishment costs

In two related but separate ATO IDs, the Tax Office deals with the deductibility of business establishment costs for a business proposed to be carried on under section 40-880(2) of ITAA 1997.

Business proposed to be carried on

In ATO ID 2008/107, the Tax Office states that a taxpayer was entitled to a deduction under section 40-880(2) for capital expenditure incurred for a business "proposed" to be carried on. This was because the taxpayer had demonstrated a commitment of some substance to commence the proposed business. Furthermore, there existed sufficient identity about the business to be carried on. Accordingly, it was reasonable to conclude the business was proposed to be carried on within reasonable time.

Facts

The taxpayer incurred capital expenditure to incorporate a company where the taxpayer was a director and shareholder. Within two months of its incorporation, the company:

- entered into a lease agreement for business premises and pre-paid 2 months' rent;
- purchased materials to fit out the business premises;
- entered into an agreement with another entity for the supply of services clients;
- printed letterhead and business cards, and had keys cut for the premises; and
- insured the business premises.

However, the company never traded and the taxpayer resigned as director after several months. Therefore, the business never did commence trading.

Business not proposed to be carried on

In ATO ID 2008/108, the Tax Office states that a taxpayer who incurred capital expenditure travelling to another country to investigate the viability of a business venture in that country was not entitled to a deduction under section 40-880(2). This was because the taxpayer had failed to demonstrate that, at the time the expenditure was incurred, there existed sufficient identity about the business proposed to be carried on.

Facts

Prior to incurring the expenditure, the taxpayer conducted research into the viability of a business venture in another country and developed a business plan. At the time the taxpayer incurred the expenditure, various decisions as to the business entity, activities, etc, had not been made. Following the taxpayer's return to Australia, a decision was made not to proceed with the business venture.

Legislative background

Section 40-880 of ITAA 1997 provides a deduction for certain business expenditure (commonly termed as "blackhole" expenses) that is incurred on or after 1 July 2005, which is deductible on a straight-line basis over five years. No apportionment is necessary for expenditure incurred part-way through the year.

For a business expenditure to qualify for a deduction under this section, it must not be deductible under any other provisions in the income tax law and not expressly made non-deductible (other than because the expenditure is of a capital nature).

The deduction under section 40-880 can apply to a business that is proposed to be carried on by any entity (pre-business expenditure). For pre-business expenditure to be deductible, it is important to give regard to any relevant circumstance and reasonably conclude that the proposed business will be carried on within a reasonable time: section 40-880(7).

The Explanatory Memorandum accompanying the Tax Laws Amendment (2006 Measures No 1) Bill 2006, which introduced the rewritten section 40-880, states that:

2.25 The provision is concerned with expenditure that has the character of a business expense because it is relevantly related to the business. The concept used to establish this character or requisite relationship between the expenditure incurred by the taxpayer and the business carried on (current, past or prospective) is 'in relation to'. The connector 'in relation to' allows the appropriate latitude to enable the deductibility of qualifying capital expenditure incurred before the business commences or after it has ceased.

2.31 For a business to be proposed to be carried on for the purposes of this provision, the taxpayer needs to be able to demonstrate a commitment of some substance to commence the business, and sufficiently identify about the business that is proposed to be carried on. The deductibility of expenses in advance of the business being carried on will rest **on the facts on each case, but this commitment and identity must be tangible; that is, there would need to be some evidence that would enable an objective assessment of the existence of that commitment and identity.** [Emphasis added]

2.33 Such commitment could be shown by, but is not limited to, at least some of the following:

- a business plan;
- the establishment of a business premises;
- research into the likely markets or profitability of the business; and
- capital investment in assets of the business.

The Tax Office considers that these paragraphs from the EM indicate that capital expenditure incurred on a proposed business to be carried on is established at the time when the expenditure is incurred. Accordingly, it is important that a taxpayer demonstrate a commitment of some substance to commence the business and develop sufficient identity about the business proposed to be carried on before the expenditure can be deductible.

Note that pre-business expenditure such as the cost of a feasibility study and market research and post-business expenditure incurred as a consequence of the business ceasing to operate are also deductible.

TPD premium deductions

In the minutes to the NTLG Superannuation Technical Sub-group meeting held on 31 March 2008, the Tax Office stated its preliminary view on the deductibility for premiums paid for total and permanent disability (TPD) insurance, where the policy was held through a superannuation fund.

Under the now repealed sections 297 and 279 of ITAA 1936, a superannuation fund was entitled to a deduction for premiums paid if the premiums were in respect of policies that provided benefits to members in the event of their permanent disability. As the term "permanent disability" was not defined in ITAA 1936, many superannuation funds interpreted it as covering a range of different TPD definitions.

The sections governing the deductibility of TPD premiums have been rewritten in sections 295-460 and 295-465 of ITAA 1997. Under section 295-465 of ITAA 1997, a complying superannuation fund may claim a deduction for a portion of any premiums for an insurance policy related to death or disability benefits. Generally, the portion varies depending on the type of policy involved. The specific percentages are referred to in the table in section 295-465(1) of ITAA 1997.

Section 995-1 of ITAA 1997 specifically defines "disability superannuation benefit" as a superannuation benefit if:

- the benefit is paid to a person because the person suffers from ill-health (whether physical or mental); and
- two legally qualified medical practitioners have certified that, because of the ill-health, it is unlikely that the person can ever be gainfully employed in a capacity for which he or she is reasonably qualified because of education, experience or training.

It is common that the definition contained in section 995-1 differs from that in a TPD policy, which leads to the issue of whether the premiums will be deductible.

The Tax Office in the meeting stated that it will be necessary for the definition in a TPD policy to be aligned with that of section 995-1 in order for a superannuation fund to be able to claim the premiums as a deduction. Where the benefits provided by the TPD policy are not aligned to the benefit definitions in section 295-460, a portion of the premium may be deductible as determined under either item 5 or item 6 of section 295-465, which may require an actuarial certificate to be obtained prior to the deduction.

Decision Impact Statement on "Shed case"

The Tax Office has released a Decision Impact Statement (DIS) outlining its view on the application of the CGT main residence exemption following the decision of the AAT in *Re Summers and FCT* [2008] AATA 152. The Tribunal had held that a taxpayer's shed qualified as a main residence despite the fact that the taxpayer only moved her bed into the premises that had no electricity or gas connected (the shed had mains water and sewerage connected).

While the Tax Office views the decision of the Tribunal to be partly adverse, it has accepted the decision. The Tax Office has stated that the decision reinforces its view in TD 51 that the relevance and weight to be given to any factor in determining whether a dwelling is a taxpayer's main residence will depend upon the circumstances of each case.

(The case and TD 51 were discussed in the April 2008 edition.)

Compliance matters

Marine vessels and data matching

The Tax Office has announced that it will request and collect details of taxpayers who registered a marine vessel with the following State marine vessel registering bodies:

- NSW Maritime Authority;
- Maritime Safety Queensland;
- Marine Safety Victoria;
- Marine and Safety Tasmania;
- Department for Transport, Energy and Infrastructure (Safety and Regulation Division) (SA); and
- Department for Planning and Infrastructure (Marine Safety) (WA).

The Tax Office says the details will be electronically matched with certain sections of its data holdings to identify non compliance with lodgment and payment obligations under taxation law. In cases where a marine vessel (usually a commercial vessel) is operated by an agent, the Tax Office says it will pursue the outstanding tax lodgments of the agent and owner, as both parties are deriving benefits from the asset. According to the Tax Office, the ownership of a commercial or recreational marine vessel may be an indicator of conspicuous unreported wealth. Records relating to approximately 160,000 persons or entities will be matched.

Cash transactions and businesses

In its effort to combat the cash economy, the Tax Office will send 37,000 letters to businesses in the retail, construction and consumer service industries that have high volumes of cash transactions throughout July and August. It has stated that the letters outline the assistance available for businesses, including practical tools that can help with record keeping. In addition, the letters explain how the Tax Office selects businesses for review.

The Tax Office has stated that while it is not conducting a review of the businesses at this juncture, it has identified that those businesses may be under financial stress, may have outstanding tax liabilities, or the information that the businesses have reported may be outside the normal ratios.

As a follow-up measure, the Tax Office will send a further 7,000 letters throughout September and October. The bulk of the letters will be sent to businesses that it has identified as likely to present risks in connection with cash economy participation. The remainder of the letters will be sent to the businesses' tax agents, alerting the agents that they may have clients in this position.

The Tax Office has said that it is likely that some of the businesses identified under this compliance program will be subject to further review. Therefore, it encourages tax agents to discuss any potential compliance issues with their clients identified under this program.

Outstanding lodgments

The Tax Office has said that tax agents may soon receive a letter which includes a list of their clients who have outstanding income tax returns and/or activity statements. The letters are due to be issued on 1 August 2008. The list will include the names of clients who have:

- lodged or advised that they did not need to lodge their 2006 income tax returns and have not lodged their 2007 income tax returns - these clients will appear at the top of the list; or
- not lodged nor advised that they did not need to lodge their 2006 income tax returns and who may have other outstanding documents.

The Tax Office is asking tax agents to help ensure that all clients complete and lodge any outstanding documents as soon as possible. If clients do not need to lodge, the Tax Office asks tax agents to advise it immediately. If any of the clients listed have stopped using a tax agent's services, the Tax Office asks that the agent send it the last known business or residential address of affected clients through the Tax Agent Portal to ensure that the agent does not receive unnecessary correspondence.

Excess superannuation contributions

According to the draft minutes from the ATO Tax Practitioner Forum held on 16 May 2008, the Tax Office says that it has identified 7,588 "potential" cases of individuals exceeding the \$1 million cap on non-concessional superannuation contributions made during the transitional period from 12 May 2006 to 30 June 2007. However, the Tax Office acknowledged that the number of "actual" excess contributions tax assessments to be raised is likely to be less than the number of potential cases, once the Commissioner has been able to examine a number of factors, including:

- potential misreporting by funds and individuals;
- the exclusion of CGT and personal injury exemptions;
- amounts of pre-10 May 2006 contributions;
- employer contributions from multiple employers (noting that concessional contributions in excess of age based limits also counted towards the \$1 million cap); and
- the potential application of the Commissioner's discretion under PS LA 2008/1, and the potential availability of transitional release authorities.

To identify the actual excess contribution tax cases, the Tax Office said it will conduct a pilot investigation of 200 representative cases to assess the matter.

("Excess contributions tax" was discussed in the August 2008 edition.)

Transitional arrangement

Between 10 May 2006 and 30 June 2007, a transitional arrangement enabled taxpayers to contribute up to \$1 million of post-tax undeducted contributions into their superannuation funds, subjected to certain conditions.

A taxpayer who made after-tax contributions of more than \$1 million is liable for excess non-concessional contributions tax (at 46.5%) on the contributions above the threshold, unless the Commissioner exercises his discretion to disregard or reallocate the contributions to a different income year. This discretion only applies to all excess non-concessional contributions made between 10 May 2006 and 30 June 2007. The Commissioner has previously indicated that the discretion will only be exercised where circumstances must make it unjust, unreasonable or inappropriate to impose the liability for excess non-concessional contributions tax.

Minors and tax-free threshold

The low income tax offset of \$1,200 for 2008-09 has effectively increased the Division 6AA of ITAA 1936 tax-free threshold for the "unearned income" of an eligible resident minor to \$2,667 for 2008-09.

If the unearned income of a child is less than \$2,667 for 2008-09, taking into account the low income tax offset of \$1,200 under section 159N of ITAA 1936 (up from \$750 for 2007-08), no income tax return is required and no tax will be payable where the minor has no other taxable income.

There is no provision in section 159N that disqualifies a minor assessed at Division 6AA rates from entitlement to the tax offset. As a result, the Division 6AA tax-free threshold for the "unearned income" of minors is effectively increased from \$416 to \$2,667 for 2008-09 (up from \$1,667 for 2007-08).

The Division 6AA tax-free amount is calculated by dividing the low income tax offset under section 159N (i.e. \$1,200 for 2008-09) by the effective marginal rate for resident minors (i.e. 45% for the income range above \$1,307 where the offset will be operating under section 13 of *Income Tax Rates Act 1986*), i.e. $\$1,200 / 45\% = \$2,667$.

Resident minors Division 6AA income for 2008-09	
Division 6AA income (\$)	Tax payable
0 – 416*	Nil
417 – 1,307	66% of excess over \$416
1,308+	45% of entire amount

* The low-income tax offset may effectively increase the Division 6AA tax-free threshold for the unearned income of eligible resident minors from \$416 to \$2,667 for 2008-09.

Tax treatment of minors' income

The tax treatment of income derived by minors (i.e. those under 18) is set out in Part III of Division 6AA of ITAA 1936. Broadly, the Division applies to "prescribed persons". A "prescribed person" is a person who is under 18 on the last day of the income year and is not an "excepted person". The income to which Division 6AA applies is known as "eligible taxable income". The Division applies to all income of all minors unless a specific exclusion exists. For example, the minor might be excluded as an "excepted person" or be deriving "excepted assessable income".

Note that the assessability or deductibility of a minor's income is determined in the usual manner by the relevant provisions of ITAA 1936 and ITAA 1997. Division 6AA merely identifies that portion of assessable income which is to be taxed at the highest marginal rate.

The rates of tax applicable to minor are set out in the table above.

Excepted person

Under section 102AC(2) of ITAA 1936, an "excepted person" includes:

- a minor engaged in a full-time occupation on the last day of the income year;
- a minor in receipt of a disability support pension, or in respect of whom a carer allowance is payable, under the *Social Security Act 1991* (SSA) in respect of a period of time during the relevant year including the last day of the income year, or in receipt of a rehabilitation allowance under SSA and would otherwise be entitled to an invalid pension;
- a minor who the Commissioner is satisfied is, on the last day of the income year, a disabled child or a disabled adult within the meaning of Part 2.19 of SSA, a person with a continuing inability to work within the meaning of Part 2.3 of SSA or who is permanently blind (a medical certificate to that effect must be provided to the Commissioner);
- a minor in respect of whom a double orphan pension was payable under SSA, or would have been payable but for section 1003 of SSA (i.e. where the minor receives a pension under Part II or Part IV of the *Veterans' Entitlements Act 1986*), in respect of a period during the relevant income year including the last day of the year; and

- a minor who the Commissioner is satisfied suffers, on the last day of the income year, a permanent disability and, as a result, is unlikely to be able to engage in a full-time occupation (a medical certificate to that effect must be provided to the Commissioner).

As an integrity measure, section 102AC(8) of ITAA 1936 states that a minor will not be taken to be engaged in a full-time occupation on the last day of the income year (and thus will not be an "excepted person") unless the Commissioner is satisfied that, on the last day of the year, the minor intends to remain in a full-time occupation (or occupations) during the whole or a substantial part of the next succeeding income year and does not intend to engage in a full-time educational course at any time during the next succeeding income year.

Excepted assessable income

"Excepted assessable income" is excluded from the application of the special rates of tax that apply to income derived by a minor. Broadly, the categories of "excepted assessable income" are:

- employment income;
- business income;
- income from deceased estates;
- income from property (including money) received in relation to legal or "moral" claims;
- trust income included in a minor's assessable income under section 97 or section 100 of ITAA 1936, unless Division 6AA applies to that income;
- excepted trust income;
- partnership income;
- income derived from investing winnings, which are capable of verification, from a legally organised and conducted lottery; and
- income derived from investing "excepted assessable income", or income that would have been "excepted assessable income" if Division 6AA had operated in relation to the income year in which it was derived, and from investing exempt income which would have been "excepted assessable income" if it had been assessable income.

Transfer of overpaid income tax instalments

The Tax Office has announced that it has recently completed a review of credit balances on activity statement accounts, which are also referred to as integrated client accounts. The review identified that some credit balances were due to overpaid income tax instalments and were often for small amounts. The Tax Office has advised tax agents that any credit identified as an overpayment of income tax instalments has been transferred to their client's income tax account and will be included on their next income tax assessment as "Other amounts refundable".

The Tax Office says the credit amount can be viewed via the Tax Agent Portal by accessing the client's income tax and integrated client accounts. The credit will appear as "Credit transferred in from another account" on the income tax account and "Credit transferred out to another account" on the integrated client account. If tax agents who do not want the credit to issue in their client's next income tax assessment, a request for refund or transfer can be submitted via the Tax Agent Portal.