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Tax Laws Amendment (2004 Measures No. 1) Bill 2004

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Tax Laws Amendment (2004 Measures No. 1) Bill 2004

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Economics, Commerce and Industrial Relations Group
31 March 2004

Contents

The following abbreviations and acronyms are used in this Bills Digest.

Abbreviation	*Definition*
ABN	Australian Business Number
ABN Act	*A New Tax System (Australian Business Number) Act 1999*
ABN Regulations	*A New Tax System (Australian Business Number) Regulations 1999*
ABR	Australian Business Register
ATO	Australian Taxation Office
CBP	Prime Minister's Community Business Partnership
CGT	capital gains tax
Commissioner	Commissioner of Taxation
DAFGS	Diesel and Alternative Fuels Grants Scheme
DGR	deductible gift recipient
DFRS	Diesel Fuel Rebates Scheme
EGCS	Energy Grants (Credits) Scheme
EGCS Act	Energy Grants (Credits) Scheme Act 2003
EGCS(CA) Act	Energy Grants (Credits) Scheme (Consequential Amendments) Act 2003
FBT	fringe benefits tax
FBT Act	*Fringe Benefits Tax Assessment Act 1986*
GST	goods and services tax
GST Act	*A New Tax System (Goods and Services Tax) Act 1999*
ITAA 1997	*Income Tax Assessment Act 1997*
ITAA 1936	*Income Tax Assessment Act 1936*
Myer Report	*Report of the Contemporary Visual Arts and Craft Inquiry*
Registrar	Registrar of the Australian Business Register
TAA 1953	*Taxation Administration Act 1953*

Tax Laws Amendment (2004 Measures No. 1) Bill 2004

Date Introduced: 19 February 2004

House: House of Representatives

Portfolio: Treasury

Commencement: Formal provisions of the Bill commence on Royal Assent. The various measures contained in the Bill have various application dates, which are detailed in the Main Provisions section.

Purpose

There are 11 Schedules to this Bill and the main purpose of each Schedule is set out below.

1. **Schedule 1** will amend the ITAA 1936 to broaden the list of eligible medical expenses under the medical expenses tax offset to include payments made in maintaining properly trained dogs for guiding or assisting people with a disability.

2. **Schedule 2** will amend the income tax law to provide an income tax deduction for certain expenses incurred in travel between workplaces.

3. **Schedule 3** will amend the ITAA 1997 to improve the operation of the test that is used to determine when an entity controls a discretionary trust for the purpose of applying the small business CGT concessions.

4. **Schedule 4** will amend the transitional arrangements of the Energy Grants (Credits) Scheme (EGCS), which deal with the treatment of claims for fuel purchased in the three years preceding the introduction of the scheme. The changes will rectify an anomaly that may result in an unintended entitlement to concessional treatment in certain circumstances under the EGCS that did not previously exist in the schemes that it replaces.

5. **Schedule 5** will amend the ITAA 1997 to ensure that GST net input tax credits are excluded from the cost base, reduced cost base and other relevant amounts used for the purposes of working out the amount of a capital gain or capital loss.

6. **Schedule 6** will amend the *A New Tax System (Australian Business Number) Act 1999* (ABN Act) to put beyond doubt the scope of the purposes for which protected Australian Business Number (ABN) information is able to be disclosed to Commonwealth agency heads and States and Territories department heads.

7. **Schedule 7** will amend the income tax law to provide an income tax deduction for contributions of cash or property to a deductible gift recipient (DGR), where a minor benefit is received in return.

8. **Schedule 8** will amend the ITAA 1936 to ensure that a trustee cannot shelter trust income at the prevailing company tax rate by creating a present entitlement to a private company without paying it and then distributing the underlying cash to a shareholder of the company. The rules replace the former section 109UB of the ITAA 1936 that had a similar, but more limited, application.

9. **Schedule 9** will amend Part III of the ITAA 1936 to ensure a deduction available to certain resident companies for on-payments of certain unfranked or partly franked non-portfolio dividends to their wholly-owned foreign parents, continues to be available to taxpayers. This deduction was inadvertently made inoperative with the removal of the inter-corporate dividend rebate within wholly owned companies in connection with the introduction of the consolidated regime applying generally after 30 June 2003.

10. **Schedule 10** will amend the ITAA 1997 to require charities, including public benevolent institutions and health promotion charities to be endorsed by the Commissioner in order to access all relevant taxation concessions. The amendments in **Schedule 10** will also require any charity so endorsed to display their charitable status on the Australian Business Register (ABR).

11. **Schedule 11** will amend the ITAA 1997 to update the lists of specifically listed deductible gift recipients (DGRs).

Background

As there is no central theme to the Bill, the background to the various measures will be discussed under the Main Provisions section.

Main Provisions

Schedule 1 – Broaden the list of eligible medical expenses for the tax offset to include costs of maintaining trained dogs by disabled persons

Section 159P of the ITAA 1936 allows a tax offset at the rate of 20% of any net qualifying medical expenses (i.e. qualifying medical expenses less any reimbursements such as Medicare and private health insurance refunds) above $1500 in an income year.

Payments for maintaining properly trained dogs for people who are blind can now be claimed as medical expenses for this tax offset under paragraph 159P(4)(i). **Item 1** of **Schedule 1** of the Bill will repeal paragraph 159P(4)(i) and substitute **proposed paragraph 159(4)(i)** to extend the eligibility to payments for maintaining trained dogs to disabled persons generally.

Application

Item 2 of **Schedule 1** provides that this amendment is taken to have applied in relation to the 2002-03 income year and later income years.

Schedule 2 – Provide an income tax deduction for certain expenses incurred in travel between workplaces

The general deduction provisions in section 8-1 of the ITAA 1997 allow deductions for expenses incurred in gaining or producing assessable income or necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

Expenses incurred in travelling between two places of unrelated income-earning activity are not deductible under section 8-1 of the ITAA 1997 as decided by the High Court in *Payne's case*[1]. The High Court held that the expenses were not incurred in the course of earning income from either activity but rather incurred in the interval between the two activities.

Item 3 of **Schedule 2** inserts **proposed section 25-100** to the ITAA 1997 to allow a deduction for transport expenses incurred in travel between workplaces where:

- an individual incurs transport expenses in travelling directly between workplaces
- the purpose of the travel between workplaces is to earn assessable income at the second workplace, and
- the individual does not reside at either place.

Transport expenses deductible under this provision include transport expenses incurred in travel between:

- two places of employment
- two places of business, and
- a place of employment and a place of business.

Application

Item 11 of **Schedule 2** provides that these amendments apply to assessments for the income year 2001-2002 and each later income year as announced in the Treasurer's Press Release No 78 of 8 October 2001**.**

Schedule 3 – Small business CGT relief and discretionary trusts

A small business entity can access the small business CGT concessions in Division 152 of the ITAA 1997 only if it satisfies the maximum net asset value test in section 152-15. To pass the maximum net asset value test, the entity (together with its small business CGT affiliates and any connected entities) must not own assets with a total net value of more than $5 million.

Broadly, an entity is connected with another entity if either entity controls the other, or both entities are controlled by the same third entity.

The practical effect of the control test for a small business entity that operates through a discretionary trust is that the assets of all beneficiaries of the trust, whether potential or actual, are counted as assets of the entity for the purposes of applying the maximum net asset value test. The total net value of assets held by these actual and potential beneficiaries often exceeds $5 million. Consequentially, many small businesses that operate through a discretionary trust are technically unable to access the small business CGT concessions.

Item 4 of **Schedule 3** repeals the existing subsections 152-30(5) and (6) of the ITAA 1997 and substitutes **proposed subsections 152-30(5)** and **(6)** for the purpose of modifying the control test to ensure that an entity will be taken to control a discretionary trust only if, for any of the four income years before the income year for which access to the small business tax concession is sought:

- the trustee paid to, or applied for the benefit of, the entity and/or its small business CGT affiliates any income or capital of the trust, and

- the amount paid or applied to the entity and/or its small business CGT affiliates is at least 40% (the control percentage) of the total amount of income or capital paid or applied by the trustee for that income year.

As is the case with the control test for other entities, such as companies and fixed trusts, where the control percentage is between 40% and 50%, the Commissioner will have discretion to determine that the entity does not control the discretionary trust under amendments proposed by **item 3** of **Schedule 3**.

Application

Under **Item 7** of **Schedule 3** these amendments apply to CGT events happening after 11.45 am, by legal time in the Australian Capital Territory, on 21 September 1999. The maximum net asset value test in section 152-15 took effect from 21 September 1999 and the amendments will benefit discretionary trusts retrospectively.

Schedule 4 – Energy Grants (Credits) Scheme transitional arrangement

On 1 July 2003, the Energy Grants (Credits) Scheme (EGCS) came into effect. It replaced the Diesel and Alternative Fuels Grants Scheme (DAFGS) and the Diesel Fuel Rebate Scheme (DFRS) and largely adopted their provisions with some changes (see the Bills Digest for the Energy Grants (Credits) Scheme Bill 2003)[2]. The purpose of DAFGS was to reduce transport costs to business and particularly to benefit regional Australia. It provided grants for diesel and reduced the cost of alternative fuels such as ethanol, compressed natural gas and liquefied petroleum gas to maintain previous price relativities with diesel. The DFRS—which was also called the off-road scheme—provided a rebate of the excise on diesel and like fuels used in certain eligible activities. The commitment to introduce an EGCS was part of the Government's *Measures for a Better Environment* statement in May 1999. The Government undertook to introduce an energy credit scheme that would provide price incentives and funding for conversion from the dirtiest to the most appropriate and cleanest fuels.

The Schedules to the *Energy Grants (Credits) Scheme (Consequential Amendments) Act 2003* (EGCS (CA) Act) contain transitional provisions for the DAFGS and DFRS. For example, under the DAFGS transitional provisions of Schedule 2, DAFGS claims made under section 15 of the *Diesel and Alternative Fuels Grants Scheme Act 1999* before 1 July 2003 in respect of diesel or alternative fuel used during a grant period ending before 1 July 2003, remain subject to the *Diesel and Alternative Fuels Grants Scheme Act 1999* as if it had not been amended by the EGCS (CA) Act.

An unintended consequence of these arrangements has been the possible creation of entitlements under the EGCS that did not exist under the previous schemes.

Item 4 of **Schedule 4** inserts a **new subitem 1(1A)** into Schedule 7 to the EGCS(CA) Act to exclude from the scope of the transitional arrangements:

- the on-road alternative fuels liquefied natural gas and biodiesel, and
- off-road diesel fuel purchased prior to 1 July 2002 for use in generating electricity in a retail or hospitality business without access to grid power.

Application

As the amendments rectify an anomaly in the law, they will apply from 1 July 2003, the date when the existing provisions first applied. This is provided in Item 3 in the table in **proposed subsection 2(1)** of the Bill.

Schedule 5 – Net input tax credits and capital gains tax

At present taxpayers who make a capital gain on the disposal of a CGT asset in many circumstances can include GST net input tax credits in the cost base of the asset even though the relevant GST expenditure is effectively recouped. Consequently, the amount of capital gain on disposal of the asset is reduced by the amount of the GST net input tax credits.

Similarly, taxpayers who make a capital loss on the disposal of a CGT asset can include GST input tax credits in the reduced cost base of the asset even though the relevant GST expenditure is effectively recouped.

The measures in **Item 3** of **Schedule 5** of the Bill will provide that in working out the amount of any capital gain or capital loss:

- GST net input tax credits will be excluded from the cost base and reduced cost base, and
- if the capital gain or capital loss is worked out by reference to an amount other than the cost base or reduced cost base, GST net input tax credits will be excluded from that other amount.

Application

Item 9 of **Schedule 5** provides that the amendments apply to CGT events that happen after the end of the day this Bill was introduced in Parliament (i.e. after 19 February 2004).

Schedule 6 – Confidentiality of ABN information

Section 30 of the *A New Tax System (Australian Business Number) Act 1999* (ABN Act) protects the confidentiality of ABN information. In particular, paragraphs 30(3)(c) and (d) authorise the disclosure of information to particular persons for specific purposes:

- subparagraphs 30(3)(c)(i) and 30(3)(d)(i) allow the disclosure of information to a Commonwealth Public Service Agency Head for the purposes of legislation administered by the Agency Minister, and
- subparagraphs 30(3)(c)(vi) and 30(3)(d)(iv) allow disclosure to State and Territory Department heads for the purposes of legislation administered by the Minister responsible for that department.

The *A New Tax System (Australian Business Number) Regulations 1999* (ABN Regulations) were amended with effect from 15 October 2001 to extend the disclosure of protected ABN information to Commonwealth agency heads and State and Territory department heads in respect of all agency or department functions and not restricted to matters covered by legislation administered. The Explanatory Memorandum to the Bill[3] takes the view that there is a risk that a Court may find the amendment to the Regulations invalid on the basis that the regulation alters the scope of the ABN Act.

Items 1 and **3** of **Schedule 6** will amend subparagraphs 30(3)(c)(i) and 30(3)(d)(i) of the ABN Act respectively to provide that ABN information could be disclosed to Commonwealth agency heads for the purpose of carrying out functions of the agencies. **Items 2** and **4** will amend subparagraphs 30(3)(c)(vi) and 30(3)(d)(iv) respectively to provide that ABN information could be disclosed to State and Territory Departments for the purpose of carrying out functions of those Departments.

Application

Item 5 of **Schedule 6** provides that the amendments will apply from 15 October 2001. This will ensure that the ABN Act and ABN Regulations are aligned and that any disclosure made in accordance with ABN Regulations on or after 15 October 2001 does not give rise to an offence if the amendment to the ABN Regulations is held by a Court to be invalid.

Schedule 7 – Deductions for contributions relating to fund-raising events

Section 78A of the ITAA 1936 provides that a deduction is not allowable for gifts made to a deductible gift recipient (DGR) in working out taxable income of an individual under Division 30 of the ITAA 1997, if the gift is made under an arrangement whereby the true value of the gift does not equal the amount or value claimed as a deduction. That is, a deduction will be denied where *inter alia*, the donor receives a collateral benefit in connection with the gift.

In consequence, if a DGR holds a fundraising dinner, under current tax law none of the cost of attending the dinner is deductible even if some of the payment is intended as a donation.

The Prime Minister's Community Business Partnership (CBP) had raised concerns with the Government that section 78A was an impediment to fund raising by DGRs. The Prime Minister in a Press Release of 9 September 2003 announced that the income tax law will be amended to provide with effect from 1 July 2004 an income tax deduction for contributions of cash or property to a DGR, where a minor benefit is received in return. The *Report of the Contemporary Visual Arts and Craft Inquiry* (Myer Report) had also recommended that the tax law should be amended to clearly state that an advantage or benefit received by donors should not preclude donors from claiming tax deductions provided the benefit did not exceed a specified limit.

Under the measures proposed in **Schedule 7** of the Bill people will receive a tax deduction for the donation component of any payments to a deductible gift recipient. The amendment applies to specific one-off fundraising events of DGRs which may include both attendance at charitable events or sale of goods and services at charitable auctions. Fundraising events held by political parties are ineligible for a deduction under the proposed amendments.

The amendments that are proposed to be made to section 30-15 of the ITAA 1997 by **Item 2** of **Schedule 7**:

- will allow an individual to receive a deduction for eligible contributions to DGRs where the value of the contributions is more than $250, and the minor benefit received in return is no more than $100 or 10% of the value of the contribution, whichever is the less, and

- apply to contributions of money and property and where the contribution is property, it must be valued at more than $250 and either purchased within 12 months of making the contribution; or owned by the contributor and valued by the Commissioner at more than $5000.

The deductions are limited to individuals and cannot be claimed by companies using the fund-raising events of DGRs to entertain clients. Companies may be able to claim their contributions as an ordinary business deduction.

Application

Item 13 of **Schedule 7** provides that the amendments will apply to contributions made on or after 1 July 2004.

Schedule 8 – New integrity measures for distributions by trustees to certain entities

In its August 1998 statement *A New Tax System (ANTS)*[4], the Government outlined a proposal to tax all trusts like companies. The case for this proposal was stated succinctly as follows:

> Achieving consistency of treatment across companies and trusts under these redesigned company tax arrangements would provide simplicity, clarity and fairness in treatment. It would also address techniques that have come to light through the High Wealth Individuals Project which take advantage of highly complex structures[5].

The proposal was later narrowed down to cover only discretionary trusts and the Government released exposure draft legislation in October 2000. However, in a Press Release of 27 February 2001, the Treasurer stated that the Government received a great number of submissions which raised technical problems particularly in relation to distinguishing the source of different distributions, and valuation and compliance issues that meant that the draft legislation was not workable.

The Treasurer added that the Government had also taken advice from the Board of Taxation which recommended that the Bill not proceed and suggested looking at alternative approaches.

The Treasurer announced that the Government was withdrawing the draft legislation and would not be legislating it. It would begin a new round of consultations on principles which can protect legitimate small business and farming arrangements whilst addressing any tax abuse in the trust area. The Board would be part of consultation.

In a report titled *Taxation of Discretionary Trusts* (November 2002), the Board of Taxation concluded in recommendation 1 that there were no compelling arguments for broad based reform to more closely align the tax treatment of discretionary trusts and companies and that the Government should retain the current flow-through treatment of distributions of non-assessable amounts by discretionary trusts.

However, the Board of Taxation considered ways in which the tax treatment of trusts could be improved and in particular the operation of section 109UB of the ITAA 1936. In a Press Release dated 12 December 2002, the Treasurer whilst releasing the report of the Board of Taxation on the *Taxation of Discretionary Trusts* announced that the Government would legislate with effect from 12 December 2002 to introduce new provisions in place of Section 109UB of the *Income Tax Assessment Act 1936* dealing with distributions from trusts to give effect to the recommendations of the Board.

What is the purpose of section 109UB?

Division 7A of Part III of the ITAA 1936 treats 3 kinds of amounts as dividends paid by a private company:

- amounts paid by the company to a shareholder or shareholder's associate under section 109C
- amounts lent by the company to a shareholder or shareholder's associate under sections 109 and 109E, and
- amounts of debts owed by a shareholder or shareholder's associate to the company that the company forgives under section 109F.

Subdivision E of Division 7A allows a private company to be taken to pay a dividend to an entity (the target entity), if an entity interposed between the private company and the target entity makes a payment or loan to the target entity under an arrangement involving the private company.

Section 109UB in Subdivision E deals with the case of a private company treated by the trustee as a beneficiary of the trust with present entitlement to trust income in any particular year. However, without making the payment of that income to the private company the trustee makes a loan to a shareholder of the private company or an associate of that shareholder. Section 109UB deems the loan to have been made to the shareholder at the time the trustee made the loan. This loan is then a dividend paid by the private company to the shareholder under Division 7A.

The report of the Board of Taxation identified two aspects of the operation of section 109UB which required amending legislation to make it operate effectively as well as remove any unintended consequences.

Cases in which section 109UB is ineffective

The report of the Board of Taxation indicated (at paragraphs 74 to 76) an instance when section 109UB is ineffective:

> Section 109UB, however, does not cover a case in which:
>
> - the trustee makes a private company presently entitled to trust income, but does not pay the income to the company, and
> - the trustee then distributes the underlying cash to trust beneficiaries, but not as a loan.

> In such circumstances, the individuals are able to access, without further tax liability, trust income that has been taxed only at the company tax rate.
>
> One way of distributing the underlying cash other than as a loan is for the trustee to re-value assets of the trust and then to use the cash to make a (tax free) distribution of the corpus to a beneficiary. The beneficiary then lends the corpus distribution back to the trust, thus setting up a loan account reflecting the trustee's indebtedness to the beneficiary. When the trust then repays that loan to the beneficiary, section 109UB does not operate to deem the repayment to be a loan made by the company, and so the deemed dividend rules do not apply.

Item 2 of **Schedule 8** of the Bill repeals section 109UB and **Item 3** will insert **new Subdivision EA – Unpaid present entitlements** to Division 7A of Part III of the ITAA 1936. Broadly, a deemed division will arise under **new Subdivision EA** where a private company is presently entitled to income of the trust but that income has not been paid and the trustee shifts value from the trust to a shareholder of a private company in the form of a payment, loan or a forgiven debt. The reader is referred to paragraphs 8.6 to 8.23 of the Explanatory Memorandum to the Bill for details of the operation of **proposed sections 109XA** and **109XB** of **proposed Subdivision EA** which are intended to achieve this result.

The broad scheme of the provisions in **proposed Subdivision EA** is to treat the trust as a private company for the purposes of determining whether a deemed dividend arises in circumstances where the trustee has made a payment, loan, or forgiven a debt.

Cases in which section 109UB operates unfairly

The report of the Board of Taxation indicated that section 109UB acts unfairly when certain transactions would be treated as loans when in fact they are not loans. In such cases there is no mechanism in section 109UB (as there is in section 109C) to reverse the impact of the section by repaying such amounts. Extracts from paragraphs 77 and 78 of the report which describe this anomaly are set out below.

> The effect of section 109UB is to treat certain transactions as creating loans that are then affected by the deemed dividend rules. Once the section operates to deem a loan to exist, there is no scope for reversing the operation of the section, such as by repaying the loan (opportunities that are available under similar provisions in other parts of the tax laws.) That is, section 109UB has a finality not found in other provisions of the deemed dividend rules.
>
> The inability to avoid the operation of section 109UB by regularising the arrangements that created the deemed loan may have particularly adverse or unintended consequences in cases where a trust operates a small or medium-sized business. The Board has been advised that arrangements that are caught by section 109UB are, typically, temporary accounting balances that would usually be extinguished at year end through trust distributions. In other cases, the 'loans' arise

> where the operators of the business, in the course of running the business, inadvertently fail to distinguish between the trust's cash and their own cash. In other words, these are 'accidental loans', but section 109UB has no mechanism for reversing the initial deeming of the loans to be dividends.

The provisions in proposed **subsection 109XC (3)** in **new Subdivision EA** provide the mechanism for repayment of such amounts which are in fact not loans. This subsection provides that a loan is taken to have been repaid at the end of the year if it is repaid by the earlier of the due date for lodgement and the date of lodgement of the trust's return for the income year of the trust.

Application

Item 8 of **Schedule 8** provides that the amendments generally apply to payments, loans and debts forgiven on or after 12 December 2002.

However, if a private company becomes presently entitled to an amount from the net income of the trust, after the actual transaction takes place, as opposed to before, and the other requirements of section 109XA are met, the amendments will have effect as from the date the Bill is introduced into Parliament (i.e. from 19 February 2004).

Schedule 9 – Deductions for dividends on-paid to non-resident owners

The income tax law was amended, with effect from 1 July 2000, to generally deny the inter-corporate dividend rebate under sections 46 and 46A of the ITAA 1936 on unfranked dividends received by all resident companies, except for dividends paid within a wholly-owned group.

Section 46FA of the ITAA 1936 allows certain resident companies, subject to certain conditions, a deduction for payments of unfranked or partly franked non-portfolio dividends on-paid to a wholly-owned foreign parent.

One of the conditions for the deduction is that the resident company would be entitled to the rebate under section 46 in respect of the unfranked amount of the dividend but for the rebate being denied.

On the introduction of the consolidation regime, the inter-corporate dividend rebate under sections 46 and 46A for unfranked dividends paid within company groups has been removed. As a result, the above condition that the resident company would otherwise be entitled to the rebate can no longer be satisfied. Thus the deduction under section 46FA has been inadvertently denied.

The amendments proposed in **Schedule 9** will ensure that the deduction under section 46A continues to be available to taxpayers.

Application

Under **item 9** of **Schedule 9** the amendments will generally apply to dividends paid after 30 June 2003, subject to the transitional rule allowing groups to consolidate either before 30 June 2003 or on the first day of the first income year after 30 June 2003 and before 1 July 2004.

Schedule 10 – Endorsement of charities etc.

Current position in relation to endorsement of charities for tax concessions and self-assessment of tax concessions

- Under Subdivision 50-B of the ITAA 1997 an entity must be endorsed by the Commissioner in order to access the income tax exemption for charities.
- Under Subdivision 30-BA of the ITAA 1997 an entity may be endorsed for deductible gift recipient (DGR) status to receive donations that are tax deductible to donees.

  Endorsed charities and DGRs can receive refundable imputation credits
- Charities and public benevolent institutions and health promotion charities self-assess for the purposes of claiming the FBT rebate, the $30 000 capped FBT exemption and GST concession for charities.

Governments response to the Report of the Inquiry into the Definition of Charities and Related Organisations

One of the recommendations in the *Report of the Inquiry into the Definition of Charities and Related Organisations* was that commercial purposes should not deny charitable status where such purposes further, or are in aid of, the dominant charitable purposes or where they are incidental or ancillary to the dominant charitable purposes.

The Treasurer announced in a Press Release on 29 August 2002 that the Government agreed with this recommendation, but was concerned to ensure that the taxation concessions provided to charities were not abused. The Treasurer added that the Government had therefore decided that from 1 July 2004, charities, public benevolent institutions and health promotion charities will be required to be endorsed by the ATO in order to access all relevant taxation concessions. Depending on the character of the charity, these concessions are the income tax exemption as a charity, refundable imputation credits, deductible gift recipient status, the FBT rebate, the $30 000 capped FBT exemption and GST concessions.

Proposed extension of the endorsement processes

The amendments proposed in **Schedule 10** extend the endorsement processes currently undertaken by the ATO to all the taxation concessions to which charities, public benevolent institutions and health promotion charities are entitled. Where a charity can currently self-assess its eligibility for a taxation concession, it will be required from 1 July 2004 to satisfy the Commissioner that it is eligible for the taxation concession.

There are five new categories under which an entity may be endorsed:

- a charitable institution under proposed subsection 176-1(1) of the GST Act (**Item 15** of **Schedule 10)**
- a trustee of a charitable fund under subsection 176-5(1) of the GST Act (**Item 15** of **Schedule 10)**
- a public benevolent institution under subsection 123C(1) of the *Fringe Benefits Tax Assessment Act 1986* (FBT Act) or for the operation of a public benevolent institution under subsection 123C(3) of the FBT Act (**Item 23** of **Schedule 10)**
- a health promotion charity under subsection 123D(1) of the FBT Act (**Item 23** of **Schedule 10)**, and
- a charitable institution covered by paragraph 65J(1)(baa) of the FBT Act under subsection 123E(1) of that Act (**Item 22** of **Schedule 22**).

There is no change to the requirements that charities, public benevolent institutions and health promotion charities have to fulfil to qualify for taxation concessions. The process for endorsement for each taxation concession will now be contained in the **proposed Division 426** to be inserted into the *Taxation Administration Act 1953* (TAA 1953) (**Item 41** of **Schedule 10**).

To be endorsed, entities must identify themselves to the Commissioner by applying for an ABN and applying for endorsement for tax concessions. The Commissioner could approve a form that is part of an application form for an ABN under **proposed section 426-15** of the TAA 1953.

Schedule 11 – Specific gift recipients

Income tax law allows taxpayers to claim income tax deductions for certain gifts to the value of $2 or more to deductible gift recipients (DGRs). To be a DGR, an organisation must fall within a category of organisations set out in Division 30 of the ITAA 1997, or be specifically listed under that Division. The amendments in **Schedule 11** will include the funds and organisations specified in the table below as DGRs.

New DGRs and Application

Name of fund	Amendments proposed by Schedule 11	Minister for Revenue and Assistant Treasurer's Press Release No.	Date of effect
Country Education Foundation of Australia Limited	**Item 1** will amend the table at end of subsection 30-25(2) (Education) to include this fund as item 2.2.31.	C081/03	
Crime Stoppers South Australia Incorporated	**Item 2** will amend the table in subsection 30-45(2) (Welfare and rights) by including this fund as item 4.2.27	C090/03	The gift must be made on or after 19 September 2003.
Dunn and Lewis Youth Development Foundation Limited	**Item 4** will amend the table in section 30-105 (Other recipients) by including this fund as item 13.2.6	C102/03	The gift must be made on or after 10 November 2003 and before 10 November 2005.

Concluding Comments

Increasing complexity in the law relating to the taxation of discretionary trusts

It was noted above in considering the amendments in Schedule 8, that the Board of Taxation in its report titled *Taxation of Discretionary Trusts* came to the conclusion in Recommendation 1 that there are no compelling arguments for broad-based reform to more closely align the tax treatment of discretionary trusts and companies and that the Government should retain the current flow-through treatment of distributions of non-assessable amounts by discretionary trusts.

The report also noted (in paragraph 62) that since the 1990s a number of amendments have been made to the taxation treatment of trusts, to address specific tax planning opportunities. It adds that indications from the ATO are that this legislation 'appears to have modified behaviour' and that non-compliance with the new provisions 'is not a significant concern (although extensive compliance reviews have not been completed on some measures)'.

However, in paragraph 63 the report records the reservations of the ATO in enforcing specific provisions to prevent tax abuse:

> The ATO has also advised that targeted anti-abuse rules are difficult to apply in some circumstances where taxpayers have very complex arrangements. In these cases, it can be almost impossible to trace the ultimate source of funds; consequently, it can be very difficult to identify tax abuse techniques and enforce the rules.

The entity tax regime would have ensured that a minimum tax will be collected on business income derived by discretionary trusts. The flow-through method of taxing trusts is dependent upon ultimate beneficiaries returning shares of trust income which may have passed through a number of interposed entities without changing its character to capital. Thus from the revenue collection point of view it is clear that the entity tax regime coupled with an imputation regime is about the most effective and efficient way to handle tax abuse using trusts and complex arrangements. An illustration of the use of interposed entities to avoid tax being paid at the top marginal rates was given in relation to section 109UB. Hence the need to replace section 109UB by inserting an entire **new Subdivision EA** to Division 7A of Part 111 of the ITAA 1936.

In addition the integrity of the tax system is under a cloud when there are avoidance possibilities open to one sector of taxpayers who have the resources to enter into complex arrangements to avoid targeted anti-abuse rules which the ATO has acknowledged are difficult to enforce. Targeted anti-abuse rules also add to the complexity and length of tax legislation as seen by the amendments in **Schedule 8** where a single section 109UB is being replaced by an entire new Subdivision EA to address a specific type of tax abuse.

Endnotes

1 *Commissioner of Taxation v Payne* [2001] HCA 3.

2 Bills Digest No. 119, 2002–03.

3 Explanatory Memorandum to the Bill; paragraph 6.5, page 42.

4 *Tax Reform – not a new tax – a new tax system*: The Howard Government's Plan for a New Tax System (AGPS August 1998).

5 ibid., p. 115.