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Tax Laws Amendment (2006 Measures No. 3) Bill 2006

New Business Tax System (Untainting Tax) Bill 2006

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Law and Bills Digest Section

Contents

Abbreviations

ADRAS	Alternative Dispute Resolution Assistance Scheme
Amendment Bill	Tax Laws Amendment (2006 Measures No. 3) Bill 2006
CGT	Capital Gains Tax
Commissioner	Federal Commissioner of Taxation
Court	Full Court of the Federal Court
FBT	Fringe Benefit Tax
FBTAA	*Fringe Benefit Tax Assessment Act 1986*
GST	Goods and Services Tax
GST Act	*A New Tax System (Goods and Services) Act 1999*
ITAA 1936	*Income Tax Assessment Act 1936*
ITAA 1997	*Income Tax Assessment Act 1997*
ITTPA	*Income Tax (Transitional Provisions) Act 1997*
MLS	Medicare Levy Surcharge
SGAA	*Superannuation Guarantee (Administration) Act 1992*
TAA 1953	*Tax Administration Act 1958*
TIA	Taxation Institute of Australia
Untainting Tax Bill	New Business Tax System (Untainting Tax) Bill 2006
UTAS	Unfair Termination Assistance Scheme

Tax Laws Amendment (2006 Measures No. 3) Bill 2006
New Business Tax System (Untainting Tax) Bill 2006

Date introduced: 25 May 2006

House: House of Representatives

Portfolio: Treasury

Commencement: The Bills have various commencement dates. Where necessary, the respective commencement dates will be provided as part of the analysis of the individual Schedules below.

Purpose

The Tax Laws Amendment (2006 Measures No. 3) Bill 2006 (Amendment Bill) is an omnibus bill and has a variety of purposes. Each of the purposes is set out as part of the analysis of each of its 15 Schedules below. The New Business Tax System (Untainting Tax) Bill 2006 (Untainting Tax Bill) will impose an untainting tax.

Background

The Backgrounds to the respective Schedules of the Amendment Bill as well as the Untainting Tax Bill will be, where necessary, discussed as part of the analysis of each of the 15 Schedules below.

The Tax Laws Amendment (2006 Measures No. 3) Bill 2006

Schedule 1—Cyclone Larry income support payments

Background

End of March 2006, the category five Cyclone Larry hit the northern shores of Queensland, causing significant devastation, especially in the area around the North Queensland town of Innisfail.[1] It followed a broad wave of support to help those affected by the cyclone, with both the State and Federal governments promising immediate help.[2] The support provided at federal level included, so far, ex-gratia payments and reimbursements under the Natural Disaster Relief Arrangements. These measures were announced by the by the Prime Minister, the Hon. John Howard immediately after the devastating cyclone hit the area.[3] More recently, the Prime Minister announced further assistance to farmers and small businesses, including concessional loans with deferred repayment options and an income support program.[4] The measure contained in Schedule 1 of this Bill is part of the comprehensive package of support measures, provided to the people of the region by the Federal government.

Current law and the proposed amendments

Under current income tax law, income support payments are considered to be ordinary income. Ordinary income, however, is fully taxable unless a statute provides that the payment can be offset. An offset is a direct subtraction from the income tax liability of the taxpayer.[5] In order to provide tax relief to recipients of Cyclone Larry income support payments, a statutory basis for a tax offset must be created. The proposed measure in Schedule 1 will make the necessary amendments to create this statutory basis by making changes to the *Income Tax Assessment Acts 1936* (ITAA 1936) and the *Income Tax Assessment Act 1997* (ITAA 1997). These changes will extend the applicability of rebatable benefit provisions to Cyclone Larry income support payments as provided to farmers and small businesses.

Main provisions

Item 1 proposes to add proposed **paragraph 160AAA(1)(e)** to the provisions to the statutory definition of rebatable benefit. This proposed paragraph will provide that monies paid by way of income to support farmers and small business owners affected by Cyclone Larry will qualify for the tax offset.

Items 2 and **3** will make the necessary changes to Division 13 of the ITAA 1997, the tax offset guide. Division 13 of the ITAA 1997 lists all the payments which can be offset. These two items will add Cyclone Larry income support payments to the lists of payments.

Application

Under **item 4** of Schedule 1, the amendments will only be applicable to the income years spanning from 2005-06 to 2007-08. The financial impact of this measure will be negligible in relation to revenue for the income year 2006-07 and $500,000 for the income year 2007-08.[6] The compliance costs for taxpayers will be negligible.[7]

Comment

Under the proposed law, Cyclone Larry income support payments will be treated the same way as payments made by the government to recipients of the New Start allowance.

Schedule 2—Non-assessable, non-exempt income relating to Cyclone Larry

Background

In the wake of Cyclone Larry, the Federal governments also announced to provide certain payments to business out of the Business Assistance Fund[8] and for fuel excise relief.[9] The measure contained in Schedule 2 of this Bill will ensure that the payments made to the businesses will be tax free.

Current law and the proposed amendments

Under current income tax law, government support payments such as the business assistance payments are considered to be ordinary income which is fully taxable as assessable income. Further, fuel excises relief is considered under tax law to be a subsidy or bounty and therewith assessable income. As a result, these relief payments are also taxable. The proposed measure in Schedule 2 will ensure the tax-free status of these two payments by deeming the payments to be non-assessable non-exempt income. Non-exempt non assessable income is income which is both:

- excluded from the taxpayers assessable income, and
- ignored when working out the taxpayer's available losses.[10]

Main provisions

Item 1 of Schedule 2 stipulates that business assistance and fuel excise relief payments will be non-assessable non-exempt income.

Application

The availability of the measure in Schedule 2 is limited to the income years 2005-06 and 2006-07. However, its financial impact is expected to reverberate through until the income tax year 2009-10. The revenue implication of this measure will be:[11]

Year	2006-07	2007-08	2008-09	2009-10
Impact on revenue	–$38.0m	–$21.5m	–$11.0m	–$7.5m

the implementation costs are expected to be small, with the ongoing compliance costs for taxpayers minimal.[12]

Schedule 3—Interim income support payments

Schedule 3 will extend the beneficiary tax offset available for interim income support payments to drought affected taxpayers. The amendments proposed relate to subsection 160AAA(1) ITAA 1936 and section 13-1 of the ITAA 1997. The amendments resemble the amendments made by Schedule 1 of the Amendment Bill and the reader is referred to this discussion above.

Application

The offset available to interim income support payments available to drought affected taxpayers will apply from the income tax year 2005-06 onwards.

According to the Explanatory Memorandum, the revenue implications of this measure will be $1 million per income tax year projected of the next four income tax years. The compliance costs for the taxpayers is expected to be negligible.

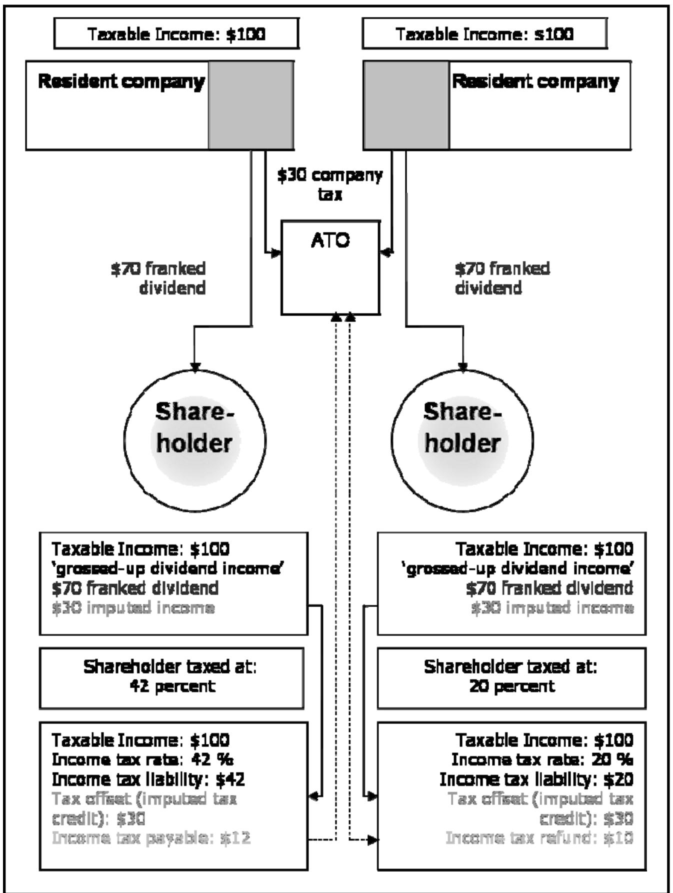
Schedule 4—Simplified imputation system (share capital tainting rules)

Schedule 4 will make further amendments to the simplified imputation system. This measure will re-introduce so-called share capital tainting rules which had been 'turned-off' by the legislature in 2002, perhaps, as recently suggested, 'inadvertently'.[13]

The simplified imputation system

The origins of the imputation system in Australia reach back to 1987 when the *Taxation Laws Amendment (Company Distributions) Act 1987* inserted Part 111AA, dealing with franking of dividends, into the ITAA 1936.

Broadly speaking, the simplified imputation system (SIS) is a device which enables income tax payments made by a corporate tax entity to be passed on to its shareholders: the company's tax is imputed to the taxpayer. The imputation occurs in the form of an imputation credit. The credit is passed on and included in the assessable income of the resident taxpayer. The resident taxpayer is entitled to use the imputation credit as an offset in the amount equal to the credit. The purpose of the SIS is to avoid the double-taxation of both income earned and distributions made by companies.[14]



The flow-chart to the right explains the workings of the SIS in relation to a resident company/resident taxpayer:[15]

Tainted share capital accounts and share capital tainting rules—past, present and future

For a detailed discussion of tainted share capital accounts, their history and the different tax treatment of tainted and untainted accounts, the reader is referred to the Bills Digest prepared in relation to the Taxation Laws Amendment (No. 7) Bill 1999.[16] The rules relating to tainted share capital accounts are part of a whole suite of measures designed to limit the possibility for abuse of the imputation system. In their original form, the share capital tainting rules aimed at preventing 'companies disguising a dividend as a tax preferred capital distribution from the share capital account'.[17] These original rules applied to companies are until 1 July 2002. The CCH Australian Master Tax Guide 2006 explains their operation:

> Under the pre-1 July 2002 provisions, special rules applied where a company "tainted" its share capital account by transferring amounts from other accounts to it (eg by capitalising profits and transferring them into the account). If a company's share capital account was tainted, distributions debited to the account were unfrankable.
>
> Broadly, where a company transferred an amount to its share capital account from another account, the account was tainted and was no longer treated as a share capital account (…). Further, a franking debit arose on the day of the transfer.
>
> A company could untaint its share capital account by making an irrevocable written election (…). In certain circumstances, this election might trigger an additional franking debit or a liability to pay untainting tax.[18]

The period after 1 July 2002, collapses into two further periods because the measure proposed in this Amendment Bill will not operate retrospectively to cover this entire period. Therefore, after the successful passage of this proposed law, the following periods can be distinguished:

- between 1 July 2002 and 25 and May 2006, no applicable tainting rules will exist, even after the amendments proposed by this Amendment Bill have been passed into law. As a result, any amounts transferred by a company into its share capital account between this period will not cause the share capital account to be tainted.[19]
- from 26 May 2006 onwards, the day after the proposed measure in Schedule 4 has been introduced into Parliament, the proposed new regime will apply. For more information on the new regime, see the discussion under **Main Provisions** below.

Main provisions

Schedule 4 is comprised of four parts. These parts contain:

- the re-written share capital tainting rules (Part 1 of Schedule 4)

- the consequential amendments relating to the re-written rules (Part 2 of Schedule 4)
- several amendments to the original share capital tainting rules (Part 3 of Schedule 4), and
- the relocation of the definition of share capital account (Part 4 of Schedule 4).

Re-written share capital tainting rules (Part 1 of Schedule 4)

Item 1 proposes to add **Division 197** to the ITAA 1997, setting out the rules concerning tainted share capital accounts. Proposed **subsection 197-5(1)** contains the general rule, that is, that Division 197 will apply to amounts transferred to a capital share capital account from any other company account. This subsection also clarifies that the general rule will apply to Australian resident companies. However, proposed **subdivision 197-A** contains a number of exclusions which, if they are fulfilled, stop Division 197 from applying to the amount with the result that the account may not be tainted. These exclusions include the following accounting events:

- exclusions for amounts that could be identified as share capital (proposed **section 197-10**)
- exclusion for amounts transferred under debt/equity swaps (proposed **section 197-15**)
- exclusions for amounts transferred leading to there being no shares with a par value—non-C*orporations Act* companies (proposed **section 197-20**)
- exclusion for transfers from option premium reserves (proposed **section 197-25**)
- exclusion for transferred made in connection with demutualisation of non-insurance etc companies (proposed **section 197-30**)
- exclusion for transfers made in connection with demutualisations of insurance etc. companies (proposed **section 197-35**), and
- exclusions for post-demutualisation transfers relating to life insurance companies (proposed **section 197-40**).

For details in relation to individual exclusions and examples as to their application, the reader may refer to the Explanatory Memorandum.[20] Some of the proposed exclusions are re-enactments of previously existing ones, however, the list has been expanded. It has been suggested that the most commonly used exclusions will be exclusions relating to the debt/equity swaps and the conversion or demutualisation of companies.[21]

The tainting of the capital account has consequences for the company. Proposed **subdivisions 197-B** and **197-C** will deal with the consequences arsing out of the transfer of an amount captured by this Division.

Proposed **subdivision 197-B**, comprised of proposed **section 197-45,** stipulates that a franking debit will arise in a company's franking account if an amount is transferred as described in proposed **section 197-5**. This franking debit will arise immediately before the end of the franking period in which the transfer of amount occurred (proposed **subsection (197-45(1)**). Proposed **subsection 197-45(2)** sets of the formula according to which the franking debit is calculated. The calculation of franking debit is depending upon the franking benchmark set by the company for the franking period.

Proposed **subdivision 197-C** deals with the second consequence of the transfer—the tainting of the share capital account. Where an amount is transferred pursuant to proposed **subsection 197-5(1)**, the transfer will taint the share capital account. It will remain tainted until the company chooses to untaint the account (proposed **section 197-50**). The choice to untaint the account can be made at any time using an approved form, however, once made, the choice is irrevocable (proposed **subsection 197-55(2)**). When choosing to untaint the account, several implications may arise. These include:

- a liability to tainting tax may arise (proposed **section 197-60**), and
- a further franking debit may arise (proposed **section 197-65**)

The amount of tainting tax payable under proposed **section 197-60** will depend upon, first, the type of shareholders a company has and, second, a company's chosen franking rate. The type of shareholder is defined in proposed **subsection 197-60(1)**, distinguishing between:

- lower tax members—shareholders with a marginal tax rate on dividend income of less than 30 percent. Proposed **paragraph 197-60(1)(a)** lists other companies, complying superannuation entities and foreign residents as falling within this category, or
- higher tax members—shareholders whose marginal tax rate on dividend income is more than 30%.

Specialist revenue law advisers Greenwoods + Freehills have explained the interaction between kind of the type of taxpayer and the choice of benchmark as follows:

> - If the company is owned entirely by taxpayers with a marginal tax rate on dividend income at or below 30% (for example, complying superannuation funds, other companies or non-residents) and its franking rate was 100% in both years, no untainting tax is payable. […]
>
> - If the company is owned only by shareholders which are complying superannuation funds, other companies or non-residents, but its franking rate was less than 100%, untainting tax is payable. […]
>
> - If the company has any individual shareholders, again untainting tax is payable. […][22]

The actual imposition of the tainting tax is, for constitutional reasons, effected through separate legislation, the proposed New Business Tax System (Untainted Tax) Bill 2006. The constitutional background to this proposed legislation is discussed in the second part to this Bills Digest.[23]

Division 2 of Part 1 sets out the application and transitional provisions, proposing to amend the *Income Tax (Transitional Provisions) Act 1997* (ITTPA). **Item 2** proposes to add **Division 197** to the ITTPA. Generally, proposed **section 197-5** will provide that proposed Division 197 (as inserted into the ITAA 1997 by Part 1 of Schedule 4) will apply to amounts transferred from 26 May 2006 onwards. Proposed **subdivision 197-C** will set out special provisions, dealing with accounts tainted at the time the pre-1 July 2002 regime was closed off.

Consequential amendments relating to the re-written rules (Part 2 of Schedule 4)

Proposed **Part 2** will make certain consequential amendments necessary to implement the share capital tainting rules set forth in Part 1 of this measure. Proposed are amendments to various provisions of the ITAA 1936, the ITAA 1997 and the *Tax Administration Act 1953*, necessary because of the proposed new tainting rules. To achieve harmony between Part 1 and Part 2, **item 14** will stipulate that Part 2 amendments will apply in relation to transfers made from 26 May 2006 onwards.

Amendments to the original share capital tainting rules (Part 3 of Schedule 4)

Part 3 proposes to amend the ITAA 1936, modifying the *original* share capital tainting rules which are still stipulated in this legislation.[24] These amendments aim at ensuring the harmonisation of the original and proposed new rules. The amendments concern the following ITAA 1936 provisions dealing with:

- debt/equity swaps
- option premium reserves
- demutualisation of insurance companies, and
- post-demutualisation transfers relating to life insurance companies.

The application of the provisions in Part 3 is regulated by **item 19** which proposes that the changed provisions will apply for the period between 1 July 1998 and 30 June 2002.

Relocation of the definition of share capital account (Part 4 of Schedule 4)

Part 4 proposes the relocation of the definition of the term *share capital account*. Proposed **Division 1**, i**tem 20** will insert proposed **subdivision 975-G** which defines the meaning of the term *share capital account* for the purposes of the tainted share capital account rules (proposed **section 975-300)**. Proposed **Division 2** will make further consequential amendments which arise from the relocation of the definition.

Reactions to the proposed changes

There has been little reaction to the proposed changes. However, the reaction from some of the major accounting firms seems to suggest some relieve that the issue has now been addressed by the legislature and a proposed legislative framework for tainting rules is before Parliament.[25] Only some areas have attracted criticism, including:

- lack of retrospectivity of the *new* rules—as a result of the new tainting rules not applying retrospectively:
  - a total of three periods with different regulation content will have to managed by companies and accountants, and
  - a significant unregulated gap will exist between 1 July 2002 and 25 May 2006.[26]
- impact of the changes on groups—it has been noted, that whilst the Explanatory Memorandum provides some explanation as to the potential impact of the proposed changes on both consolidated and multiple entry consolidation (MEC) groups, the proposed legislation does not attend to the issue expressly. In the absence of such express provisions, it has been criticised that the examples and explanations provided by the Explanatory Memorandum are insufficient. G + F have commented that '[a]gain, it is disappointing that such important matters are not giving specific attention in the legislation.'[27]

Schedule 5—Government grants

Background

Schedule 5 will make amendments to the ITAA 1997 for the purpose of providing a statutory exemption from capital gains tax (CGT) for recipients of certain government financial assistance payments. The financial assistance payments specifically concerned in this schedule are:

- Unlawful Termination Assistance Scheme, and
- Alternative Dispute Resolution Assistance Scheme.

The grants paid by the government under these financial assistance schemes either to employers or employees accompany the government's recent changes to the *Workplace Relations Act 1996*.[28] Both assistance schemes aim at providing financial relief to those who seek remedies against unlawful termination of their employment or in relation to any other dispute arising between the employee and the employer.[29]

Current law

Under current tax law, financial assistance payments such as made under the *Unlawful Termination Assistance Scheme* and *Alternative Dispute Resolution Assistance Scheme* would qualify as a capital gain. This capital gain could lead to an increase in the assessable income of the taxpayer and therewith to an increase in the taxpayers' tax liability.[30] To avoid this consequence, the proposed new law will provide that for CGT purposes, capital gains in form of payments made and under the financial assistant schemes will be ignored.

Main provisions

Item 1 of Schedule 5 will the repeal current subsection 118-37(2) of the ITAA 1997, replacing it with proposed **subsection 118-37(2)**. This new subsection will deem exempt from CGT, certain payments which have been received either as:

- reimbursement
- payment of expenses
- voucher, or
- certificate.

Under proposed **paragraph 118-37(2)(e)**, this will include payments made under the *Unlawful Termination Assistance Scheme* or *Alternative Dispute Resolution Assistance Scheme*.

Application and costs

Under **item 2**, payments received under the *Unlawful Termination Assistance Scheme* or *Alternative Dispute Resolution Assistance Scheme* will be ignored from the income year 2005-06 onwards. According to the Explanatory Memorandum, the financial impact of this measure as well as the compliance cost will be negligible.[31]

Schedule 6—Tax offset for Medicare levy surcharge (lump sum payments in arrears)

Background

Schedule 6 will introduce a new measure which will enable certain taxpayers to offset the Medicare levy surcharge (MLS) where the taxpayer received a significant proportion of income in one income year in form of a lump sum payment in arrears. Currently, such payments, even if made in relation to a previous tax year, attract the MLS of 1.5 percent of the taxpayer's total taxable income. New proposed law will provide that certain lump sum payments will not attract the MLS. These lump sum payments include according to proposed **section 61-590** ITAA 1997:

- Lump sum payments of eligible income within the meaning of 159ZR of the ITAAA 1936 which is included in the taxpayer's assessable income, and
- Lump sum payments included in the taxpayer's exempt foreign employment income (MLS lump sum).

Essentially, the proposed measure harmonises the treatment of MLS Lump Sums for income-tax and MLS purposes.

Main provisions

Item 4 of Schedule 6 will introduce proposed subdivision 61-L 'Tax offset for Medicare levy surcharge (lump sum payments in arrears)' into the ITAA 1997. The operative provisions of this subdivision include:

- proposed **section 61-580**: 'Entitlement to tax offset'—this provision will set out the prerequisites for the entitlement to the *Medicare Levy Surcharge lump sum* (MLS lump sum) offset.[32] The requirements in proposed **subsection 61-580(1)**, concerning the taxpayer, include, amongst others:
  - – that the Medicare levy surcharge will be payable for the current income year
  - – that the *assessable income* or the taxpayer's *exempt foreign employment income* for the current income year includes one or more MLS lump sum payments,[33] and
  - – the *MLS surcharge lump sum* payment in arrears is equal to or greater then ten percent of the taxpayer is taxable income.

  Proposed **subsection 61-580(2)** provides the requirements for a tax offset for MLS lump sum payments available to a taxpayer's spouse. These requirements include that:

  - – the person was during all or a part of the current financial year married to the taxpayer
  - – the taxpayer is entitled to the tax offset for the current financial year
  - – the Medicare levy surcharge is payable
  - – that the spouse is not entitled to the tax offset as a taxpayer in his or her own right under section 61-580(1), and
  - – the Medicare levy surcharge would be payable by the taxpayer if the analyst lump sum is were not paid, were disregarded.

Proposed **section 61-585** sets out the method of calculating the amount of the tax offset.

Proposed **section 61-590** provides the definition for the newly introduced term *MLS lump sum*.

Items 5, **6** and **7** will introduce new definitions into the definition subsection 995-1(1) of the ITAA 1997. The terms include *exempt foreign employment income*, *Medicare Levy surcharge* and *MLS lump sum*.

Items 1, 2, 9, 10 and **11** will make several consequential amendments, including adding notes identifying the offset in the *Medicare Levy Act 1986* and the *Medicare Levy Surcharge – Fringe Benefits) Act 1999*.

Application

Item 8 proposes to insert Part 2-20 into the *Income Tax (Transitional Provisions) Act 1997*, providing that the application of proposed Subdivision 61-L as discussed above will commence with the income year 2005-06.

Revenue implications and costs

According to the Explanatory Memorandum, the costs to revenue will be $0.1 million for the income years 2006-07 to 2008-09. The compliance costs are estimated to be minimal.[34]

Comment

It may be possible for employee to restructure their income in a way to receive income, or a substantial proportion of their income, as payment in arrear, attracting the operation of this Division. In this instance, these employees could avoid the application of the MLS despite not being privately health insured.

Schedule 7—Reporting superannuation contributions

Schedule 7 proposes amendments to the *Superannuation Guarantee (Administration) Act 1992* (SGAA), introducing certain reporting requirements, including:

- reporting requirement for superannuation contributions (proposed **section 78 SGAA**), and
- the reporting requirement the contributions are transferred between superannuation providers (proposed **section 78A SGAA**).

The reporting requirements existed prior to the abolition of the superannuation surcharge.[35] The information was to be communicated to the Commissioner so that the superannuation surcharge liabilities could be ascertained.

Main provision

Item 3 proposes to insert new sections 78 and 78A into the SGAA. These new provisions set out the framework under which superannuation providers have to report to the Commissioner. This includes:

- the circumstances in which the superannuation provider has to provide information to the Commissioner (proposed **subsections 78(3) – (5)** and **78A(3) – (5) SGAA**)
- the kind of information which must be provided (proposed **subsections 78(3)** and **78A(3) SGAA**), and

- an administrative penalty regime, setting out the circumstances in which superannuation providers will be liable to an administrative penalty of five penalty units (proposed **subsections 78(1) – (2)** and **78A(1) – (2) SGAA**).

Application, retrospectivity and costs

The reporting requirements will apply retrospectively in relation to financial years starting on or after 1 July 2005 (**item 6**, **clause (1)**). This measure has the potential to conflict with subsection 12(2) *Legislative Instruments Act 2003* which provides that legislative instruments will have no effect if they operate retrospectively and affect rights of persons to their disadvantage or impose liabilities. Accordingly, **item 6**, **clause (2)** overrides this subsection to ensure retrospectivity.

According to the Explanatory Memorandum, the financial impact of the measure is expected to be nil, with negligible compliance costs for taxpayers.

Comment

These proposed changes are essential for the proper administration of the Superannuation Guarantee regime.

Schedule 8—Exclusion for fringe benefits to address personal security concern

Background

Schedule 8 proposes amendments to the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) to implement a fringe benefit exclusion for fringe benefits provided employers to their employees to address certain security concerns. The then Assistant Treasurer, the Hon. Mal Brough, has announced this measure on 8 September 2005.[36] The measure has been the subject of a consultation process, however, the consultation has been conducted confidentially.[37]

Current law

The CCH Australian Master Tax Guide 2006 describes the fringe benefits tax as:

> a tax payable by employers on the value of certain benefits, known as “fringe benefits”, that have been provided to the employees or to associates of those employees in respect of their employment.[38]

The benefit which attracts the fringe benefit tax (FBT) is generally understood to include any right, privilege, service or facility.[39] Accordingly, measures taken to address an employee’s security concerns would constitute a benefit for the purposes FBT which, if exceeding a certain limit, would have to reported. As a result, the benefits may become taxable. The reporting of such benefits is excluded where a statutory fringe benefit exclusion applies to the benefit. The proposed new law in Schedule 8 aims at creating such statutory exclusion.

Main provisions

Item 1 will add proposed **paragraph 5E(3)(l)** to existing subsection 5E(3) of the FBTAA. This added paragraph will provide that a personal security related benefit, for example in form of monitored intruder alarms or bodyguards, is provided by employers to employees or their associates, would not attract fringe benefits tax. Crucial for the operation of this proposed paragraph are the following three terms:

- **security concerns—**according to the Explanatory Memorandum, a security concern will exist 'where there is a risk to the employee's personal safety specifically connected to the nature of the work carried on by the employee, regardless of whether there is a direct threat from identified individuals all parties.'[40]
- **personal safety—**the measure will only cover benefits provided to employees to ensure their *personal* safety. *Personal* safety concerns in this context may arise from threats, such as, for example, death threats, but also threats of being kidnapped or assaulted. According to the Explanatory Memorandum, it is the legislature's intention that benefits, which relate to other safety aspects such as threats to the property of the employee or associate, will not be covered by this fringe benefit exclusion.[41]
- **in respect of the employee's employment—**for the exclusion to operate, the security concern must have arisen within the context of the employee's employment. The Explanatory Memorandum notices that the phrase 'in respect of' used in proposed paragraph 5E(3)(l) ought to include the meaning 'by reason of, by virtue of, or for or in relation directly or indirectly to that employment.'[42]

The measure is designed to extend to benefits which are provided not only to current employees, but also to past and future employees. Further, the provision will be broad enough to not only include the provision of benefits to the employee but, by virtue of section 159 FBTAA and 26AAD of the ITAA 1936, also to the employee's relatives, spouse and children.

Item 2 will add proposed subsection 5E(6) to the FBTAA. This provision will stipulate that only those fringe benefits which were provided consistent with a threat assessment will come within the scope of the exclusion. The provision will also provide that the threat assessment must have been made by a person deemed to be competent to make such threat assessments. This includes:

- a relevant industry body or government body, or
- the Commissioner.

Application and costs

The exclusion will apply retrospectively from 1 April 2004 for all future FBT years.[43] According to the Explanatory Memorandum, the measure will cost approximately $1 million in revenue per year. It is expected that the compliance cost taxpayers is minimal.

Schedule 9—Pre-1 July 88 funding credits

Background

The measure in Schedule 9 aims at adequately restricting funding credits use. Funding credits can be applied by certain superannuation funds to reduce taxable contributions relating to the unfunded liabilities.[44] In relation to unfunded superannuation funds, credits were granted so that contributions made after 1 July 1988 to fund benefits that accrued prior to 1 July 1988 are tax neutral. The credits must be available because unfunded superannuation schemes can be funded by a one-off contribution covering the entire period a person worked: from the day the person commenced work until the day the person retires and receives the benefits from the unfunded superannuation scheme.[45] Where the person's work commencement day was prior to 1 July 1988, and both the day of the one-off contribution to the fund and the retiring date were after 1 July 1988, the 15 percent contribution tax applied to the whole contribution. This is the result despite parts of the contribution covering the pre-1 July 1988 period (that is, the pre-contribution period in which no tax liability existed). To remedy this situation, funding credits were available to offset effectively the contributions tax paid for the pre-1 July 1988 portion of the contributions tax. The Explanatory Memorandum contains a timeline with further explanations to which the reader is referred.[46]

Main provisions

The current law permits the use of funding credits by superannuation funds to reduce their tax liability in relation to some of the contribution made with respect to post 1 July 1988 benefits. This 'unintended outcome' is proposed to be rectified by **items 1** to **4** which amend sections 275B and 275C of the ITAA 1936. Importantly, item 1 proposes to change the current formula-based rule relating to funding credits to a principle-based rule, to be substituted as proposed **paragraph 275B(2)(b)**.

Item 5 stipulates the application of the measure, providing that the measure will apply from 9 May 2006 onwards. The application provision also attempts to prevent avoidance of the new provisions by providing that outstanding objections or requests for amendments lodged on or after 9 May 2006 can only be amended in relation to funding credits up to the amount that can be claimed under the new law.

Application and costs

It is estimated that the compliance costs with respect to this measure will be minimal, whilst the financial impact of the proposal will be $150 million of the next four financial years.

Comment

The Explanatory Memorandum notes that the payment of tax may occur in circumstances where a fund becomes 'fully funded' in a particular income year, but pays out benefits of comparatively lesser value than the amount contributed to the fund. Currently, the number of private sector unfunded superannuation scheme is declining rapidly and this circumstance may be occurring more commonly. The proposed amendments seek to ensure that the correct amount tax is collected in these circumstances.

Schedule 10—Allowing certain funds to obtain an ABN

Under the current law, *Public Ancillary Funds* and *Prescribed Private Funds* are not eligible to apply for an Australian Business Numbers (ABN).[47] As a result, they are not able to access certain tax benefits for which an ABN is an essential prerequisite. The measure in **Schedule 10** will make changes to the *A New Tax System (Goods and Services Tax) Act 1999* (**items 1** and **2**) and the *A New Tax System (Australian Business Number) Act 1999* (**items 3** and **4**) to provide these funds with the opportunity to obtain an ABN. Once an ABN is obtained, the ABN holding funds can seek endorsement through the Commissioner to have access to income-tax exemptions, to receive input tax credits for goods and services tax (GST) as well as other GST related benefits.

Item 5 prescribes that the measure will be applicable to tax periods starting on or after 1 July 2005. The Explanatory Memorandum specifies the costs to revenue and compliance costs as unquantifiable, yet insignificant, and minimal respectively.[48]

Schedule 11—Deductible gift categories

Schedule 11 proposes the creation of five new general categories of so-called 'deductible gift recipients' (DGRs).

Background and current law on deductible gift recipients

Many organisations engaged in activities which, in layman's terms, may be considered charitable, will not qualify as a charity in the legal sense when assessed against the strict common-law definition of charity developed by the courts.[49] Thus, they would not be entitled to important benefits available to charities, including significant tax benefits.

To provide such organisations with relief from the overall tax burden and to encourage potential donors to give to such organisations, the legislature has enabled the Australian Taxation Office (ATO) to endorse certain types of organisations as so-called DGRs.

Endorsement occurs based on assessing the organisation against a set of criteria set out in categories.[50] Examples of these categories are public benevolent institutions, public universities, public hospitals, school building funds, public libraries, registered cultural and environmental organisations and ancillary funds. A full list is set out in Division 30, subdivision 30-B of the *Income Tax Assessment Act 1997*. Importantly, these are not just plain administrative categories. Rather, they are created by the legislature with the basic applicable rules relating to DGRs set out in Division 30 of the ITAA 1997.

Once an organisation is endorsed by the ATO, the organisation is able to attract two kinds of tax concessions—for itself in form of certain tax exemptions and benefits and for the donor who can claim certain donations as a tax deduction.

Main provisions

The measure in Schedule 11 proposes to establish five new DGR categories, including a category for:

- war memorials
- disaster relief
- animal welfare
- charitable services, and
- educational scholarships.

War memorials

Item 6 of Schedule 11 proposes to add **item 5.1.3** to subsection 30-50(1), creating the legislative basis for the endorsement of organisations solely providing funds to reconstruct or make critical repairs to war memorials. This category will be subject to further conditions, including that the memorial:

- is located in Australia
- commemorates certain events or people
- is the focus of public commemoration of such events or people, and
- is solely on mainly used for this purpose.

The Explanatory Memorandum contains a set of examples to which the reader may refer.[51]

Disaster relief

The proposed amendments also create a category in relating to disaster relief. Importantly, this category will distinguish between and disaster relief provided by certain funds to:

- disaster relief in Australia, and
- disaster relief in developed countries.

Disaster relief in Australia

Item 4 will add proposed **item 4.1.5** to subsection 30-45(1) which will provide the anchor point for this category. Under the proposed law, public funds established for a charitable purpose aiming solely at providing money for the relief of people in Australia and distress may be endorsed as DGRs.

Item 5 will insert a proposed **section 30-46** into the ITAA 1997. This section will provide the criteria for a public fund to be endorsed as a DGR. Relevantly, this proposed provision will characterise the kind of disaster for which the funds may provide relief. For a disaster to qualify under this measure, it must:

- be declared to be a disaster by the relevant decision maker (proposed **paragraph 30-46(1)(a)**)
- have developed rapidly (proposed **paragraph 30-46(1)(b)**), and
- have resulted in the death, serious injury or other physical suffering of a large number of people or in widespread damage to property or the natural environment (proposed **paragraph 30-46(1)(c)**).

Under proposed **subsection 30-46(2)**, a time frame will apply within which gifts to DGRs endorsed under this category must be made to be deductible. This time frame is two years and is linked to the day on which the disaster was declared to be a disaster for the purposes of this provision.

Disaster relief in developed countries

Item 8 proposes to add proposed **item 9.2.2** to subsection 30-80(1) which will establish a category under which certain public funds providing money for the relief of people in countries other than:

- Australia, and
- declared developing countries

may be endorsed as a DGR. These public funds must be established and maintained by a public benevolent institution. Relief must be provided in relation to disasters which fulfil the criteria contained in proposed **subsection 30-86(1)**.

Item 11 proposes to insert **section 30-86**. Proposed **subsection 30-86(1)** provides that the disaster must be recognised by the Treasurer. The Treasurer may recognise a disaster if satisfied that the disaster:

- developed rapidly, and
- resulted in death serious injury or other physical suffering of a large number of people or in widespread damage to property or the natural environment.

Proposed **subsection 30-86(2)** provides certain procedural requirements applying to the Minister's recognition of the disaster, and proposed **subsection 30-86(4)** limits DGR status of disaster relief organisations to a maximum if two years. The recognition of a disaster by the Minister is not a legislative instrument within the meaning of the *Legislative Instruments Act 2003* and therefore not subject to the disallowance procedure in Parliament (proposed **subsection 30-86(3)**).

Animal welfare

Schedule 11 will also introduce a new DGR category for charitable institutions which provide care and rehabilitation to certain animals. **Item 4** will add proposed **item 4.1.6** to the table in subsection 30-45(1) the ITAA 1997, creating this new category.

This new item 4.1.6 will provide that charitable institutions with the principal activity of either:

- providing short-term direct care to animals that have been lost or mistreated or are without owners, or
- rehabilitating orphaned, sick or injured animals that have been lost or mistreated or are without owners

may be endorsed by the ATO as DGRs. Importantly, charitable institutions looking after native animals will not be able to be endorsed as a DGR under this proposed new category. According to the Explanatory Memorandum, such institutions maybe covered as a general environmental organisation under sections 30-55 of the ITAA 1997.[52] Also notice that the principal activity must be care or rehabilitation—where the principal purpose is, for example, political lobbying, the institution will not be able to gain endorsement by the ATO under this category. The Explanatory Memorandum contains a number of examples, to which the reader may refer.[53]

Charitable services

Under the current law, public benevolent institutions concerned with the:

- prevention or control of disease in human beings, or
- prevention and control of behaviour that is harmful or duty to human beings

are not capable of endorsement as a DGR. **Item 4** will rectify this situation, proposing to add new **item 4.1.7** to the table contained in subsection 30-55(1) of the ITAA 1997, creating a new DGR category labelled *Charitable Services*. This category will only be open to institutions, which also provide the above-mentioned services. Institutions which provide solely the above-mentioned services will not be caught by this proposed category, however, they may qualify as charitable under other provisions in the ITAA 1997, including as a possible health promotion charity (section 30-20 ITAA 1997) or a harm prevention charity (section 30-45 ITAA 1997).

Educational scholarships

Item 1 of **Schedule 11** proposes to add **item 2.1.13** to subsection 30-25(1) of the ITAA 1997, proposing to create a new DGR category for educational scholarships. Proposed item 2.1.13 will provide that public funds which are established for charitable purposes, solely providing money for scholarships, bursaries or prices may be endorsed by the ATO as a DGR. The category, however, is subject to the provisions in **item 2**, proposed **section 30-37** of the ITAA 1997, which applies a set of conditions to scholarships, bursaries or prices provided by the public fund. These conditions include that scholarships, bursaries and prices:

- may only be awarded to citizen or permanent residents
- must be open to individuals or groups within certain geographical areas
- must promote education in preschools, primary schools, secondary or tertiary education institutions both in Australia or overseas, and
- must be awarded on either equity or merit grounds.

In addition, a public fund may impose reasonable criteria and eligibility conditions, so that the scholarships, bursaries and prizes can be targeted appropriately. Importantly, payments which are made to the public fund must be made voluntarily for them to remain tax deductible. For example, a payment will not be considered voluntary payment if it was made with the intention of achieving a beneficial flow-on effect such as in form of reduced school fees for the donor's child.[54] Again, the Explanatory Memorandum contains numerous examples which assist in explaining the various conditions of this DGR category.[55]

Schedule 12—GST treatment of gift-deductible entities

Schedule 12 will make several amendments to the *A New Tax System (Goods And Services Tax) Act 1999* (GST Act), modifying some of the law relating to certain *charities* within the meaning of the GST Act (charities).[56] Primarily, the changes relate to the following issues:

- eligibility for cash accounting
- eligibility for GST free supplies
- the choice to elect to input tax fund raising events
- the ability to create non-profit sub entities
- the ability to treat certain reimbursements as credit the creditable acquisitions, and
- no denial of input tax credit for gifts made to certain entities.

Below is a brief discussion of each of the issues, including, where necessary, a brief background relating to the issue and a discussion of the main provisions. The reader may note that the Digest follows the structure of the Explanatory Memorandum for ease of reference.[57]

Eligibility for cash accounting, Subdivision 29-B GST Act

This measure will make changes to the cash accounting rules for some charities and gift-deductible entities.

Unless an entity has chosen to account for its goods and services tax (GST) liability on a cash basis, or the commissioner has committed this entity to do so, the general principle is that the entity is required to comfort GST on accrual basis only.[58] The *Australian GST Handbook 2004/05* explains that:

> There can be significant cash flow consequences depending on whether an entity accounts for GST on a cash or accruals basis. Whether the consequences are positive or negative for a particular entity depends on the speed with which it pays its creditors and collect payment from its because.[59]

Section 29(40) GST Act sets out the requirements according to which an entity can choose to use cash basis accounting. Importantly, the entity has to within the current cash accounting turnover threshold. This threshold is currently $1 million. This cash accounting turnover threshold, however, does not apply to gift-deductible entities. They can utilise cash accounting regardless of their turnover. Based on the Report of the *Inquiry Into The*

Definition Of Charities And Related Organisations, the Government has decided to modify the cash based accounting rules relating to gift-deductible entities. These changes are designed to encounter suggestions that, under the current law, gift-deductible entities which operate funds or institutions endorsed as tax deductible gift recipients can use cash accounting for its entire operations even though only a minor part of the entity's activities is charitable.

Under the proposed law, cash accounting for GST will only be available to the whole operation of the entity if it fulfils the general requirements applicable under the GST Act. **Item 14** of the Schedule 12 will insert **proposed Division 157** into the GST Act for two reasons:

- first—it is envisaged that the new location for the framework will emphasise that it implements a special rule for the GST treatment of charities, and
- second—it will set out the new framework upon which charities can choose their accounting basis.

Proposed **subsection 157-5(1)** will set as general principle that charities may choose to account on cash basis in relation to GST liability. This provision will also contain the timing device, stipulating that this choice will take effect from the first day accounting basis has been chosen by the charity. Proposed **subsections 157-5(2)** and **(3)** provide exceptions to this general principle:

- **subsection 157-5(2)** will specify that charitable institutions and trustees of charitable funds must be themselves *endorsed* charitable institutions or *endorsed* trustees for the above general principle to apply, and
- **subsection 157-5(3)** will provide in relation to *gift-deductible entities* that the general principle will not apply unless the entity is itself a charity.[60]

The proposed effect of these amendments is that a charity will be unable to choose cash based accounting merely on the basis of having some operations which have some form of recognised charitable status. In order to be able to make this choice, the charity must qualify for the accounting base in its own right.

Eligibility for GST free and input taxed supplies, Subdivision 38-G GST Act

A similar problem arises in relation gift-deductible entities' entitlement to provide GST free or input taxed supplies. Under the current law, gift-deductible entities are entitled to provide supplies GST free or input taxed. However, due to the breadth of the term gift-deductible entities, such entities may be eligible provide GST free or input taxed supplies for their entire operation, although only a minor or even negligible aspect of the operation attracts GST free or input taxed treatment. **Schedule 12** of the Bill proposes a variety of modifications to the GST Act to counteract this problem and bring the law in-line with the intended government policy.[61] **Items 6**, **7**, **9**, **10** and **12** propose amendments to current sections 38-250, 38-255, 38-270, 40-160 and 111-18 of the GST Act, adding subsections to clarify that supplies made by gift-deductible entities will only attract GST free and input taxed status if the supplier, that is the gift-deductible entity, is a charity. The Explanatory Memorandum contains examples in relation to this measure to which the reader is referred.[62]

Non-profit sub entities, Division 63 GST Act

The problem also arises in relation to the ability to create so-called *non-profit sub-entities*.[63] Non-profit sub-entities can be created by certain charities under the special rule contained in Division 63 of the GST Act. The effect of creating such sub entities is that their parents cease to be responsible for them, a departure of the general treatment of parents and branches under Division 54 of the GST Act.[64] Due to the broad meaning of the term gift-deductible entity, such entities may avail themselves of this special rule even though only a small part of their operation in fact can attract the application of the rule. **Item 11** proposes to repeal current paragraph 63-5(2)(a), substituting it with new paragraphs 63-5(2)(a) and (aa) with the aim to ensure that only certain charities as well as gift-deductible entities which are non-profit bodies will be able to create non-profit sub-entities under Division 63 of the GST Act.

Change in use of acquisition, Division 129 GST Act

For each tax period, entities must ascertain the so-called *net amount* pursuant to section 17(5) of the GST Act. This net amount is calculated by subtracting all input tax credits from the total amount of GST for which the taxpayer is liable on the taxable supplies attributable to that particular tax period (section 17-5(1) GST Act). Depending upon the net amount, the taxpayer has either a liability to, or a claim against, the Commonwealth. In some circumstances, it is necessary to adjust the net amount. Such adjustments may increase or decrease the net amount and therewith the liability or claim of the taxpayer.[65] The Australian GST Handbook 2004/05 describes the situation in which acquisition-related adjustments can arise as follows:

> If a registered entity makes acquisition or importation and utilises the acquisition or importation solely or partly for a creditable purpose, it is entitled to an input tax credit. However, where the extent of the creditable purpose changes in a subsequent period than the amount of input taxed originally claimed as a credit may have to be adjusted. This will alter the net amount calculated for the relevant tax period.[66]

This kind of adjustment occurs according to Division 129 which provides the framework for this kind of adjustment. Importantly, under subsection 129-45(1) GST Act, the need for adjustment does not arise where the supply took the form of a gift to a charity. Subsection 129(2) provides an exception to this general rule: charitable institutions or trustees of charitable funds, unless they are endorsed, are not covered by it. However, the limitation does not extend to gift deductible entities. Accordingly, the problem alluded to above may arise in this context as well. **Item 13** will insert proposed **subsection 129-45(3)** to provide that gift-deductible entities will not be able to invoke the general rule, unless the entity is a charity itself.

Charities operating retirement villages

Under section 38-260 GST Act, charitable institutions and trustees of charitable funds operating retirement villages can provide certain supplies GST free. This includes the supply of accommodation in the retirement village, the supply of services relating to the accommodation and meal supplies, as long as the supply is made to a resident of the retirement village (subsections 38-260(a) – (c)). **Item 8** we will substitute the current wording of paragraph 38-260(a) clarifying that only *endorsed* charitable institution or trustees to will be able to access this concession.

Schedule 13—Technical correction

Chapter 13 of the Bill will implement a technical clarification by amending the *Tax Laws Amendment (Improvements to Self Assessment) Act (No. 2) 2005* (the Act). It is envisaged, that this clarification will put beyond doubt that the repeal of the six year amendment period for general of anti-avoidance (part IVA) amendments will apply to the 2004-05 income year and later income years. According to the Explanatory Memorandum, this technical correction will bring into line the government's policy as announced in the Treasurer's Press Release No. 106 of 2004 and the its legal implementation.[67]

The financial impact and the compliance cost impact of this measure are estimated to be nil.[68]

Schedule 14—Wine equalisation tax

Background

The background to the Wine Equalisation Tax, and especially the tax rebate on the Wine Equalisation Tax which is the issue of the tax measure of this Schedule, has been discussed in detail in the Parliamentary Library's Bills Digests to the Tax Laws Amendment (Wine Producer Rebate and Other Measures) Bill 2004.[69] Subsequent to the introduction of the rebate, the New Zealand government made strong representations arguing that the rebate on the Wine Equalisation Tax granted to Australian wine producers would contravene the Australia and New Zealand Closer Economic Relations Trade Agreement of 1983 (CER). Further, it was argued that the rebate would also violate the *General Agreement on Tariffs and Trade 1994*[70] (GATT), an integral part of the *Marrakech Agreement Establishing the World Trade Organization* (WTO Agreement) (referred to in this Bills Digest as WTO/GATT Agreement).

The Federal government reacted to these representations and agreed to extend the eligibility to the rebate to New Zealand wine producers. The respective measures have been introduced as Schedule 4 of the Tax Laws Amendment (2005 No. 4) Bill 2005. Please refer to the Parliamentary Library's Bills Digest to the Tax Laws Amendment (2005 No. 4) Bill 2005 for a comprehensive background, detailed analysis of the main provisions and discussion of the potential issues under the WTO/GATT Agreement.[71] Notice, however, that the measures passed as Schedule 4 of the Tax Laws Amendment (2005 No. 4) Bill 2005 have not yet commenced operation.[72]

Current law

Under the *A New Tax System (Wine Equalisation Tax) Act 1999* (WET Act), the Commonwealth levies a wine tax on dealings in wine at wholesale level. The tax rate is currently 29 percent (paragraph 5-5(3)(b) of the WET Act). In order to assist especially small and boutique wine producers, the Federal government decided in 2004 to provide a tax rebate available to all wine producers. Under the current law, wine producers are entitled to tax rebates capped at $290 000. This equates to the equivalent of selling wine valuing $1 million before the wine equalisation tax applies.

Main provision

Under the proposed law, the tax rebate cap will be lifted from $290 000 to $500 000. **Items 1** and **2** will make the necessary changes to subsections 19-15 and 19-25 of the WRT Act, substituting the current cap set at $290 000 with a cap set at $500 000.

Application and revenue implications

According to **item 3**, the increased cap will apply to dealings in wine from 1 July 2006.

According to the Explanatory Memorandum, the revenue implications of this Schedule will be as follows:[73]

Income year	2006-07	2007-08	2008-09	2009-10
Impact on revenue	–$25m	–$33m	–$33m	–$35m

However, it is unclear whether this projection includes the expansion of the rebate to the New Zealand wine producers. See the comment below.

It is expected that there will be no additional compliance costs for taxpayers.

Comment

As indicated in the Bills Digests to the Tax Laws Amendment (Wine Producer Rebate and Other Measures) Bill 2004 and Tax Laws Amendment (2005 No. 4) Bill 2005, the rebate given to Australian and New Zealand wine producers is likely to be a contravention of Australia's international obligations under the WTO/GATT agreement. The issues surrounding this rebate and its extension to the New Zealand wine producers have been discussed at length in these two Bills Digests to which the reader is referred accordingly.

In addition, it is currently unclear whether the predicted revenue implications will include the planned extension of the measure to New Zealand wine producers. If not, the figures set out in the Explanatory Memorandum will be significantly higher as soon as the amendments made by the Tax Laws Amendment (2005 No. 4) Bill 2005 will come into force. In the Explanatory Memorandum to the Tax Laws Amendment (2005 No. 4) Bill 2005, the additional costs for the Australian taxpayer were estimated at $32 million dollars over a period of 4 income years.[74]

Schedule 15—GST treatment of residential premises

Background

This measure is proposed to counteract the Full Court of the Federal Court's decision in *Holdings Pty Ltd v Commissioner of Taxation* [2004] FCAFC 307.

The Marana decision

The measure in this schedule is the legislature's reaction to the Full Court of the Federal Court's (Court) decision in *Marana Holdings Pty Ltd v Commissioner of Taxation* [2004] FCAFC 307 (Marana). The decision in Marana concerned the tax treatment of the sale of a particular strata title property. A property developer purchased an old hotel converted the property, after subdividing and renovating it, into residential apartments. The developer then on-sold one of the apartments.

Relevant to the matter before the Court were two property transactions: first, the transaction between the original owners of the motel and the developer (first sale) and, second, the sale of the property from the developer to a purchaser (second sale).

The second sale between the developer and the purchaser was the contentious issue between the applicants and the Commissioner for Taxation (Commissioner) because a question whether the sale of the property was the sale of a *new residential property* for the purposes of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act). If not, the transaction could have been input taxed—if so, the second sale would have attracted Good and Services Tax (GST) (section 40-65 of the GST Act). Against the submissions of the applicants, the

Court decided that the second sale was a transaction concerning a *new residential premises*, basing its decision on a detailed consideration of the terms 'residence' and 'residential'. Accordingly, the transaction attracted GST.

The outcome of the decision and problems

The Court's decision has caused uncertainty for some taxpayers. The Explanatory Memorandum notes that:

> The court's judgment has resulted in potential difficulties in distinguishing between supplies of premises that are residential premises and therefore input taxed and suppliers that are taxable.[75]

It specifies the following areas of being of particular concern:

- the short-term letting of strata title units such as serviced apartments by owners to guests
- leasing of strata title units to Hotel operators or similar operators, and
- leasing of display homes and provision of certain short-term employee of accommodation.[76]

The proposed amendments aim at clarifying this uncertainty and better implementing the Government's policy intent of the GST law.

The Senate Inquiry into this measure

The Bill was referred to the Senate's Economics Legislation Committee (Committee) on 14 June 2006. The Committee reported on the Bill on 21 June 2006.[77] In relation to the measure set out in Schedule 15, the Committee received two written submissions, one by the Taxation Institute of Australia (TIA) and one by KPMG.[78] At the hearing, it also received oral evidence, provided by the policy manager of the Real Estate Institute of Australia (REIA).[79]

The written submissions as well as the oral evidence provided to the Committee were critical of the proposed amendments and suggested the rejection of the measure. The main concern of the TIA was the retrospectivity of the measure. It was argued that measure could be a breach of the rule of law.[80] The submission of KPMG focused more on the effect of the amendment itself, setting out several examples or 'Illustration of the Flaws in the Bill' to demonstrate that the intended changes, as described in the Explanatory Memorandum, would not be achieved by the proposed law.[81] A third area of critique concerned the drafting process of the ATO's GST Ruling 2000/20.[82] Officers of the Treasury also provided oral evidence in relation to this measure.[83]

Despite these concerns, the Committee, chaired by Senator Brandis, recommended that the Senate should pass the legislation, agreeing with the views expressed by the Treasury.[84] The

Labor Senators, Senator Ursula Stephens and Senator Ruth Webber, provided additional remarks to the Report. The Senators noticed that the evidence provided by Treasury conflicted with the information provided in the Explanatory Memorandum and requested the Minister to explain the inconsistency.[85] The Senators also shared the concerns relating to the retrospectivity of the measure, asking the Minister to seek advice from the Commissioner as to whether discretion could be used to grant relief to the taxpayers affected by the retrospectivity.[86]

Main provisions

The amendments counteract the *Marana* decision. It is intended to achieve this by disconnecting the meaning of *residential premises* from the period of occupant occupation or intended occupation of the premises. This is done in form of a clarification. Accordingly, items **2** to **6** of Schedule 15 will amend various provisions in the GST Act, adding the clarification to the current provisions.

Item 8 proposes to insert a similar clarification into the definition of 'floating home', whilst **item 9** will repeal the definition of *residential premises*, substituting it with a new definition which also contains the clarification. **Item 7** inserts the clarification into paragraph 40-75(1)(a) ITAA 1997 to ensure that property can be sold as *new residential premises* within the meaning of the GST Act, despite having been sold previously as *commercial residential premises*.

The Explanatory Memorandum contains a number of examples which demonstrate the effect of the proposed amendments.[87] The reader may also refer to the examples provided by KPMG to the Committee which suggest that the effect of the proposed legislation may not correlate fully with its intended purpose. [88]

The New Business Tax System (Untainting Tax) Bill 2006

The New Business Tax System (Untainting Tax) Bill 2006 (Untainting Tax Bill) will impose the untainting tax.[89]

Whilst the administrative measures concerning the imposition of the tax are set out in the Amending Bill, the actual imposition of the tax must be contained in separate legislation. This separation is required for constitutional reasons: under section 55 of the Constitution, a law 'imposing taxation shall only deal with the imposition of taxation, and any other matter therein dealing with any other matter shall be of no effect'.

Section 55 is the so-called 'anti-tacking' provision which is important because of the special constitutional role the Senate holds in relation to the House of Representatives when fiscal legislation is concerned. When compared to the House of Representatives, section 53 curbs the Senate's equal legislative powers in relation to fiscal laws. In particular, the Senate cannot amend laws which impose taxation. To protect the Senate from being sidelined with respect to amending legislation which *also* contains the imposition of taxation, the framers decided to stipulate the anti-tacking provision.

Item 3 specifies that the tax stipulated in proposed **section 197-60** is imposed.[90]

Concluding comments

Where necessary, concluding comments have been included in relation to the individual Schedules above.

Endnotes

1. I Gerard, Atomic storm shatters Innisfail, *The Australian*, 21 March 2006, p. 5.
2. Editorial, Media joins swell of support for appeal, *The Courier Mail*, 21 March 2006, p. 3.
3. The Hon J Howard, Prime Minister, North Queensland Cyclone, *press release*, 20 March 2006.
4. The Hon J Howard, Prime Minster, Assistance Measures For Those Affected By Both Tropical Cyclones Monica And Larry, *press release*, 26 May 2006.
5. In contrast, a deduction is a reduction of the assessable income for any loss or outgoing incurred to gain or produce assessable income.
6. Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No. 3) Bill 2006 and New Business Tax System (Untainting Tax) Bill 2006, p. 3.
7. ibid.
8. The Hon J Howard, Prime Minister, Tropical Cyclone Larry, *press release*, 22 March 2006.
9. The Hon J Howard, Prime Minister, Tropical Cyclone Larry – Fuel Excise Relief, *press release*, 26 March 2006.
10. CCH, CCH Master Tax Guide 2006, CCH Australia Limited, Sydney, 2006, p. 286.
11. Explanatory Memorandum op. cit., p. 3.
12. ibid.
13. Greenwoods + Freehills, Share Capital Tainting Rules, *Client Briefing Paper*, 9 June 2006, p. 1.
14. For more information on the simplified imputation system see B Pulle, 'New Business Tax System (Imputation) Bill 2002', Bills Digest, Nos. 165-67, Department of the Parliamentary Library, Canberra 2002-03; CCH Master Tax Guide, op. cit., pp 141-179.
15. Flow-chart compiled by Thomas John for the Department of Parliamentary Services, 2006.

16. C Field, Tax Laws Amendment (No. 7) Bill 1999, Bills Digest, No. 202, Department of the Parliamentary Library, Canberra 1999.
17. CCH Master Tax Guide, op. cit., p. 171.
18. ibid., pp. 174-5.
19. Explanatory Memorandum op. cit., p. 44.
20. ibid., at pp. 28-35.
21. Greenwoods + Freehills, op. cit., pp. 2.
22. Greenwoods + Freehills, op. cit., pp. 1.
23. See explanations in relation to the New Business Tax System (Untainting Tax) Bill 2006 below.
24. These rules apply to pre-1 July 2002 transactions and tainted accounts.
25. PriceWaterhouseCoopers, New share capital tainting rules introduced, *Client Brief*, June 2006; Greenwoods + Freehills, op. cit., pp. 1
26. Greenwoods + Freehills, op. cit., pp. 1-2.
27. Greenwoods + Freehills, op. cit., p. 2
28. Various authors, Workplace Relations Amendment (Work Choices) Bill 2005, Bills Digest, No. 66, Department of Parliamentary Services, Canberra, 2005-06.
29. The eligibility criteria for the Alternative Dispute Resolution Assistance Scheme (ADRAS) are set out in the Operational Arrangements to the scheme; the eligibility criteria for the Unlawful Termination Assistance Scheme (UTAS) are set out in the Operational Arrangement to that regime. For a discussion of the alternative dispute resolution provisions contained in the Workplace Relations Act 1996, please refer to the Bills Digest to the Workplace Relations Amendment (Work Choices) Bill 2005, ibid., pp. 67-77.
30. Decisive is the net capital gain which is calculated on the basis of the capital gains against capital losses.
31. Explanatory Memorandum op. cit., p. 5.
32. The term '*MLS lump sum*' will be defined in subsection 995-1(1), section 61-590 of the ITAA 1997. See discussion below.
33. The taxpayer's *assessable income* is comprised of incoming according to so-called ordinary concepts as well as other amounts which are included into the assessable income by virtue of the provisions of the ITAA 1936 and ITAA 1997. CCH Master Tax Guide 2006, op. cit., p. 15. The term *exempt foreign employment income* will be defined in subsection 995-1(1) of the ITAA 1997. See item 5 to Schedule 6 of the Bill.
34. Explanatory Memorandum op. cit., p. 5.
35. On the abolition of the surcharge, see generally L Nielson, Superannuation Laws Amendment (Abolition of Surcharge) Bill 2005, Bills Digest, No. 169, Department of Parliamentary Services, Canberra, 2004-05. See also L Nielson, Superannuation ready reckoner: taxation, preservation,

self-managed superannuation funds and social security rules for 2005–06, Research Brief, No. 3, Department of Parliamentary Services, Canberra, 2005-06.

36. The Hon M Brough, Assistant Treasurer, Fringe Benefit Tax Reporting Exclusion, press release, 8 September 2005.

37. The Treasury, Treasury's consultation processes on announced tax measures, currency: 26 February 2006, p. 10.

38. CCH Master Tax Guide 2006, op. cit., p. 1730.

39. ibid., p. 1731.

40. Explanatory Memorandum op. cit., p. 70.

41. ibid,. p. 69.

42. ibid.

43. Note that FBT years run from 1 April of one year to 31 March of the following year.

44. CCH Master Tax Guide 2006, op. cit., p. 308. *Unfunded liabilities* are those superannuation liabilities for employment services already rendered but for which no assets are held.

45. The Department of Finance and Administration explains the term 'unfunded superannuation scheme' as follows: [A] scheme where the employer does not pay contributions to a superannuation fund. Instead, the employer contributes when the employee's benefit is paid. For taxation purposes, it is also known as an untaxed scheme. Some schemes provide a combination of funded and unfunded benefits.' Department of Finance and Administration, Superannuation Glossary.

46. Explanatory Memorandum, op. cit., p. 78.

47. **Public ancillary funds** are established and maintained under a will or instrument of trust, solely for the purpose of providing money, property or benefits to deductible gift recipients (DGSs) or the establishment of such DGRs. Australian Tax Office, *Endorsed DGRs - GiftPack for deductible gift recipients & donors – Ancillary Fund*, available at http://www.ato.gov.au/nonprofit/content.asp?doc=/content/34490.htm&page=13, accessed 28 June 2006. A **prescribed private fund** is a 'trust to which businesses, families and individuals can make tax deductible donations. It is prescribed by law. The fund may make distributions only to other deductible gift recipients that have been either endorsed by the ATO or are listed by name in the income tax law.' Australian Tax Office, Prescribed Private Funds – An overview, available at http://www.ato.gov.au/nonprofit/content.asp?doc=/content/8724.htm, accessed 29 June 2006.

48. Explanatory Memorandum, op. cit., p. 8.

49. T John, Extension of Charitable Purpose Bill 2004, Bills Digest, No. 164, Department of Departmental Services, Canberra, 2002-04.

50. The only DGRs that do not need to be endorsed are those specifically listed by name in the income tax law, including prescribed private funds.

51. Explanatory Memorandum op. cit., pp. 89-91.

52. ibid., p. 96.
53. ibid., pp. 96-97, examples 11. 14 to 11.19.
54. ibid., p. 102.
55. ibid., pp. 99 – 104, examples 11.22 to 11.32.
56. A charity is defined under the GST Act include: charitable institutions, trustees of charitable funds, gift-deductible entities and government schools. A Carey, J A Davison, P R Hill, I G Murray-Jones, P A Stacey, *Australian GST Handbook 2004/05,* Australian Tax Practice, Thompson ATP, Melbourne, 2005, p. 246.
57. Explanatory Memorandum, op. cit., pp. 108-112.
58. Applying cash accounting principles means that GST is payable on money received as opposed to debts owed.
59. Australian GST Handbook 2004/05, op. cit., p. 119.
60. A *gift-deductible entity* is defined in section 195-1 of the GST Act as 'an entity is a gift-deductible entity if gifts or contributions made to it can be deductible under Division 30 of the ITAA 1997.' See also A Carey, J A Davison, P R Hill, I G Murray-Jones, P A Stacey, *Australian GST Handbook 2004/05*, Australian Tax Practice, Thompson ATP, Melbourne, 2005, p. 247.
61. Explanatory Memorandum op. cit., p. 109.
62. ibid., pp. 110-111.
63. These non-profit sub entities include charities within the meaning of the GST Act. See further Australian GST Handbook 2004/05, op. cit., p. 459-60.
64. ibid., p. 459.
65. ibid., p. 133.
66. ibid., p. 138.
67. Explanatory Memorandum op. cit., p. 113.
68. ibid., p. 9.
69. T John, Tax Laws Amendment (Wine Producer Rebate and Other Measures) Bill 2004, Bills Digest, No. 9, Department of Parliamentary Services, Canberra, 2004-05.
70. Which incorporates the *General Agreement on Tariffs and Trade 1947.*
71. T John, Tax Laws Amendment (2005 No. 4) Bill 2005, Bills Digest, No. 22, Department of Parliamentary Services, Canberra, 2005-06.
72. The commencement provision section 2 of the Tax Laws Amendment (2005 No. 4) Act 2005, stipulates that Schedule 4, the wine equalisation tax measures, will commence: at a single day to be fixed by Proclamation or, 'if any of the provision(s) do not commence within the period of 12 months beginning on the day on which this Act receives the Royal Assent, they commence on the first day after the end of that period'. The Tax Laws Amendment (2005 No. 4) Act 2005 received Royal Assent on 19 December 2005, so that the latest these measures will come into force will be 20 December 2006.

73. Explanatory Memorandum op. cit., p. 10.
74. Explanatory Memorandum to the Tax Laws Amendment (2005 No. 4) Bill 2005, p. 5.
75. Explanatory Memorandum, op. cit., p. 117.
76. ibid.
77. Senate Economics References and Legislation Committees, Provisions of the Tax Laws Amendment (2006 Measures No. 3) Bill 2006, Report, Canberra, 21 June 2006.
78. The submissions were published by the Committee at http://www.aph.gov.au/Senate/committee/economics_ctte/tlab_3/submissions/sublist.htm.
79. The oral evidence is summarised and referred to in the Committee's Report: Senate Economics Committee, *Inquiry into the provisions of the Tax Laws Amendment (2006 Measures No. 3) Bill 2006*, Report, 21 June 2006.
80. Taxation Institute of Australia, Submission to the Senate Economics Committee, 16 June 2006.
81. KPMG, Submission to the Senate Economics Committee, 19 June 2006.
82. Committee Report, p. 10.
83. ibid., pp. 11-13.
84. ibid., p. 13.
85. ibid., p. 16.
86. ibid., p. 17.
87. Explanatory Memorandum, op. cit., pp. 120-123, Examples, 15.1-15.4. The examples provided by KPMG can be found in their written submissions to the Committee, KPMG, op. cit., pp. 3-5.
88. KPMG, Submission to the Senate Economics Committee, 19 June 2006.
89. See discussion above, Schedule 4 to the Bill.
90. See discussion above, Schedule 4 to the Bill.

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