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BILLS DIGEST

8 August 2007, nos. 15–17 2007–08, ISSN 1328-8091

Tax Laws Amendment (2007 Measures No. 4) Bill 2007

Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No. 1) 2007

Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No. 2) 2007

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Economics Section

Contents

Tax Laws Amendment (2007 Measures No. 4) Bill 2007

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Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No. 2) 2007

Date introduced: 21 June 2007

House: House of Representatives

Portfolio: Treasury

This Bills Digest deals with the Tax Laws Amendment (2007 Measures No. 4) Bill 2007 (the Bill) and the companion Taxation (Trustee Beneficiary Non-Disclosure Tax) Bill (No.1) 2007 (the No. 1 Bill) as well as the companion Taxation (Trustee Beneficiary Non-Disclosure Tax) Bill (No.2) 2007 (the No. 2 Bill). The Explanatory Memorandum covers the three Bills.

Commencement:

- The *Tax Laws Amendment (2007 Measures No. 4) Act 2007* commences on the day it receives the Royal Assent. The amendments made by the Schedules to this Act commence and apply at various dates which are indicated in the commentaries under each Schedule.
- Sections 1 and 2 of the *Taxation (Trustee Beneficiary Non-disclosure Tax) Act (No. 1) 2007* commence on the day they receive the Royal Assent. Sections 3 and 4 commence at the same time as Schedule 4 to the *Tax Laws Amendment (2007 Measures No. 4) Act 2007* commences.
- Sections 1 and 2 of the *Taxation (Trustee Beneficiary Non-disclosure Tax) Act (No. 2) 2007* commence on the day they receives the Royal Assent. Sections 3 and 4 commence at the same time as Schedule 4 to the *Tax Laws Amendment (2007 Measures No. 4) Act 2007* commences.

Links: The relevant links to the Bill, Explanatory Memorandum and second reading speech can be accessed via BillsNet, which is at http://www.aph.gov.au/bills/. When Bills have been passed they can be found at ComLaw, which is at http://www.comlaw.gov.au/.

Purpose

There are eight Schedules in the main Bill and the purpose of the amendments in each Schedule is briefly set out below.

- Schedule 1 - This Schedule establishes and rewrites new simplified foreign income tax offset rules in the *Income Tax Assessment Act 1997* (ITAA 1997), replacing the current foreign loss and foreign tax credit quarantining rules in the *Income Tax Assessment Act 1936* (ITAA 1936).
- Schedule 2 – This Schedule provides a capital gains tax (CGT) roll-over relief when a membership interest in a medical defence organisation (MDO) is replaced with a similar membership interest in another MDO.
- Schedule 3 – This Schedule modifies several sections of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) to:
  - allow superannuation funds to invest in instalment warrants of a limited recourse nature; and
  - alter the in-house asset rules within the SIS Act so that investment in a related trust forming part of an instalment warrant arrangement will, in certain cases, only be considered to constitute an in-house asset where the underlying asset would itself constitute an in-house asset of the fund if it were held directly.
- Schedule 4 – This Schedule provides for trustees of closely held trusts to provide the Commissioner with details of trustee beneficiaries that are presently entitled to income of the trust instead of the ultimate beneficiaries of trust income.
- Schedule 5 – This Schedule amends various Acts to assist in the transition to the *Simplified Superannuation* regime.
- Schedule 6 – This Schedule amends the ITAA 1997 to update the list of deductible gift recipients (DGRs).
- Schedule 7 – This Schedule makes technical corrections and other minor amendments to improve readability and correct errors.
- Schedule 8 – This Schedule amends the trust loss provisions in Schedule 2F of the ITAA 1936 to enable family trust elections and interposed entity elections to be revoked or varied in certain limited circumstances. It also changes the definition of family trust to include lineal descendants.

The No. 1 Bill imposes the trustee beneficiary non-disclosure tax on the failure of the trustee to make a correct statement. This is to impose the tax to reflect the amendments proposed in Schedule 4 the main Bill. Tax is levied on the trustee beneficiary's share of net income at 46.5 per cent.

The Taxation (Trustee Beneficiary Non-Disclosure Tax) Bill (No.2) 2007 (the No. 2 Bill) imposes a penalty tax of 46.5 per cent on the whole or part of the untaxed part of the net income. This addresses the proposed amendments in Schedule 4 to the main Bill. A share of net income of a closely held trust is included in the assessable income of a trustee beneficiary when the trustee of the closely held trust becomes entitled to the whole or part of that net income. This penalty tax is intended to discourage income flowing to and from a chain of trusts without reaching an ultimate beneficiary.

Schedule 1—New foreign income tax offset rules

Background and Main provisions

Basis of policy commitment

The amendments in Schedule 1 of the Bill give effect to the Government's announcement in the May 2005-06 Budget to relieve double taxation by providing a tax offset in certain circumstances.

In the Treasurer's Press Release on 10 May 2005, the Treasurer announced the Government's decision to remove the existing rules that limit the utilisation of foreign losses and which require the allocation of foreign tax credits against separate classes of income.[1] The Treasurer stated that the removal of the foreign loss and foreign tax credit quarantining rules are part of the changes arising from the Government's Review of International Tax Arrangements (RITA) that were announced on 10 May 2005:

> The reforms are part of an ongoing process that the Government is undertaking to ensure that Australia has a competitive international tax system. By attracting foreign capital to supplement local savings, higher rates of economic growth and employment levels are possible, resulting in higher standards of living for Australians than otherwise could be achieved.

Review of International Taxation Arrangements

On 28 February 2003, the Board of Taxation (the Board) reported to the Government on the outcome of its consultation processes and its recommendations (based on consultation paper prepared by Treasury titled *Review of International Taxation Arrangements - A Consultation Paper*.[2]

On 13 May 2003, the Treasurer released the Board's report titled *Review of International Taxation Arrangements*, and the Government's response to the report.[3] The Treasurer's

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1. The Hon. Peter Costello, MP, Treasurer, *International Tax Reforms*, Media Release, 10 May 2005.

2. The Treasury, *Review of International Taxation Arrangements – A Consultation Paper*, Canberra, 19 September 2002.

3. The Board of Taxation, *Review of International Taxation Arrangements*, A report to the Treasurer, Canberra, 28 February 2003.

Press Release indicated the relative priorities of the taxation reforms by assigning them to particular tranches of legislation.[4]

Position of significant interest groups

The introduction of the Bill follows a period of consultation with interested parties and the accounting profession. The Institute of Chartered Accountants has welcomed the new rules with minor reservations:

> The Institute is pleased to see these amendments finally being introduced, following a series of confidential consultations with Treasury spanning over two years. Whilst these amendments provide some improvements to the foreign loss and foreign tax credit measures, there are aspects of these amendments that are not so favourable. For example, the ongoing ability to carry forward excess foreign tax credits has been removed. However, at least partly due to our lobbying efforts, a transitional rule has been included to allow the carrying forward of excess foreign tax pertaining to the five years prior to the commencement of the new rules. (See FTEs, abolition of foreign loss & foreign tax offsets quarantining.)

On 21 June 2007, the Bill was referred to the Senate Economics Legislation Committee for inquiry and its report was tabled on 1 August 2007.[5]

In its submission to the inquiry, the Australian Bankers' Association (ABA) supported the general thrust of the Bill and new foreign income tax offset rules, but recommended a number of changes to the offshore banking provisions in the Bill to overcome some new and unintended consequences:

> Whilst the ABA strongly welcomes the abolition of foreign loss and foreign tax credit quarantining and the simplification to the current law proposed under the TLAB No. 4, the ABA believes the amendments as they impact Offshore Banking Units is in conflict with the policy intent behind the Offshore Banking regime, instead weakening Australia's attractiveness as a financial centre. In addition, the current proposed amendments create inconsistencies between the way double taxation is

4. The Hon. Peter Costello, MP, Treasurer, *Review of International Taxation Arrangements*, Media Release, 13 May 2003.

5. Senate Standing Committee on Economics:

Tax Laws Amendment (2007 Measures No. 4) Bill 2007 [Provisions]

Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No. 1) 2007 [Provisions]

Taxation (Trustee Beneficiary Non-disclosure Tax) Bill (No. 2) 2007 [Provisions] (August 2007)

> relieved with respect to Offshore Banking (OB) income and non-OB income. (See Submission No. 1, Australian Bankers' Association.)

Key issues

The main effect of the measures in Schedule 1 of the Bill is to remove the existing foreign loss and foreign tax credit quarantining rules and replace them with new simplified foreign tax offset rules. Schedule 1 also contains transitional rules dealing with existing foreign losses and credits as well as a mechanism to provide relief from economic double taxation arising from transfer pricing adjustments.

In their private commentary on the measures in Schedule 1 of the Bill, Greenwoods & Freehills noted that the basic elements of the current foreign tax credit (FTC) system are unchanged and that the proposed measures formalise many of the tax rulings by the Australian Taxation Office on the FTC system:

> In an unexpected move, the drafter has taken the opportunity to re-write this legislation in its entirety. The re-write addresses some of the existing problems in the FTC system, but it can be safely predicted that the changes in terminology will introduce some new and unintended issues. In addition to the unintended changes, several aspects of the FTC system policy have been deliberately changed in the re-written provisions. The Bill also formalises many of the current "administrative fixes" that the Australian Taxation Office has adopted over the years in a multitude of tax rulings to make the FTC system work properly.
>
> Many of the basic elements of the foreign income tax offset system are the same as the existing FTC system:
>
> - The tax offset is available for foreign tax on amounts included in Australian assessable income.
> - A tax offset is only available for foreign income taxes. Some taxes will not qualify as income taxes, and the Bill retains the current exclusion for a credit absorption tax or unitary tax. The Explanatory Memorandum ("**EM**") to the Bill states that a tax offset is available for national income taxes, sub-national income taxes, and even supra-national income taxes – it gives the example of income taxes paid to the EU. The Bill also continues the existing reversal of the offset if the foreign tax is subsequently refunded or is otherwise reimbursed to the taxpayer.
> - The amount of tax offset is limited to the greater of the amount for foreign tax paid or the Australian tax payable.
> - The foreign tax must be one which the taxpayer has paid or, in some cases, borne. Current law expresses this requirement in a rule that the tax must be one for which the taxpayer was "personally liable." According to the EM, the Bill removes this additional requirement because it is unnecessary – a

> simpler formula will achieve what is required, namely, that a person who pays tax in a representative capacity is not entitled to the tax offset. Other provisions in the Bill provide that a person who has borne the cost of tax imposed by law on, and paid by, another, or paid by another under an arrangement, will be entitled to the tax offset. (See, Further International Tax Reforms.)

Greenwoods & Freehills also noted that the measures in Schedule 1 of the Bill make important changes to the current policy, namely:

- It is no longer a requirement that the amount included in the assessable income of a taxpayer has a foreign source; and
- The new rules will extend to amounts that are included in the assessable income of non-resident taxpayers.

Overview of amendments

Item 1 in **Part 1** of **Schedule 1** of the Bill amends the ITAA 1997 to introduce new foreign tax offset provisions that will allow taxpayers to claim relief in the form of a tax offset for foreign income tax paid on an amount included in their assessable income. The amendments also cap the foreign tax offset by reference to the amount of Australian tax payable on double-taxed amounts and other assessable income amounts that do not have an Australian source.

Proposed section 770-75 inserts a limit on the tax offset for a year. According to the Explanatory Memorandum to the Bill, the rationale for the foreign tax offset limit will allow a greater average capacity and is the rationale for the removal of the carry-forward of excess foreign tax credits:

> In ascertaining the amount of the foreign tax offset, taxpayers will no longer be required to quarantine assessable foreign income amounts into four separate classes. Rather, a taxpayer can combine all assessable foreign income amounts when working out a tax offset entitlement, allowing the taxpayer a greater averaging capacity than under the old foreign tax credits. This greater averaging capacity will minimise the amount of foreign tax that goes unrelieved. Consequently, the mechanism allowing the carry-forward of excess foreign income tax will be removed.[6]

The amendments in **Part 2** of **Schedule 1** to the ITAA 1936 and the ITAA 1997 provide that an Australian taxpayer who is attributed with income from holding an interest in a controlled foreign company (CFC) or foreign investment fund (FIF) is entitled to a tax offset for the underlying tax that the CFC or FIF has paid.

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6. *Explanatory Memorandum*, p. 15.

Part 3 of **Schedule 1** inserts transitional provisions to the *Income Tax (Transitional provisions) Act 1997* concerning the treatment of pre-commencement foreign losses.

Part 4 of **Schedule 1** inserts consequential amendments to various Acts.

As the amendments in **Schedule 1** of the Bill in fact rewrite the provisions of the ITAA 1936 relating to foreign income tax offsets into the ITAA 1997 it is beyond the scope of this Bills Digest to make a detail commentary of the main provisions. The reader is therefore referred to paragraphs 1.18 to 1.29 on pages 14 to 21 of the Explanatory Memorandum for a summary of the new law and tables setting out a comparison between the new law and the current law.

Financial impact

The Explanatory Memorandum on page 3 states that the cost to revenue of the new foreign income tax offset rules will be $40 million per annum.

Application

The new foreign income tax offset rules commence for the income year that starts on or after 1 July, after the Bill receives Royal Assent (under **item 2** in the table in **clause 2** of the Bill). The earliest date for the commencement of the new rules is 1 July 2008 for the 2008-09 income year.

Schedule 2— Capital gains tax roll-over for medical defence organisations

Background

The Review of Business Taxation (the Review) in its report titled *A New Tax System Redesigned* recorded that a number of submissions suggested that the then existing CGT provisions were an impediment to corporate acquisition activity in Australia.[7] The review noted that entities may be forced to pay a premium when making an acquisition to induce equity holders with potential CGT liabilities to accept an offer. This did not contribute to an efficient use of resources. The Review therefore recommended a scrip-for-scrip roll-over relief to resident taxpayers. The effect of the roll-over relief will be that resident taxpayers will retain the value of their membership interests represented by the original

7. *A New Tax System Redesigned* (July 1999), the report of the Review of Business Taxation under the Chair of Mr John Ralph AC, p. 61.

scrip and will not be required to pay tax on capital gains at the time of the takeover. The CGT payable will be deferred until the ultimate disposal of the new scrip.

In consequence of accepting this recommendation of the Review, Subdivision 124-M was inserted into the ITAA 1997 to provide a CGT scrip-for-scrip roll-over by Act No 165 of 1999. Subdivision 124-M allows a person to choose a roll-over where post-CGT shares or trust interests owned by that person are replaced with other shares or interests.

However, in the case of companies limited by guarantee (where there are no shareholders but only members who have a membership interest), the roll-over relief is not available under Subdivision 124-M where the membership interest in a company limited by guarantee is exchanged for a membership interest in a like company.

On 14 February 2007, the Minister for Revenue and Assistant Treasurer announced in a Press Release that the Government had decided to amend the ITAA 1997 to extend the CGT scrip-for-scrip roll-over to membership interests in companies limited by guarantee that are medical defence organisations (MDOs).[8] The press release indicated that the amendments will ensure that CGT need not be an impediment to mergers of MDOs.

Main provisions

Item 5 of **Schedule 2** inserts **proposed Subdivision 124-P** into the ITAA 1997 to provide roll-over relief where a person exchanges his or her interest as a member of a MDO for an interest as a member of another MDO.

Proposed section 124-980 of Subdivision 124-P sets out the conditions when roll-over relief is available to an entity. These are:

(a) an entity exchanges an interest (the original interest) in an MDO (the original MDO) as a member of the original MDO for a similar interest (the replacement interest) in another MDO (a new MDO), and

(b) both the original MDO and the new MDO are companies limited by guarantee, and

(c) the exchange is in consequence of a single arrangement that satisfies **proposed subsection 124-980(3)**, and

(d) the entity would make a capital gain, apart from the roll-over, and

(e) the entity chooses to obtain the roll-over, and

(f) the entity acquired the original interest on or after 20 September 1985.

8. The Hon Peter Dutton, MP, The Minister for Revenue and Assistant Treasurer, *Amendments to the Capital Gains Tax Scrip for Scrip Roll-Over*, Media Release, 14 February 2007.

Proposed subsection 124-980(3) sets out the types of arrangement for the exchange of membership interests. These are that the arrangement must:

(a) result in the new MDO becoming the sole member of the original MDO, and

(b) be one where holders of interests in the original MDO must be able to participate as members of the new MDO on substantially the same terms.

In other words, the new MDO must takeover all the member interests in the old MDO and provide substantially similar membership interests in the new MDO to the members of the old MDO.

A MDO is defined in section 5 of the *Medical Indemnity Act 2002* and is adopted for the purposes of the ITAA 1997. MDOs provide indemnity insurance to members of the medical profession through wholly-owned captive insurers.

Financial Impact

The Explanatory Memorandum to the Bill on page 4 states that the financial impact of this measure is nil.

Application

Item 6 of **Schedule 2** provides that the amendments made by this Schedule apply to CGT events happening on or after 14 February 2007.

Schedule 3—Investment by superannuation funds in instalment warrants

Background

Instalment warrants allow investors to obtain an interest in a share or asset by paying part of the purchase price upfront and the remaining part in instalments.[9] Traditionally

9. The Explanatory Memorandum for the proposed Bill states (p. 122): 'Traditionally, such arrangements provide the investor with the right, but not the obligation, to buy the underlying asset through the payment of instalments. Investors in instalment warrants have a beneficial interest in the underlying asset, subject to a security interest held by the issuer that secures the payment of later instalments. Once the investor has made the first instalment they are likely to be entitled to income from the underlying asset (eg, dividends from shares).'

instalment warrants have involved investments in listed shares but, more recently, warrants have also been available on other assets such as managed funds and property.[10]

While precise figures are unavailable on the extent to which superannuation funds (and self-managed funds more specifically) have invested in instalment warrants over time, the Minister for Revenue and Assistant Treasurer, the Hon. Peter Dutton, MP, in a Press Release stated that:

> … the practice is long standing and widespread and superannuation fund investment comprises a significant proportion of the instalment warrant market.[11]

The attractiveness of instalment warrants (particularly for self-managed superannuation funds) lies in part in their 'set and forget' nature – they allow investors to purchase an interest in a share or asset through an initial part payment and to then pay the remainder at a later date, with the assistance of an income stream (dividends and franking assets) from the underlying share or asset. The Australian Financial Markets Association (AFMA), in a submission to the Senate Economics Committee inquiry into the Bill have also suggested that instalment warrants offer a number of other important benefits, including:

- leveraged investment exposure to the movement of the underlying asset's capital value,
- the investor is entitled to tax benefits from deductions and franking credits, and
- capital protection for the amount of the loan exists because the completion payment for the underlying asset is not compulsory.[12]

A number of provisions within previous legislation are relevant to the investment in instalment warrants by superannuation funds. These provisions are listed on pp. 121-122 of the Explanatory Memorandum, and include:

- section 67 of the SIS Act, which prohibits superannuation fund trustees from borrowing money (with certain exceptions, primarily relating to short term liquidity).
- sections 82 and 83 of the SIS Act, which prohibit superannuation fund trustees from retaining or acquiring in-house assets representing more than 5 per cent of the value of

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10. See, for example, J. Wasiliev, 'Decision clears up uncertainty, at last', *Australian Financial Review*, 30 May 2007.

11. The Hon. Peter Dutton, MP, Minister for Revenue and the Assistant Treasurer, *Investment in Instalment Warrants by Superannuation Funds*, Media Release, 3 November 2006.

12. Australian Financial Markets Association, 2007, Tax Laws Amendment (2007 Measures No. 4) Bill 2007– Schedule 3, submission to the Senate Standing Committee on Economics, 10 July 2007.

all the fund's assets, and subsection 71 (1), which states that an investment in a related trust of the fund is an in-house asset of the fund (subject to certain exceptions), and

- regulation 13.14 of the *Superannuation Industry (Supervision) Regulations 1994* which prohibits a trustee from giving a charge over, or in relation to, an asset of the fund (except in relation to certain charges which are unrelated to instalment warrants).

Recent regulatory interpretation of these provisions has created uncertainty about ongoing superannuation fund investment in warrants. In November 2006 the Hon. Peter Dutton, MP, announced that both the Australian Taxation Office and the Australian Prudential Regulation Authority had concluded that instalment warrants entailed a borrowing for the purposes of section 67 of the SIS Act and were therefore not an allowable investment under current legislation.[13] The Assistant Treasurer also announced at this time that, following industry consultation, the Government intended to legislate to allow a continuation of investment by superannuation funds in instalment warrants.

Thus, as the Senate Standing Committee on Economics (2007) states, the changes contained with Schedule 3:

> … are intended to provide superannuation funds with greater flexibility in their investment options, while still maintaining the integrity of the risk provisions that apply to superannuation funds.[14]

Position of significant interest groups

The proposed Schedule 3 amendments have received broad support from the superannuation industry. Several commentators have described the amendments as providing a welcome clarification of the investment status of instalment warrants, particularly the so-called new generation of warrants involving assets such as managed funds and property.[15] The amendments have also been seen by the industry as providing

13. Australian Financial Markets Association, 2007, Tax Laws Amendment (2007 Measures No. 4) Bill 2007– Schedule 3, submission to the Senate Standing Committee on Economics, 10 July.

14. Senate Standing Committee on Economics, 2007. *Tax Laws Amendment (2007 Measures No. 4) Bill 2007 [Provisions], Taxation (Trustee Beneficiary Non-Disclosure Tax) Bill (No.1) 2007 [Provisions], Taxation (Trustee Beneficiary Non-Disclosure Tax) Bill (No. 2) 2007 [Provisions]*, Final Report, August, p. 5.

15. J. Wasiliev, 'Decision clears up uncertainty, at last', *Australian Financial Review*, 30 May 2007.

much needed clarity for the self-managed superannuation funds sector, where investment in instalment warrants is popular.[16]

In its recent submission to the Senate Standing Committee on Economics (2007), AFMA suggested that the wording of Schedule 3 should be altered to include investments in instalment warrants by superannuation funds that do not involve borrowing.[17] It states:

> Instalment-style investments that are structured so they do not feature a borrowing (and, hence, are already compliant with section 67) cannot access this exception under the current wording. Instead, they must rely on the Excluded Instalment Trust exception which is limited under the subsection 10(1) definition to listed securities.
>
> It seems strange that instalment arrangements that feature a borrowing enjoy a broader exception than those which do not. Accordingly we recommend the subsection 10(1) definition be expanded, and offer the following wording to illustrate how this might be achieved (expanded term in bold font):
>
> "excluded instalment trust", of a superannuation fund, means a trust:
>
> (a) that arises because a trustee or investment manager of the superannuation fund makes an investment under which a listed security (within the meaning of subsection 66(5))(the underlying security) **an asset which the superannuation fund is not otherwise prohibited by this or any other Act from acquiring** is held in trust until the purchase price of the underlying security is fully paid.[18]

In response to this point, Treasury stated that it:

> had not formulated a position on the issues raised by AFMA about instalments with no borrowing because
>
> (a) these issues are essentially outside the scope of the bill; and
>
> (b) that particular part of the market appears to be small.[19]

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16. J. Wasiliev, 'Instalment warrant laws ease', *Australian Financial Review*, 23 May 2007.

17. Australian Financial Markets Association, 2007, Tax Laws Amendment (2007 Measures No. 4) Bill 2007– Schedule 3, submission to the Senate Standing Committee on Economics, 10 July.

18. Australian Financial Markets Association, 2007, Tax Laws Amendment (2007 Measures No. 4) Bill 2007– Schedule 3, submission to the Senate Standing Committee on Economics, 10 July, p. 2.

19. Senate Standing Committee on Economics, 2007, Final Report, op. cit, p.15.

Main provisions

Item 1 of **Schedule 3** inserts **proposed subsection 67(4A)** into the SIS Act. This provides for an exception to the prohibition on borrowing in section 67 of the Act and will allow superannuation fund trustees to borrow money under certain conditions. These conditions are described on p. 123 of the Explanatory Memorandum as follows:

- the borrowing is used to acquire an asset that is held on trust so that the superannuation fund trustee receives a beneficial interest and a right to acquire the legal ownership of the asset (or any replacement) through the payment of instalments,
- the lender’s recourse against the superannuation fund trustee in the event of default on the borrowing and related fees, or the exercise of rights by the fund trustee, is limited to rights relating to the asset, and
- the asset (or any replacement) must be one which the superannuation fund trustee is permitted to acquire and hold directly.

Item 2 of **Schedule 3** inserts **proposed subsections 71(8) and (9)** into section 71 of the SIS Act which contain the in-house asset rules. This is to provide that investment in a related trust will only be deemed to be an in-house asset where the original or replacement asset is an in-house asset of the fund. This essentially means that an investment in an instalment warrant will not be automatically counted against an in-house asset limit.[20]

Financial impact

The Explanatory Memorandum to the Bill on page 5 states the above measures will have the revenue implications set out in the following table.

2006-07	2007-08	2008-09	2009-10
-$50m	-$90m	-$100m	-$110m

Application

The amendments by **Schedule 3** apply from the day on which this Act receives the Royal Assent.

20. *Explanatory Memorandum*, p. 124

Schedule 4—Trustee beneficiary reporting rules for certain closely held trusts

Background and Main provisions

Division 6D - *A New Tax System* initiative in 1999 to address tax minimisation through complex trust structures

The genesis of Division 6D can be traced to the announcement made by the Government on presenting the package of measures in the *A New Tax System* (ANTS package) in August 1998 to address tax minimisation through the use of complex trust structures.[21]

A full background and history is at Attachment A of this Bills Digest.

Announcement of changes to Division 16D

As part of the 2006-07 Budget, on 9 May 2006 the Treasurer announced that a range of simplified tax arrangements would be introduced, including for family trust elections, ultimate beneficiary reporting and distributions to non-residents by trusts and managed funds.[22] The Treasurer stated that the changes relating to ultimate beneficiary reporting would simplify the reporting requirements under the **ultimate beneficiary rules** so that trustees of closely held trusts need only identify and report first-tier trustee beneficiaries in receipt of trust distributions. The ultimate beneficiary rules in operation at present require these trustees to trace through chains of trusts to identify the ultimate beneficiaries of distributions from the trust. Currently a trustee could be liable to pay ultimate beneficiary non-disclosure tax if a mistake is made by any trust anywhere along the chain.[23]

Measures implemented by Schedule 4

The main purpose of Division 6D will be changed from requiring the trustee of a closely held trust to disclose the ultimate beneficiaries of the trust to one requiring the trustee to advise the Commissioner details of the trustee beneficiaries that are presently entitled to a share of the income or of a tax-preferred amount. These trustee beneficiaries are generally

21. *Tax Reform not a new tax a new tax system*, The Howard Government's Plan for a New Tax System, circulated by the Hon. Peter Costello, MP, Treasurer of the Commonwealth of Australia, Canberra, August 1998.

22. The Hon Peter Costello, MP, Treasurer, *Further measures to simplify and streamline tax system*, Media Release, Canberra, 9 May 2006.

23. ibid.

referred to as the first-tier trustee beneficiaries. **Item 1** of **Schedule 4** repeals subsection 102UA(1) and substitutes **proposed subsection 102UA(1)** to state the changed purpose of Division 6D. **Items 2** and **3** amend subsections 102UA(2) and (3) as a consequence to this altered purpose of Division 6D.

Ultimate beneficiary (UB) statements replaced by trustee beneficiary (TB) statements

The concept of Correct UB statement in section 102UG is being replaced by the concept of Correct TB statement. **Item 15** of **Schedule 4** repeals section 102UG titled – Correct UB statement, and substitutes **proposed section 102UG** titled - Correct TB statement, under which the trustee of a closely held trust must advise the Commissioner, in the form approved by the Commissioner, of certain details about each trustee beneficiary that is entitled to a share of the trust's net income or tax-preferred amounts.

Item 16 repeals section 102UH which deals with UB statement period and substitutes it with **proposed section 102UH** dealing with TB statement period. The TB statement must be provided by the due date for lodgment of the closely held trust's tax return (or further period allowed by the Commissioner).

Commissioner may determine that a class of trustees is not required to make a TB statement

Under **proposed subsection 102UK(1A)** the Commissioner can make a determination by legislative instrument that a specified class of trustees is not required to make a TB statement for a year of income.

Proposed subsection 102UK (1B) provides that a determination made under **proposed subsection 102UK(1A)** may be expressed to be subject to conditions and may be for one or more years of income. Note **proposed subsection 102UK(2)(a)** imposes the liability to pay the relevant tax which is separately levied by virtue of Bill No. 1.

Family trusts and certain other trusts to be excluded from the definition of closely held trusts and hence from the TB reporting requirements

Family trusts (and related trusts) will be excluded from the reporting requirements on the basis that any outside distributions are already subject to penalty tax.

What is a closely held trust?

A closely held trust as defined in section 102UC currently includes:

- any fixed trust where up to 20 individuals have between them, directly or indirectly, fixed entitlements to 75 per cent or greater share of the income or capital of the fixed trust (paragraph 102UC(1)(a), or
- a discretionary trust – that is, trusts with a discretionary element (paragraph 102UC(1)(b).

However, the following are not closely held trusts as they come within the definition of 'excluded trusts' as defined in subsection 102UC(4):

- complying superannuation funds, complying approved deposit funds and pooled superannuation trusts
- deceased estates up to the end of the year of income in which the fifth anniversary of the death occurs, and
- fixed trusts where income tax exempt bodies have fixed entitlements to all the income and capital of the trusts.

Financial impact

The Explanatory Memorandum to the Bill on page 6 states that the overall cost to revenue of these amendments is unquantifiable but expected to be minimal against the forward estimates.

Application

Item 51 of **Schedule 4** provides that the amendments made by this Schedule apply to the first income year starting on or after the day on which this Act receives the Royal Assent and later income years.

Schedule 5—Superannuation amendments

Background

In the May 2006 Budget the Government announced its intention to simplify and streamline superannuation processes.[24] Schedule 5 contains measures designed to streamline tax reporting requirements in a number of areas. These include:

- new provisions to facilitate the provision of tax file numbers (TFN) to superannuation and retirement savings account providers,

24. Further description of the main features of the new system are available at: http://www.aph.gov.au/library/pubs/rp/2007-08/08rp02.pdf

- changes to the tax treatment of income derived from assets which are segregated current pension assets,
- extension of relief from capital gains tax (CGT) for small business on the proceeds of CGT events used for retirement to events occurring prior to the *Simplified Superannuation* transitional period (10 May 2006 to 30 June 2007) or the 2007-08 income period, and
- a rewrite of superannuation tax law in several areas, including changes to the way in which the tax-free component of pensions is calculated; several amendments affecting the taxation treatment of superannuation death benefits; and an insertion to enable employers to claim a deduction for contributions made on behalf of employees (as defined in section 12 of the *Superannuation Guarantee (Administration) Act 1992*) who are not engaged in producing the entity's assessable income or engaged in the entity's business.

Main provisions

Items 8, 26 and 27 of **Schedule 5** insert new provisions in the ITAA 1997, the SIS Act and the *Retirement Savings Account Act 1997* to ensure that where a TFN is provided for employment purposes it is automatically taken to be quoted for superannuation purposes. Thus, the individual is taken to have quoted their TFN where the Commissioner of Taxation gives notice of their TFN to a superannuation or RSA provider. The higher rate of taxation will therefore not apply to contributions made by that individual.

The ITAA 1997 gives complying superannuation funds an exemption for income derived from assets which, at the time of derivation, are segregated current pension assets.[25] **Item 5** of **Schedule 5** amends the ITAA 1997 to provide that assets which are not included in a pension account balance will not be considered as segregated current pension assets. Any income derived from such assets will therefore no longer be exempt from tax.

Item 28 of **Schedule 5** amends the application provisions within the *Superannuation Legislation Amendment (Simplification) Act 2007* to provide for CGT events happening in the 2006-07 and later income years.

Schedule 5 also contains a number of other items to ensure the consistency of the rewritten provisions to ITAA 1997, contained in the *Tax Laws Amendment (Simplified Superannuation) Act 2007*, with current policy. These include the following:

- **Items 19 to 25** contain amendments and insertions to the *Income Tax (Transitional Provisions) Act 1997* to require that amounts of a superannuation income stream purchased with amounts rolled over prior to July 1994, and any tax-free components a

25. Senate Standing Committee on Economics, 2007, Final Report, op. cit, p.7.

member has received since 1 July 2007, be considered in the calculation of the tax-free component at a trigger event (for example, the pensioner reaches age 60),[26]

- **Items 9 to 12**, which amend ITAA 1997 to extend the period of time that a superannuation benefit must be paid and still be treated as a superannuation death benefit for tax purposes. The previous requirement that a benefit must be paid within six months of the death, or within three months of the grant of probate, in order to be treated as a superannuation death benefit, is to be extended to six months after the cessation of legal action or after contact is made with the potential beneficiaries,[27]
- **Item 25** inserts section 307-290 into the *Tax (Transitional Provisions) Act 1997* so that deductions claimed for insurance premiums paid for life insurance on behalf of the member under section 279 or 279B of the ITAA 1936 are to be treated as deductions under section 295-465 or 295-470 of the ITAA 1997 respectively, and
- **Items 1 and 2** involve an insertion into the ITAA 1997 to enable an employer to claim a deduction for superannuation contributions made on behalf of employees (as defined by the *Superannuation Guarantee (Administration) Act 1992*) or engaged in producing the entity's assessable income or engaged in the entity's business.

Financial impact

The Explanatory Memorandum to the Bill on page 7 states that the amendments to prevent individuals from circumventing the minimum drawdown requirements for account-based pensions will result in a revenue gain of $20 million over the forward estimates as set out in the following table.

2007-08	2008-09	2009-10	2010-11
$4m	$5m	$5m	$6m

Application

Item 48, **paragraph (1)** of **Schedule 5** provides that the amendments made by this Schedule apply to the 2007-08 year. **Paragraphs (2)** to **(5)** modify the application of **paragraph (1).**

26. *Explanatory Memorandum*, p. 160.

27. *Explanatory Memorandum*, p. 162.

Schedule 6—Specific listings of deductible gift recipients

Background and Main provisions

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 and be endorsed by the ATO, or be specifically listed under that Division. The amendments in **items 2**, **4** and **6** of **Schedule 6** include as DGRs the organisations specified in the table below.

Name of organisation	**Date of announcement**	**Special conditions**
Australian Peacekeeping Memorial Project Incorporated	Announced by the Hon Peter Dutton MP, the Minister for Revenue and Assistant Treasurer in Press Release No. 040 of 30 April 2007.	The gift must be made after 29 April 2007 and before 1 January 2009.
Social Ventures Australia Limited	Announced by the Hon Peter Dutton MP, the Minister for Revenue and Assistant Treasurer in Press Release No. 043 of 4 May 2007.	The gift must be made after 3 May 2007.

The amendments made by **items 1**, **3** and **5** of **Schedule 6** recognise the change in the name of AAP Mawson's Huts Foundation Limited, a DGR listed as item 6.2.23 in the table in subsection 30-55(2) as a specific environment recipient, to Mawson's Huts Foundation Limited.

Financial impact

The Explanatory Memorandum to the Bill on page 8 states the above measures will have the revenue implications set out in the following table.

2007-08	2008-09	2009-10	2010-11	2011-12
–$0.62m	–$2.4m	–$2.2m	–$2.3m	–$2.3m

Application

The amendments by **Schedule 6** apply on the day on which this Act receives the Royal Assent.

Schedule 7—Minor amendments

Background and Main provisions

Schedule 7 includes amendments to correct certain minor errors as well as other amendments. For example, the purpose of extending the definition of 'tertiary course' is to extend tax deductibility for gifts to courses which include Masters or Doctoral courses. The reader is referred to the Tables on pages 172 to 191 of the Explanatory Memorandum to the Bill for a detailed explanation of the effect of the amendments.

The other amendments are listed in the Explanatory Memorandum in paragraph 7.5 on pages 171 and 172 as follows:

> 7.5 Other amendments include:
>
> - providing for income tax deductibility for gifts to certain scholarship funds for Masters or Doctoral courses as originally intended (see explanation of item 2);
> - correcting the formula for calculating the fringe benefits tax (FBT) depreciation rate for a car, to align it with the income tax diminishing value capital allowance figure (currently, 200 per cent) rather than the previous 150 per cent (see explanation of item 7);
> - preventing unintended tax file number (TFN) withholding from payments to exempt foreign superannuation funds (see explanation of item 16); and
> - preventing an unintended capital gains tax (CGT) exemption for certain 'not-for-profit mutual' organisations (see explanation of item 37).

Financial impact

The Explanatory Memorandum on page 9 states that the financial impact of the amendments is follows.

- The change in the definition of 'tertiary course' in the *A New Tax System (Goods and Services Tax) Act 1999* will result in a small reduction in income tax collections because it allows a deduction for gifts to funds for scholarships for masters or doctoral courses. There will be no change in GST revenue.

- The change in the car depreciation rate in the *Fringe Benefits Tax Assessment Act 1986* (FBTAA 1986) will result in the following gain to revenue.

2007-08	2008-09	2009-10	2010-11	2011-12
Nil	$4m	$8m	$9m	$8m

- The other amendments have no financial impact.

Application

The table to subclause 2(1) of the Bill provide for the following commencement dates.

- **Item 1** of **Schedule 7** commences on the day the Act receives the Royal Assent
- **Items 2** to **6** of **Schedule 7** commence on 1 July 2006
- **Items 7** to **104** commence on the day the Act receives the Royal Assent.

Item 8 of **Schedule 7** provides that the change in the car depreciation rate in the FBTAA 1986 applies to the FBT year starting on 1 April 2008 and to all later FBT years.

Schedule 7 has all various application dates for some of the other changes.

Schedule 8—Family trusts—Increasing flexibility

Background and Main provisions

In the 2006-07 Budget, the Government announced that it will make changes to the family trust election rules to increase flexibility for family trusts in relation to the concession under the trust loss, company loss and imputation rules. These were referred to in broad outline in *Budget Measures 2006,* Budget Paper No, 2 pages 18 and 19 as follows.

> The Government will make changes to the family trust election rules to increase flexibility for family trusts. This measure will have effect from the income year in which the enabling legislation receives Royal Assent.
>
> A family trust election allows a trust to receive concessional treatment under the trust loss, company loss and imputation rules. A company, trust or partnership is required to make an interposed entity election if it is to be included as part of the family group specified under the family trust election. These elections are generally irrevocable.
>
> This measure will allow family trust elections and interposed entity elections to be revoked or varied in certain limited circumstances. The definition of a family group

> will be broadened to include lineal descendants of family group members. In addition, trust distributions to former spouses, and to widows or widowers of family group members with new spouses, will also be exempted from family trust distribution tax.

Attachment C to the Treasurer's Press Release of 9 May 2006 also referred to the proposed changes.[28]

The amendments proposed in **Schedule 8** implement these changes.

The trust loss measures and underlying policy

Schedule 2F of the ITAA 1936 inserted by *Taxation Laws Amendment (Trust Loss and Other Deductions) Act 1998* (Act No. 17, 1998) sets out the conditions under which trust losses and other deductions are allowed in working out the net income of a trust for an income year for tax purposes. These are referred to as the trust loss measures and the main condition for deducting prior year losses in working out the net income of a trust is that there should be no change in beneficial ownership or control of the trust between incurring the loss and recouping it in a subsequent year.

Briefly, as explained in section 265-5 of Schedule 2F, if there is a change in ownership or control of a trust or an abnormal trading in its units, the trust:

- may be prevented from deducting its tax losses of earlier income years, and
- may have to work out in a special way its net income and tax loss for the income year, and
- may be prevented from deducting certain amounts in respect of debts incurred in the income year or earlier income years.

The policy underlying the trust loss measures is to prevent the tax benefit from the recoupment of trust losses and bad debt deductions being passed on to persons who did not bear the economic loss or bad debt when it was incurred in the interest of maintaining the integrity of the tax system. This is achieved by examining whether there has been a change of ownership or whether there has been a sham scheme.

The reader is referred to a fact sheet on the ATO website titled *Broad overview of the trust loss measures* for more information on the operation of the trust loss measures.

28. The Hon Peter Costello MP, *Further measures to simplify and streamline the tax system*, Media Release No. 039, Parliament House, Canberra, 9 May 2006.

Family trusts – family trust election – interposed entity election – family group

The trust loss measures do not generally apply to what tax law describes as an excepted trust. Excepted trusts as defined in section 272-100 of Schedule 2F of the ITAA 1936 are family trusts, certain superannuation funds, and deceased estates within a five year administration period, and unit trusts with unit holders that are exempt from income tax.

What is a family trust?

A family trust is a trust where the trustee of the trust has made a family trust election (FTE) under subsection section 272-80(1) of Schedule 2F of the ITAA 1936 that it is a family trust at all times after the beginning of a specified income year. Currently the FTE must under subsection 272-80(3) specify the individual (the test individual) whose family group must be taken into account in relation to the individual. The FTE must also under subsection 272-80(4A) specify the year from which the FTE will commence.

How has the right to revoke a family trust election changed?

Under subsection 272-80(5) the FTE is irrevocable except in the limited circumstance of a family trust that is a fixed trust subject to certain conditions set out in subsection 272-80(6).

Item 2 of **Schedule 8** repeals subsections 272-80(5) and substitutes **proposed subsections 272-85(5)**, **(5A)** and **(5B**) to enable the variation of a FTE. In addition, **item** 3 of **Schedule 8** inserts **proposed subsections 272-80(6A)** and **(6B)** to provide for additional cases for revoking of a FTE.

To summarise the proposed changes, a FTE will be capable of being revoked unless:

> (a) the trust, or another entity, has incurred a tax loss and had its assessable income reduced by part or all of the loss during the following period. The period concerned is that:
>
> > (i) starting at the beginning of the income year specified in the FTE , and
> >
> > (ii) finishing at the end of the income year immediately prior to the income year specified in the revocation
>
> and the trust or other entity, could not have had its assessable income so reduced had the FTE not been in force (**proposed paragraph 272-80(6A)(a)**)
>
> (b) the trust, or another entity has claimed a deduction for bad debts during the period mentioned in paragraph (a) above, and the trust or other entity could not

have claimed the deduction had the FTE not been in force (**proposed paragraph 272-80(6A)(b)**)

(c) a beneficiary of the trust in an income year during the period mentioned in paragraph (a) above received a franked distribution indirectly through the trust and paragraph 207-150(1)(a) of the ITAA 1997 would have applied in relation to this distribution had the FTE not been in force. If paragraph 207-150(1)(a) had applied the entity would not have been entitled to the tax offset in relation to the franked distribution.

The reader is referred to paragraphs 8.15 to 8.21 and the examples on pages 197 to 201 of the Explanatory Memorandum for further details of the proposed changes.

What is the impact of an interposed entity election?

An interposed entity election (IEE) may be made by a company, the partners in any partnership or the trustee of any other trust, under subsection 272-85(1) of Schedule 2F. The effect of the election is that the company, partnership or trust will be included at all times after a specified day in a specified income year in the family group of the individual specified in the family trust election made under subsection 272-80(3).

The company, partnership or trust in the IEE must pass the control test in section 272-80 for inclusion in the family group.

What are the changes made to the revocation of an interposed entity election?

A number of changes have been made to allow an IEE to be revoked by **item 6** of **Schedule 8**. This item repeals subsections 272-85(5) and (6) in Schedule 2Fand substitutes **proposed subsections 272-85(5)**, **(5A)**, **(5B)**, **(5C)**.

All interposed entity elections made in respect of a family trust for which a family trust election has been revoked are automatically revoked at the same time as the revocation of the family trust election (**proposed subsection 272-85(5B)**).

The reader is referred to paragraphs 8.22 to 8.28 on page 202 of the Explanatory Memorandum for a summary of the details of revocations of interposed entity elections.

Expanding the definition of family for the trust loss measures

The current definition of family in section 272-95 in Schedule 2F will be repealed by **item 10 of Schedule 8** and replaced by a new definition in **proposed section 272-95**. Under the proposed definition the family of an individual (the test individual) will consist of the individual and all of the following (if applicable):

(a) any parent, grandparent, brother or sister of the test individual or of the test individual's spouse (**proposed paragraph 272-95(1)(a)**),

(b) any nephew, niece or child of the test individual or the test individual's spouse (**proposed paragraph 272-95(1)(b)**),

(c) any lineal descendant of a nephew, niece or child referred to in paragraph (b) (**proposed paragraph 272-95(1)(c)**), or

(d) the spouse of the test individual or of anyone who is a member of the test individual's family because of paragraphs (a), (b) and (c) (**proposed paragraph 272-95(1)(d)**)

Basically, the definition of 'family' is widened to include any lineal descendant of a nephew, niece or child of a test individual or the test individual's spouse.

Financial impact

The Explanatory Memorandum states on page 10 that the revenue impact of the measures in Schedule 8 is as indicated in the following table.

2006-07	2007-08	2008-09	2009-10
Nil	-$8m	-$8m	-$8m

Application

Item 14 of **Schedule 8** provides that the amendments made by this Schedule apply to the income year in which this Act receives the Royal Assent and to later income years.

Concluding comment

Will it be necessary to revisit and implement the *Entity Tax Regime* in the interest of the integrity of the whole tax system?

The amendments in Schedule 4 provide for trustees of closely held trusts to give the Commissioner details of trustee beneficiaries that are presently entitled to the net income of the trust and tax-preferred amounts.

As indicated in the commentary on the Background to the measures proposed in Schedule 4 above, the current law requires the trustees to identify and report to the Commissioner the ultimate beneficiaries of closely held trusts. The current ultimate beneficiary reporting rules were put in place as part of the *A New Tax System* package in 1999 to enhance the integrity of the tax system. These rules were intended to be an interim measure until the *Entity Tax Regime* proposed in the *A New Tax System* package of measures proposed in

1998 were implemented. Under the *Entity Tax Regime*, trusts would have been taxed like companies so that trust income would be taxed at source like company profits, obviating the need for the Commissioner to ensure that ultimate beneficiaries include their share of net income of trusts in their assessable income. However, the implementation of the *Entity Tax Regime* was abandoned in 2001 as the Board of Taxation had reported that the draft legislation to implement the entity tax regime under consideration at that time was not workable.

As the Regulation Impact Statement (RIS) to the Bills under consideration relating to the changes in the trustee beneficiary reporting rules states at paragraph 4.52 on page 143 of the Explanatory Memorandum '*the amendments were aimed at addressing arrangements whereby taxpayers used complex chains of trusts to effectively obscure the ultimate beneficiary of the assessable trust income*'.

The RIS also at paragraph 4.66 on page 146 of the Explanatory Memorandum makes the following comments on *Impact group identification*:

> The proposal will impact on trustees of closely held trusts which distribute to trustee beneficiaries. These are closely held trusts spread across micro, small, medium and large businesses across different industries. Precise data on how may of these trusts distribute to trustee beneficiaries is not available.

The RIS concludes in paragraphs 4.79 to 4.80 on page 148 that Treasury and the ATO should monitor this taxation measure, *as part of the whole taxation system*, on an ongoing basis and review it five years after introduction, if not earlier.

The cautious tone of the concluding comments of the RIS is a pointer that the *Entity Tax Regime* solution may have to be revisited before long.

Attachment A

Background and history to initiatives since 1999 to address tax minimisation through complex tax structures

The *A New Tax System* (ANTS package) in August 1998 addressed tax minimisation through the use of complex trust structures.[29]

The Government indicated in the ANTS package on page 121 that the entity tax regime would address a wide range of tax minimisation opportunities available through the different treatment of trusts and companies. It also indicated on page 122 that pending the

29. *Tax Reform not a new tax a new tax system*, op. cit.

introduction of the entity tax regime, the Government had decided to introduce an anti-avoidance measure aimed at such practices.

Difficulties experienced by the Australian Taxation Office in 1999 to identify beneficiaries of complex multiple trust structures

A significant aspect of the anti-avoidance measure was for the trustees to identify ultimate beneficiaries of trusts. The Australian Taxation Office (ATO) had failed to follow the trail of distributions from trust to trust where there was chain of trusts or multiple trusts. The paragraphs from page 122 of the ANTS package making this admission of the difficulties faced by the ATO and offering a remedial anti-avoidance measure pending the introduction of the entity tax regime, are set out below.

> **Trustees to identify ultimate beneficiaries**
>
> The Tax Office has evidence that certain taxpayers are using complex chains of trusts to minimise tax. There are many legitimate reasons for tax structures containing multiple trusts. Nevertheless, some taxpayers are using multiple trust arrangements to make it difficult for the Tax office to piece together the trail of distributions from trust to trust to establish tax liability.
>
> A special anti-avoidance rule will be introduced, with immediate effect. It will require the identification by trustees of discretionary and closely held fixed trusts of the individual or company beneficiaries, and their tax file numbers if they are residents that are ultimately entitled to trust distributions. This will apply regardless of the number of trusts through which the distributions may pass. The measure will help establish tax liabilities by providing an administrative audit trail.
>
> Details of the measure are provided separately.[30]

It should therefore be noted that the special anti-avoidance measure was directed at tax minimisation by arranging distributions through multiple trust structures where there were some individual and company beneficiaries as well.

Division 6D measures were intended to apply until superseded by the entity tax regime

The details of the special anti-avoidance rules were set out in a press release titled: *Distributions made through chains of trusts*, on 13 August 1998 by the Hon. Peter Costello, MP.[31] The details are set out bellow for ease of reference.

30. ibid., p. 122.

> **Details of the measure**
>
> A widely held trust is any trust that is listed for quotation in the official list of an approved Australian stock exchange or a trust where more than 20 individuals hold 75 per cent or more of the interests in income or capital of the trust. A 'closely held trust' is any trust that is not a widely held trust. Discretionary trusts will also be treated as closely held trusts.
>
> Where the trustee fails, or is unable, to disclose the required identity of the individual or company, and the distribution is made out of the trust's net income, the trustee will generally be taxed at the highest marginal rate plus the Medicare levy in respect of any distribution out of net income for tax purposes. This will build upon the existing section 99A of the *Income Tax Assessment Act 1936* (the 1936 Act) dealing with the net income of trusts to which no beneficiary is presently entitled.
>
> Consistent with the design of Division 6 of the 1936 Act, trust distributions subject to tax under this measure will not be taxed again in the hands of beneficiaries.
>
> In situations in which the trustee has failed to identify and disclose correctly the ultimate beneficiary, or fails to withhold a required amount of tax from a distribution, the trustee will be liable to pay the amount that should have been withheld. Special rules will apply to prevent double taxation where the ultimate beneficiary is later identified.

The Treasurer in the press release of 13 August 1998 made it clear that the special anti-avoidance measures were a temporary measure to be superseded by the entity tax regime.

> The disclosure and withholding requirements are an ant-avoidance measure which is intended to apply until superseded by the entity tax system outlined in the *A New Tax System*.

Insertion of Division 6D and its anti-avoidance measures directed at tax minimisation using a chain of trusts

The *A New Tax System (Closely Held Trusts) Act 1999* which received the Royal Assent on 8 July 1999 was one of the measures to implement *A New Tax System* by amending the income tax law in respect of certain closely held trusts, and for related purpose. This Act inserted Division 6D to Part III of the ITAA 1936 which required the trustee to disclose the ultimate beneficiaries in certain circumstances. At the same time:

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31. The Hon Peter Costello, MP, Treasurer, *Distributions made through chains of trusts*, Media Press Release, Canberra, 13 August 1998.

- the *A New Tax System (Ultimate Beneficiary Non-Disclosure Tax) Act (No. 1)* was enacted to impose the Ultimate Beneficiary Non-disclosure Tax (UBNT) in the case of failure to disclose the identity of ultimate beneficiaries to net income of the closely held trust, and
- the *A New Tax System (Ultimate Beneficiary Non-Disclosure Tax) Act (No. 2)* was enacted to impose the UNBT 1999 in the case where there are no ultimate beneficiaries to net income of the closely held trust.

These measures applied to income years of the trust in which 13 August 1998 occurred.

A fact sheet titled *Closely held trusts and ultimate beneficiary schedules* on the Australian Taxation Office (ATO) website gives details of the operation of the beneficiary reporting rules in relation to closely held trusts under Division 6D.

General assessment of the measures in Division 6D on the disclosure of ultimate beneficiaries

The Regulation Impact Statement (RIS) which was included in the Explanatory Memorandum to the relative Bills made the following assessment of the impact of the measures that were enacted.

> **SUMMARY OF REGULATION IMPACT STATEMENT**
>
> ***Policy objective:***
>
> The policy objective of this measure is to ensure that the assessable income of ultimate beneficiaries correctly includes any required share of net income, and that the net assets of ultimate beneficiaries reflect the receipt of tax-preferred amounts.
>
> ***Impact**:* Low.
>
> ***Main points**:*
>
> Compliance costs will be kept to a minimum because:
>
> - a number of trusts have been carved out of the measure; and
> - in certain circumstances identification of lower level beneficiaries in chains of trusts is sufficient disclosure.

It is relevant to note that the impact is assessed as low. This can only be interpreted to mean that the exceptions and exclusions in the operation of Division 6D will have a minimum impact on the ATO performing the checks to verify whether ultimate beneficiaries have included their share of net income from the majority of trusts.

Likewise the reasons for compliance costs being low reflects the number of trusts that have been carved out of the reach of Division 6D as well as the low level disclosures which will be achieved by Division 6D.

Entity tax regime abandoned by Government on 27 February 2001

On 27 February 2001, the Treasurer in a press release announced that the Government had decided to abandon the introduction of the entity tax regime.[32] The reasons cited were that the draft legislation circulated by the Government in October 2000 was found to be unworkable. The press release also indicated that the Board of Taxation will be pursuing other approaches as indicated below.

> **ENTITY TAXATION**
>
> In October 2000 the Government released exposure draft legislation providing for the taxation of trusts like companies.
>
> Following the release of the exposure draft legislation, 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 is not workable.
>
> The Government has also taken advice from the Board of Taxation which recommended that the Bill not proceed and suggested looking at alternative approaches.
>
> As a consequence the Government is withdrawing the draft legislation and will not be legislating it. It will 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 will be part of consultation.
>
> Claims that the cost to revenue of this decision amount to $1 billion are false. *A New Tax System* policy statement costed this measure in conjunction with revenue bring forward under PAYG which has already been introduced and on a 36 per cent tax rate. Stripping out PAYG which has been introduced and allowing for a reduced tax rate at 30 per cent (as will apply from 1 July 2001), the cost of this decision in the full financial year 2001-2002 is of the order of $110 million.

Thus until the Board of Taxation made an alternative approach to enable the ATO to check that ultimate beneficiaries disclosed their share of net income from trusts the interim role of Division 6D was to continue.

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32. Hon. Peter Costello, MP, *Entity Taxation*, Media Release, Canberra, 27 February 2001.

Requirement to file ultimate beneficiary statement relaxed by the Commissioner from the 2000-01 year

On 5 September 2001, the Commissioner released ATO Practice Statement Law Administration PS LA 2001/12, under which lodgment of an ultimate beneficiary statement is only required for the 2000-01 subsequent years where the trustee has a UNBT liability for the year under consideration or the Commissioner requests an ultimate beneficiary statement. This was in response to complaints that Division 6D imposed an onerous compliance burden on trustees of closely held trusts which included family trusts.

Thus in practice many trustees have not been required to lodge an ultimate beneficiary statement since 2000-01.

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This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.