Parliament of Australia
Department of Parliamentary Services

Parliamentary Library
Information, analysis and advice for the Parliament

BILLS DIGEST

www.aph.gov.au/library

14 December 2009, no. 75, 2009–10, ISSN 1328-8091

Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009

Morag Donaldson
Law and Bills Digest Section

Note: This Digest is an historical Digest, published after the Bill was read a third time in the Senate on 2 December 2009. The Bill was passed by both Houses unamended.

Contents

Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009

Date introduced: 21 October 2009

House: House of Representatives

Portfolio: Treasury

Commencement: The formal provisions and Schedules 2 and 3 commence on Royal Assent. Schedule 1 commences on either Royal Assent or the day the proposed *Income Tax (TFN Withholding Tax (ESS)) Act 2009* receives Royal Assent, whichever occurs last. However, if that Act does not receive Royal Assent, then Schedule 2 to the current Bill does not commence at all.

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

The Bill amends various tax and superannuation legislation to give effect to measures contained in the 2009–10 Budget. Particularly the Bill is designed to:

- ensure that benefits provided to employees under an employee share scheme (ESS) are subject to income tax at the marginal rate applicable to the employee taxpayer rather than being subject to fringe benefits tax, and also to provide a tax concession to encourage low and middle-income earning employees to acquire shares under ESSs (**Schedule 1**)

- tighten the application of the rules in the *Income Tax Assessment Act 1997* (ITAA 1997) relating to non-commercial losses where an individual has an adjusted taxable income of $250 000 or more per annum so that high-income earners cannot offset deductions from non-commercial business activities (such as hobby farms) against their salary, wage or other income (**Schedule 2**), and

- require superannuation providers to transfer the balance of lost members' accounts to the Commissioner of Taxation where the balance is less than $200 or the account has been inactive for more than five years (and the provider is satisfied it will never be possible to pay an amount to the member) (**Schedule 3**).

Warning:
This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

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

Background

Basis of policy commitment and the Government's response to public criticism

The measures contained in the Bill were announced in the 2009–10 Budget.[1] However, between the Budget announcement and the introduction of the Bill into Parliament in October 2009, some of the measures were revised by the Rudd Government in response to objections not only from tax and accounting industry representatives, but from company executives and unions affected by the proposed changes to the current law.

For example, one of the Government's initial budget proposals was that all discounts received by employees under ESSs would be taxable upfront. The Australian Workers' Union (AWU) welcomed this proposal on the basis that workers participating in ESSs would not be 'disadvantaged by unintended consequences of a scheme designed to claw back the excesses of the big end of town'.[2] However, the proposal was criticised by other groups, particularly members of the finance and accounting industry, on the bases that often share scheme participants do not have the money to pay tax upfront, and there is a risk that shareholders may pay too much tax on the shares if paying tax upfront, particularly if the value of the shares falls later on.[3] Geoff Price, Managing Director of Computershare Plan Managers, which operates most of the major ESSs in Australia, was reported to have said that the plan to make all scheme participants pay tax at the time when shares or rights are issued in an ESS is 'at the very least an unintended consequence of a crackdown on tax cheats'.[4]

Both the Productivity Commission and the Australian Prudential Regulation Authority (APRA) have suggested that the Government should review the rules which require a taxpayer to pay tax on shares acquired under an ESS at the time he or she leaves the particular company's employment rather than, say, when the shares are realised.[5] The

---

1. Australian Government, 'Tax Reform' in 'Statement 1: Budget Overview', *Budget Paper No. 1—Budget Strategy and Outlook 2009-10*, Commonwealth of Australia, Canberra, 2009, p. 1-41, viewed 9 November 2009, http://www.budget.gov.au/2009-10/content/bp1/downloads/bp1_bst1.pdf

2. Australian Workers' Union, *AWU welcomes Government changes to Employee Share Schemes*, media release, 2 July 2009, viewed 27 October 2009, http://www.awu.net.au/818243_5.html

3. A Main, 'Budget chaos for employee share schemes', *The Australian*, 15 May 2009, p. 19, viewed 27 October 2009, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressclp%2FEFKT6%22

4. Ibid.

5. Fleur Anderson, 'Defer reckoning, PC says', *Australian Financial Review*, 1 October 2009, p. 11, viewed 27 October 2009,

Productivity Commission has argued that insisting that an employee should pay tax at the time he or she leaves his or her place of employment, rather than when the employee actually sells the shares (which might be a long time in the future), is 'a disincentive to keep a long-term investment in the business'—a view shared by partners at law and assurance firms PricewaterhouseCoopers, Corrs Chambers Westgarth and Deloitte Touche Tohmatsu.[6]

Originally, the Rudd Government also suggested it would change the way that shares in private companies are valued, which resulted in a number of major companies (such as Westfarmers) either suspending their share plans or putting the issuing of shares on hold pending clarification.[7] Despite the Government issuing some clarification and undertaking limited public consultation on an exposure draft of the Bill in July 2009, various industry representatives were still expressing strong reservations about the proposals just a day before the current Bill was introduced in October 2009. For example, Greg Travers, a partner in William Buck (a leading Australian national business advisory and chartered accounting firm) emphasised the fact that unlike large public companies, many private companies wishing to transfer ownership to the next generation or bring in new managers 'were being unfairly hit by the uncertainty'. He explained the ramifications for small private companies as follows:

> … the tax concessions are going to be too significant. If I get shares in BHP [Billiton] I can sell on the market; if I get shares in XYZX Pty Ltd, there is not a market to sell on. I've got no ability to sell to fund that tax liability so I've got a real cash cost but with no mechanism to fund it.[8]

Mr Travers went on to say: 'The valuation process drives the tax outcomes and adverse tax outcomes can undermine an otherwise effective succession plan or management incentive arrangement'.[9] In the event, the Bill provides that, if (for a number of reasons) it is not appropriate to use the ordinary market value of shares in a particular case, then the Income Tax Assessment Regulations 1997 may specify a specific amount that taxpayers must use

---

http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressclp%2F2ETU6%22

6. Ibid.

7. Ibid., and M Fenton-Jones, 'Incentive schemes hit hard', *Australian Financial Review*, 20 October 2009, p. 47, viewed 27 October 2009, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressclp%2FY7ZU6%22

8. M Fenton-Jones, op. cit, and William Buck (chartered accountant firm), 'Changes to the Employee Share Scheme Rules', *TaxWatch*, September 2009, p. 1, viewed 17 November 2009, http://www.williambuck.com.au/storage/media/705_Employee%20Share%20Plans.pdf

9. M Fenton-Jones, op. cit.

instead of the market value in relation to the particular share.[10] The Explanatory Memorandum explains that the existing rules in relation to unlisted rights should be replicated in those regulations as 'an interim measure until the Board of Taxation completes its review on how best to determine the market value of employee share scheme benefits'.[11]

Employee share schemes (ESS)

Employee share schemes under the current income tax assessment law

An 'employee share scheme' is a scheme under which interests (in the form of shares or rights, etc) in a company are provided by the company to its employees or their associates.[12] The shares are offered to the employee at a discount (when compared with the market value of the shares), but the discount must usually be included in the employee's assessable income in the year of income when the share or right is acquired.[13] The employee must acquire the shares 'in respect of, or for or in relation directly or indirectly to' any employment of the taxpayer (or his or her associate) or any services provided by the taxpayer (or his or her associate).[14]

In order to qualify for the concessions that currently appear in Division 13A of the *Income Tax Assessment Act* 1936 (ITAA 1936), a share in a company must meet all of the six conditions set out in section 139CD, which are:

- that the share or right is acquired by a taxpayer under an employee share scheme
- that the company is the employer of the taxpayer or a holding company of the employer of the taxpayer
- that all the shares available for acquisition under the scheme are ordinary shares and all the rights available for acquisition under the scheme are rights to acquire ordinary shares

10. **Proposed section 83A–315** of the ITAA 1997.

11. Explanatory Memorandum, Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009, p. 27, paragraph 1.110.

12. The term 'employee' includes past, present and future employees of the company.

13. If you require further technical detail about employee share schemes, see Division 13A of the ITAA 1936, particularly sections 139 (key principle of the Division), 139B (discount to be included in assessable income), and 139C (definition/explanation of 'employee share schemes'). See also Australian Taxation Office, 'Employee share schemes', *fact sheet*, viewed 10 November 2009, http://www.ato.gov.au/individuals/content.asp?doc=/content/36740.htm

14. Section 139C of the ITAA 1936.

- that, at the time the share was acquired, at least 75 per cent of the permanent employees of the employer were, or at some earlier time had been, entitled to acquire:
  - shares or rights under the scheme or
  - shares or rights in the employer, or a holding company of the employer, under another employee share scheme
- that, immediately after the acquisition of the share or right, the taxpayer does not hold a legal or beneficial interest in more than five per cent of the shares in the company, and
- that, immediately after the acquisition of the share or right, the taxpayer is not in a position to cast, or control the casting of, more than five per cent of the maximum number of votes that might be cast at a general meeting of the company.

The general rule is that the discount is included in the taxpayer's assessable income in the year of income when the share or right is acquired.[15] However, there are three main exceptions to this rule:

- the discount is not included for any period when the taxpayer is a non-resident who received the share or right in respect of, or related to, the taxpayer's engagement in foreign service[16]
- if the taxpayer acquired the share or right in anticipation of becoming an employee of the company in question, the discount is not usually included in the taxpayer's assessable income until the year of income when the person actually becomes an employee,[17] and
- if the share or right is a qualifying share or right, and the taxpayer has not made an election under section 139E in relation to the share or right, then the discount is included in the taxpayer's assessable income in the year of income when the 'cessation time' occurs.[18]

Under section 139E, a taxpayer *may* elect to include the discount in his or her assessable income in the year the share or right is acquired. In this case, the taxpayer includes the

15. Subsection 139B(2) of the ITAA 1936.
16. Subsection 139B(1A) of the ITAA 1936.
17. Subsection 139B(2A) of the ITAA 1936.
18. Sections 139CA and 139CB of the ITAA 1936 respectively set out when the 'cessation time' occurs for shares and rights. The time depends on whether there are restrictions preventing the taxpayer from disposing of the share or right before a particular time. If there is no restriction, then usually the 'cessation time' is the time when the taxpayer acquires the share or right. Otherwise it can be another point in time, including events such as when the employment in respect of which the share was acquired ceases, or the end of the 10 year period starting when the taxpayer acquired the share, whichever event occurs last. See also subsection 139B(3) of the ITAA 1936.

Warning:
This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

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

value of the discount in his or her income tax return as assessable income for the year of income the shares or rights are acquired. Any capital gain made on the disposal of the shares or rights later on is subject to capital gains tax (CGT)—although a 50 per cent discount may apply if the shares were acquired after 21 September 1999 and are owned for more than 12 months.

If an election is made under section 139E and the exemption conditions in section 139CE are satisfied, the taxpayer only includes the value of the discount in his or her assessable income where the total value of the discount exceeds $1000.[19] This is sometimes referred to as the 'upfront concession'. Even if the taxpayer has not formally made an election, he or she is taken to have made an election if the value of the discount is $1000 or less.

If the taxpayer elects to defer the taxation of the discount, there is no $1000 exemption. In the case of the 'tax-deferred concession', the taxpayer includes not only the original value of the shares, but also any increase in value between the time of acquisition and the cessation time, in his or her assessable income. In this situation, the CGT discount is not available, but CGT is only payable if the shares or rights are not sold within 30 days of the cessation time. If CGT is payable, the taxpayer may be able to take advantage of the CGT discount.[20]

Section 139CE sets out the exemption conditions that must be satisfied for section 139BA ('the upfront concession') to apply to a share acquired under an employee share scheme:

- that the scheme did not have any conditions that could result in any recipient forfeiting ownership of shares or rights acquired under it
- that the scheme was operated so that no recipient would be permitted to dispose of a share or right (the *scheme share or scheme right*) acquired under it, or of a share acquired as a result of a scheme right, before the earlier of the following times:
  - the end of the period of 3 years after the time of the acquisition of the scheme share or scheme right
  - the time when the taxpayer ceased, or first ceased, to be employed by the employer,[21] or

---

19. See section 139BA of the ITAA 1936.

20. For further details on CGT and ESSs, see Australian Taxation Office, 'Employee share schemes', op. cit., and Australian Taxation Office, 'The discount method of calculating your capital gain', *fact sheet*, viewed 18 November 2009, http://www.ato.gov.au/individuals/content.asp?doc=/content/36552.htm

21. Subsection 139CE(5) provides that a taxpayer only ceases the employment in respect of which the share or right was acquired when the taxpayer is no longer employed by the employer of the taxpayer in that employment, a holding company of the employer, or a subsidiary of the employer or of a holding company of the employer.

- that both the employee share scheme and any scheme for the provision of financial assistance in respect of acquisitions of shares or rights under the employee share scheme are operated on a non-discriminatory basis.[22]

The methods for calculating the 'market value' of a share or right are set out in subdivision F of Division 13A. The methods vary depending on a number of factors, including whether the share is listed on a stock exchange, and whether one is dealing with actual shares or merely options (or 'rights') to acquire shares, and the timeframes in which one can exercise the option.[23]

Where fringe benefits tax (FBT) would ordinarily apply, the discount is generally regarded as a property fringe benefit on which tax is payable under Division 11 of Part III of the *Fringe Benefits Tax Assessment Act 1986*. However, in order to avoid the possibility of double taxation (that is, paying tax on the same benefit twice), that Act excludes from the assessment of FBT any discount already assessed under Division 13A of the ITAA 1936.[24]

Senate inquiry and proposals to change the current law on employee share schemes

On 23 June 2009, the Senate referred the operation of ESSs in Australia to the Economics References Committee for inquiry and report by 17 August 2009.[25] Specifically, the Committee was tasked with examining:

- the structure and operation of employee share schemes;
- the benefits of employee share schemes;
- the taxation issues relating to compliance of employers and employees participating in employee share schemes;

---

22. Section 139GF of the ITAA 1936.

23. See, for example, section 139FM of the ITAA 1936 which sets out the method for calculating the market value of options.

24. Currently shares and related benefits acquired by a taxpayer under an ESS are excluded from the definition of 'fringe benefit' in paragraphs 136(1)(h) to (hc) of the *Fringe Benefits Tax Assessment Act 1986*. Those paragraphs are available electronically at http://www.austlii.edu.au/au/legis/cth/consol_act/fbtaa1986312/s136.html, viewed 18 November 2009. As a result of the insertion of **proposed Division 83A** (by **item 1** of Schedule 1 to the Bill) and the consequent deletion of Division 13A of Part III of the ITAA 1936 (**item 18** of Schedule 1 to the Bill), **item 8** of Schedule 1 to the Bill replaces paragraphs 136(1)(h) to (hc) of the *Fringe Benefits Tax Assessment Act 1986* with **proposed paragraphs 136(1)(h) and (ha)**.

25. Details of the inquiry are available at http://www.aph.gov.au/Senate/committee/economics_ctte/employee_share_schemes_09/index.htm, viewed 10 November 2009.

Warning:
This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

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

- the recent announcement of proposed changes to the treatment of employee share schemes, the background to these changes, consultation undertaken to develop these changes and the anticipated impact of these changes on employees, employers and Australian business generally;
- the rules governing employee share schemes in other countries.[26]

The Committee produced a comprehensive report, including a dissenting report by Australian Labor Party senators. It made two recommendations. The first was that the Australian Bureau of Statistics should conduct a survey of ESSs in Australia every five years, including collecting data on issues including:

- the number and type of ESSs
- the number, size and industry of companies offering these schemes
- the number of employees and equity held by them
- a breakdown of employees by occupation, educational level and wage
- the reasons for offering and participating in the scheme
- any perceived effects and effectiveness of the schemes for both employers and employees
- any perceived barriers in the take-up of the schemes, and
- a breakdown of general employee (broad-based) versus executive (narrow) schemes in terms of the number of shares offered, number of participants and equity held.

Further, it recommended that the Rudd Government should delay the introduction of the ESS tax legislation until it had considered the much-awaited reports of the Productivity Commission (into executive remuneration, including ESSs), the Board of Taxation[27] and the Henry Review.[28] However, that recommendation was not taken up by the

26. Senate Economics Reference Committee, 'Employee share schemes', *Report*, August 2009, viewed 10 November 2009, http://www.aph.gov.au/Senate/committee/economics_ctte/employee_share_schemes_09/report/index.htm,

27. Details of the Board of Taxation's review into elements of the taxation of employee share scheme arrangements is available on its website at http://www.taxboard.gov.au/content/employee_share_schemes.asp, viewed 17 November 2009. That review was announced by Senator the Hon Nick Sherry (Assistant Treasurer) on 1 July 2009 and is due to report by the end of February 2010.

28. The 'Henry Review' is shorthand for the 'Australia's Future Tax System Review' that is being conducted by a panel chaired by Dr Ken Henry, Secretary to the Treasury. That review was announced by the Hon Wayne Swan, MP (Treasurer) on 13 May 2008 and is due to report by the end of 2009. For details of the review, see its website at http://taxreview.treasury.gov.au/Content/Content.aspx?doc=html/home.htm, viewed 17 November 2009.

Warning:
This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

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

Government, which introduced the current Bill (and the related Income Tax (TFN Withholding Tax (ESS)) Bill 2009) on 21 October 2009, well before any report by the named reviews is due to be published.[29]

Many commentators (as reported in the media) queried the need to rush the current legislation through Parliament. Instead they recommended a more restrained and considered approach to the issues, having particular regard to the wide-ranging and in-depth reviews that the Government itself initiated but which are yet to report their findings and recommendations. For example, in October 2009, Yasser El-Ansary, Tax Counsel at the Institute of Chartered Accountants, suggested, in light of the Productivity Commission's draft report, that the Parliament is likely to have to revisit the issues contained in the Bill, particularly after the Productivity Commission publishes its final report in December 2009.[30] In this regard, it should be noted that in the case of some amendments, the Government itself recognises that it may need to amend the law again following the publication of major government reviews into executive remuneration and taxation law.[31]

In the event, the Bill was introduced in the House of Representatives on 21 October 2009 and read a third time on 16 November 2009. It was then introduced into the Senate on 17 November 2009 and passed unamended on 2 December 2009. It was not the subject of robust debate.[32]

On 2 December 2009, the Institute of Chartered Accountants welcomed the passage of the legislation, with Mr El-Ansary saying: 'These laws finally deliver certainty to businesses, which can now make fully informed decisions about the remuneration packages of their employees'.[33] He did, however, also say that the Institute would 'continue to work with the government to address residual issues such as the deferred taxing point for options, limitations around salary sacrifice arrangements and the realisation of tax liabilities for

---

29. The report of the Productivity Commission is not due until 19 December 2009. For details of that inquiry, see the Commission's website at http://www.pc.gov.au/projects/inquiry/executive-remuneration, viewed 10 November 2009.

30. A Main, 'Taxing times for employee share scheme', *The Australian*, 22 October 2009, p. 32, viewed 27 October 2009, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressclp%2FMZZU6%22

31. See, for example, Explanatory Memorandum, p. 27, paragraph 1.110.

32. See the Bill's homepage at http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fbillhome%2Fr4224%22, viewed 2 December 2009.

33. The Institute of Chartered Accountants in Australia, *Resolution of share scheme great news for business*, news release, 2 December 2009, viewed 2 December 2009, http://www.charteredaccountants.com.au/A123580254

employees who cease employment'. He also drew attention to the need for the legislation to accord with the findings of the Productivity Commission due later this month, saying:

> The government has committed to ensuring the new tax rules work in harmony with the findings of the Productivity Commission into director and executive remuneration, due later this month. Hopefully that report will recommend further adjustment of the tax laws to appropriately deal with these residual issues …[34]

Non-commercial losses

On 26 June 2009, the Treasury released an exposure draft of the measures in Schedule 2 to the Bill relating to non-commercial losses (or 'hobby farms') for public comment.[35] The provisions contained in the draft are ostensibly the same as those contained in Schedule 2 to the Bill as introduced into Parliament—although there are some minor changes to the wording and formatting of some provisions. Further, the Bill as introduced into Parliament provides that an application for the Commissioner of Taxation to exercise his or her discretion (and allow non-commercial losses to be offset against other income even though certain tests are not met) must now be made in an approved form. This requirement gives applicant taxpayers a clear picture of what evidence they should provide in support of their applications.

On 29 October 2009, the Senate referred Schedule 2 to the Bill (dealing with non-commercial losses) to its Economics Legislation Committee for inquiry and report by 16 November 2009.[36] Schedule 2 is designed to ensure that individuals with an adjusted taxable income greater than $250 000 can only deduct excess expenses from their non-commercial business activities (such as 'hobby farms') against future income from those activities. The Treasurer and Assistant Treasurer explained the rationale behind the measures in a joint press release on 12 May 2009:

> … the Rudd Government will close a tax loophole that allows a relatively small number -around 11,000 - of mostly high wealth individuals to exploit parts of the tax system to unfairly minimise or avoid their tax obligations.
>
> Specifically, the Government will remove the ability for high income individuals to deduct losses from unprofitable business activities against their own income.

34. Ibid.

35. The draft legislation is available on the Treasury's website at http://www.treasury.gov.au/documents/1553/PDF/Exposure_Draft.pdf, viewed 2 December 2009.

36. Details of the inquiry are at http://www.aph.gov.au/Senate/committee/economics_ctte/hobby_farms_09/index.htm, viewed 17 November 2009.

> The Government will do this by tightening the rules in the income tax law applying to the use of non-commercial losses.
>
> In certain circumstances, where expenses exceed income earned from non-commercial business activities, salaried employees can reduce their salary income with these excess expenses. Many of these activities do not have a commercial purpose or character and are no more than hobbies or lifestyle choices.
>
> This can mean that unfair personal income tax deductions can be claimed against salary, wage and other income for activities like running hobby farms that don't have a commercial purpose and may not ever make a profit.
>
> To address this loophole, from 1 July 2009, taxpayers with adjusted taxable incomes of over $250,000 will only be able to deduct those expenses against the income from the non-commercial business activity.[37]

The Committee received six submissions and later heard evidence from nine witnesses at a public hearing in Melbourne on 9 November 2009. The submission from the Thoroughbred Breeders' Association (TBA) is largely representative of the other submissions. It submitted that the legislation will have an adverse effect on a wide-range of activities that rely on investment income because 'regardless of the size and scale of the business; be it cattle farming, horse breeding or share trading, if a tax loss is returned in any year it will be quarantined if the $250,000 adjusted taxable income threshold is exceeded'.[38] It drew particular attention to the considerable amount of investment made by entrepreneurs in the 'start-up' phase of a business with little or no return for several years. It also claimed that if the proposed amendments to the non-commercial loss provisions are successful, many investors will withdraw from the horse breeding industry, which particularly relies on investment income for viability.[39]

The Economics Legislation Committee published its report on 16 November 2009.[40] After explaining the historical background to the non-commercial losses provisions in

---

37. W Swan MP (Treasurer) and C Bowen MP (then Assistant Treasurer), *Improving Fairness and Integrity in the Tax System*, press release, no. 67, 12 May 2009, viewed 2 December 2009, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressrel%2FISJT6%22

38. Thoroughbred Breeders Association Ltd, Submission to the Senate Economics Legislation Committee, *Inquiry into the Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009*, 2 November 2009, p. 2, viewed 4 November 2009, https://senate.aph.gov.au/submissions/comittees/viewdocument.aspx?id=6bc03995-e39a-47ac-9991-beccf2b550f8

39. Ibid., especially pp. 2–5.

40. Senate Economics Legislation Committee, *Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009 [Provisions] & Income Tax (TFN Withholding Tax (ESS) Bill 2009,*

Warning:
This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.
This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Division 35 of the ITAA 1997,[41] the Committee highlighted the five main areas of concern as they were identified at the public hearing on 9 November 2009, being:

- the $250 000 threshold
- the discretion vested in the Commissioner of Taxation
- the retrospectivity of the proposed changes[42]
- the impact on rural communities (many of which rely on investment from high-income, city dwellers), and
- the accuracy of the revenue projections.[43]

After discussing the relevant provisions of the Bill and the evidence received on these issues in some detail, the Committee concluded that it supported 'the intention of tightening the non-commercial losses regime of Division 35' and recommended that the Senate pass the Bill.[44]

The key differences between the current law and the amendments contained in Schedule 2 are set out in a table in the Main Provisions section below.

Report, The Senate, Canberra, 16 November 2009, viewed 2 December 2009, http://www.aph.gov.au/Senate/committee/economics_ctte/hobby_farms_09/report/report.pdf

41. The Committee explained that Division 35 of the ITAA 'was introduced to prevent "losses" of individuals from non-commercial business activities being offset against other assessable income in the year the loss was incurred' (ibid., paragraph 2.1). It also explained that the provisions were introduced by the *New Business Tax (Integrity Measures) Act 2000*, as a result of the 1999 Review of Business Taxation (the 'Ralph Review') 'which recommended that systemic changes were required to prevent "revenue leakage from unprofitable activities carried out by taxpayers" as many of those activities were more like hobbies and/or lifestyle choices' (ibid.). Further details about the Ralph Review are available on the Treasury's website at http://www.rbt.treasury.gov.au/, viewed 3 December 2009.

42. **Item 15** of Schedule 2 provides that the amendments to Division 35 apply to the 2009–10 income year and later income years (that is, from 1 July 2009). The Scrutiny of Bills Committee did not make any adverse comment on this issue of retrospectivity. See Senate Standing Committee for the Scrutiny of Bills, 'Tax Laws Amendment (2009 Budget Measures No. 2) Bill 2009, *Report Number 13 of 2009*, 18 November 2009, pp. 572–574, viewed 14 December 2009, http://www.aph.gov.au/Senate/committee/scrutiny/bills/2009/b13.pdf

43. Senate Economics Legislation Committee, [Inquiry into Schedule 2 of the current Bill], op. cit., p. 7, paragraph 3.2.

44. Ibid., p. 15, paragraphs 3.30 and 3.31.

Financial implications

The measures in **Schedule 1** to the Bill dealing with ESSs are estimated to have a revenue impact of $135 million over the forward estimates period (2010–11 to 2012–13).[45] The measures in **Schedule 2** to the Bill dealing with the offsetting of non-commercial losses is estimated to have the following revenue impacts:[46]

2009–10	2010–11	2011-12	2012-13
Nil	$330m	$240m	$130m

The financial impact of the measures targeting lost member superannuation accounts in Schedule 3 is expected to result in a gain to revenue of $238 million over the forward estimates period (up to 2012–13). The measures are also expected to increase government expenditure by $8.4 million in the same period, thus resulting in an overall estimated gain to revenue of just under $230 million.[47]

Main provisions

Given the quick passage of the Bill, it is probably unnecessary to discuss the main provisions in detail. It may, however, be useful (in the interests of future historical research) to mention some of the key issues.

Schedule 1—Employee share schemes

Item 1 of **Schedule 1** to the Bill inserts **proposed Division 83A** into the ITAA 1997 to deal with ESSs. At present the ITAA 1997 does not deal specifically with the tax treatment of ESSs—although Division 13A of the *Income Tax Assessment Act 1936* (ITAA 1936) does.

In this regard, the Government is essentially continuing the work of the Howard Government, which unsuccessfully attempted to codify (and simplify) Australia's income tax law into one piece of legislation back in 1997. Australia continues to have two main income tax assessment Acts, and it is not entirely clear—particularly to the lay reader—which Act deals with which issues. At present the ITAA 1997 primarily deals with income tax (including answering questions such as 'What instalments of income tax does a taxpayer have to pay?', 'When and how does a taxpayer pay them?' and 'What happens if

45. Explanatory Memorandum, p. 7.
46. Ibid., p. 8.
47. Ibid., pp. 8–9.

a taxpayer's income tax is more than the instalments he or she has paid?'),[48] whereas the purpose of the ITAA 1936 is 'to consolidate and amend the law relating to the imposition assessment and collection of a tax upon incomes'.[49] Additionally, there are a number of other Australian tax Acts that deal with issues such as the setting of rates of taxation and other administrative matters.[50] Thus, while **Schedule 1** to the Bill inserts **proposed Division 83A** into the ITAA 1997 (which is similar to, but also expands upon and refines existing Division 13A of the ITAA 1936), it also repeals existing Division 13A of the ITAA 1936 to avoid duplicating the same provisions in two different Commonwealth Acts.

Given this history of the ESS tax legislation (see Background section above), it is probably unnecessary to detail the nature and effect of the main provisions in Schedule 1 to the Bill any further. However, it may assist to set out the objects of **proposed Division 83A**, and also to discuss the key differences between the current legislation and **proposed Division 83A**.

The two objects of **proposed Division 83A** are:

- to ensure that benefits provided to employees under ESSs (in the form of shares or rights) are subject to income tax at the taxpayer employee's marginal rate under income tax law (and not under fringe benefits tax law), and
- to encourage the alignment of the interests of employers and employees by providing a tax concession to encourage lower and middle income earners to acquire shares under ESSs.[51]

The key differences between the current legislation and the measures contained in **Schedule 1** are as follows:

- the new measures target low- to middle-income earners by introducing an income test in order for a taxpayer to be eligible to claim the upfront concession introduced by the *Tax Laws Amendment (Budget Measures) Act 2008*[52]
- employers will be required to report any shares or rights granted under an ESS at the time of issue, rather than (for example) when the taxpayer actually commences employment with the company

---

48. Section 3–5 of the ITAA 1997.
49. Long title of the ITAA 1936.
50. See, for example, the *Taxation Administration Act 1953* which is designed to 'provide for the administration of certain Acts relating to Taxation, and for purposes connected therewith' (long title).
51. **Proposed section 83A–5** of the ITAA 1997.
52. Section 139E of the ITAA 1936.

Warning:
This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

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

- the threshold at which the $1000 tax concession is no longer available has been increased from an adjusted taxable income of $150 000 to one of $180 000
- shareholders will be able to defer the assessment of tax for up to $5000 worth of shares under some salary-sacrifice ESSs, and
- shareholders will be able to defer tax where shares are subject to performance criteria or sale of the shares is subject to time restrictions.

Schedule 2—Non-commercial losses

The key differences between the current legislation and the measures contained in **Schedule 2** can be summarised and/or contrasted in the table set out below. The table has been compiled by the author using existing law, the text of the Bill and the notes in the Explanatory Memorandum.

A more detailed comparison can be found in the Explanatory Memorandum for the Bill, which also provides useful examples of the intended operation of the new law.[53]

53. Explanatory Memorandum, pp. 103–110 (Examples 2.1–2.7).

Warning:
This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

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

Current law	Proposed law
The general rule is that an individual carrying on a business activity (alone or in partnership) has to quarantine losses to the business activity. However, the taxpayer may apply the loss from the business activity against other income in an income year if the business activity satisfies at least one of four tests: 1. the assessable income generated from the business activity must be at least \$20 000 2. the activity must have produced a profit in three out of the last five income years 3. the reduced cost base of real property (or interests in real property) used on a continuing basis in the activity is at least \$500 000, and/or 4. the reduced cost base of any other asset used on a continuing basis to carry on the activity is at least \$100 000. A taxpayer who satisfies at least one of these tests can deduct all of the costs/expenses from their business activity from both their business and other income. If for reasons such as exceptional circumstances (eg drought), the taxpayer is unable to meet one of these tests, the Commissioner of Taxation may exercise his or her discretion and allow the taxpayer to offset the losses against other income. However, in such a case, the losses are quarantined to business activity, which means that the taxpayer can only offset the loss to the extent that it is the same amount (or less) than the income of the business. Any such quarantined losses can be carried forward to be used against future income from the business activity (or other income if the taxpayer can satisfy one of the four tests in a later income year).	The general rule remains, but Schedule 2 restricts access to the four tests to taxpayers who have an adjusted taxable income of \$250 000 or more. In this way, Schedule 2 prevents high income earners from offsetting non-commercial losses against their ordinary salary, wage or other income. Not all tests will apply to all relevant taxpayers. It depends on the nature of the business activity. A taxpayer who has an adjusted taxable income of \$250 000 or more must quarantine non-commercial losses. A taxpayer who has an adjusted taxable income of less than \$250 000 who does not satisfy at least one of the four tests must quarantine non-commercial losses. A taxpayer whose adjusted taxable income is less than \$250 000 may apply to the Commissioner of Taxation <u>not</u> to apply the non-commercial loss rules. The taxpayer must satisfy the Commissioner that the nature of the business activity is such that the taxpayer will not be able to satisfy at least one of the four tests, but that based on an objective assessment, the business activity will generate assessable income greater than the available deductions or will be able to meet one of the four tests within a commercially viable period. The Commissioner's decision can be the subject of review by the Australian Taxation Office (internal review), the Administrative Appeals Tribunal and the Federal Court of Australia.

Warning:
This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

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

Schedule 3—Lost members' superannuation

Schedule 3 amends the *Superannuation (Unclaimed Money and Lost Members) Act 1999* to require superannuation providers to give the Commissioner of Taxation details relating to small accounts of lost members and inactive accounts of unidentifiable lost members. The superannuation providers must also pay to the Commissioner the value of any such accounts.

Schedule 3 amends existing provisions in that Act, but also inserts **proposed Part 4A**, which deals specifically with the payment of lost member accounts to the Commissioner.

The phrase '*lost member account*' is defined in **proposed subsection 24B(1)** to mean an account held on behalf of a lost member, where the balance of the account is less than $200 and the account does not support or relate to a defined benefit interest (as defined in section 292–175 of the ITAA 1997).

The phrase '*lost member account*' is also defined in **proposed subsection 24B(2)** to mean an account in a fund where:

- the account is held on behalf of a lost member
- the superannuation provider has not received an amount in respect of the member within the last five years
- the superannuation provider is satisfied it will never be possible for the provider to pay an amount to the member, and
- the account does not support or relate to a defined benefit interest (as defined in section 292–175 of the ITAA 1997).

Other provisions in **proposed Part 4A** set out the requirement for a superannuation provider to give a written statement to the Commissioner about lost member accounts when required,[54] and sets out how a provider may correct or supplement that information.[55] They also set out:

- how and when the superannuation provider must pay the Commissioner
- the requirement for a superannuation provider to pay a general interest charge on any amount not paid to the Commissioner within the required timeframe
- the fact that a person who fails to make a payment to the Commissioner commits an offence, punishable by a maximum penalty of 100 penalty units (that is, $11 000)

---

54. **Proposed section 24C** of the *Superannuation (Unclaimed Money and Lost Members) Act 1999*.

55. **Proposed section 24D**.

Warning:
This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

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

- how the Commissioner pays the amount held on behalf of a lost member to a single fund on behalf of the member once he or she has been found (or to his or her legal personal representative if the lost member has died)
- how the Commissioner refunds overpayments to superannuation providers
- how the Commissioner may recover an overpayment made by him or her to an eligible lost member (or to his or her legal personal representative if the lost member has died)
- the requirement that the superannuation provider must return any amount paid by the Commissioner to it as a result of locating a lost member if it turns out that the payment cannot be credited to an account on behalf of the person, and
- the liability of the Commonwealth to pay a reasonable amount of compensation to any person if the operation of **proposed Part 4A** would result in an acquisition of property from a person otherwise on just terms, and in the event of the Commonwealth and the person not agreeing on the amount of compensation, for the Commonwealth to be sued in a court of competent jurisdiction.[56]

56. **Proposed sections 24E–24M**. Note that section 51(xxxi) of the Australian Constitution empowers the Commonwealth to make laws in relation to 'the acquisition of property on just terms from any State or person for any purpose in respect of which the Parliament has power to make laws'.

© Copyright Commonwealth of Australia

This work is copyright. Except to the extent of uses permitted by the *Copyright Act 1968*, no person may reproduce or transmit any part of this work by any process without the prior written consent of the Parliamentary Librarian. This requirement does not apply to members of the Parliament of Australia acting in the course of their official duties.

This work has been prepared to support the work of the Australian Parliament using information available at the time of production. The views expressed do not reflect an official position of the Parliamentary Library, nor do they constitute professional legal opinion.

Feedback is welcome and may be provided to: web.library@aph.gov.au. Any concerns or complaints should be directed to the Parliamentary Librarian. Parliamentary Library staff are available to discuss the contents of publications with Senators and Members and their staff. To access this service, clients may contact the author or the Library's Central Entry Point for referral.

Members, Senators and Parliamentary staff can obtain further information from the Parliamentary Library on (02) 6277 2795.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

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