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Tax Laws Amendment (2010 Measures No. 1) Bill 2010

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Law and Bills Digest Section

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Tax Laws Amendment (2010 Measures No. 1) Bill 2010

Date introduced: 10 February 2010

House: House of Representatives

Portfolio: Treasury

Commencement: The formal provisions commence on Royal Assent, as do Schedules 3, 4, 5 (Parts 1–5; Part 6, Division 1; Parts 7–18; Part 19, Division 1; and Part 20) and 6 (Parts 1–5; items 106–111; and Parts 10 and 11). Other Schedules, Parts and items commence on a variety of dates. Schedule 6 (Parts 7 and 8, and items 112 and 113) commences retrospectively.

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 purpose of the Bill is to amend a range of tax and tax-related legislation to give effect to a range of 2007 election commitments and subsequent initiatives.

Background and main provisions

As each of the six Schedules to the Bill deals with a discrete issue, it may assist to discuss the background to, and main provisions of, each Schedule in turn.

Schedule 1—Approved superannuation clearing house

In the 2008–09 Budget, the Rudd Government announced that the Treasury would, among other things, provide advice in 2008–09 on the implementation of the Government's election commitments, including the establishment of an optional superannuation clearing house facility.[1] Further details about the facility were provided in *Budget Paper No. 2*, where the Government said:

> The Government will provide $16.1 million over three years to the Australian Taxation Office to fund a Superannuation Clearing House Facility from 2009-10, to

1. Australian Government, *Portfolio Budget Statements 2008-09, Budget Related Paper No. 1.17: Treasury Portfolio*, Commonwealth of Australia, Canberra, 2008, p. 27, viewed 23 February 2010, http://www.budget.gov.au/2008-09/content/pbs/download/Consolidated.pdf

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> assist in managing employers' obligations to provide superannuation choice to employees.
>
> This facility will be offered free of charge by the Australian Government to small businesses with fewer than 20 employees and on a fee-for-service basis to larger businesses. The facility will be contracted to the private sector.[2]

On 14 November 2008, the Government issued a two-part consultation paper.[3] Thirty-six submissions addressed Part A of the paper, which discussed implementation issues associated with the clearing house proposal, including:

- the division of responsibilities between employers and the clearing house in relation to superannuation guarantee and choice of fund
- the regulatory framework for the clearing house, and
- whether the clearing house should be delivered through a single or multiple providers.[4]

Treasury reports that while a number of submissions noted the difficulties 'in improving efficiency in the industry given the variability in employers' and funds' administration systems', there was also widespread support 'for efforts to encourage greater standardisation of transaction flows and adoption of electronic payment methods'.[5] Treasury also reports that while some submissions 'noted the potential cost savings to the Government of a single provider model', the multiple provider approach could 'reduce the impact of the measure on existing clearance house arrangements [in other arenas]'.[6]

On 6 November 2009, Chris Bowen MP (the Minister) and Dr Craig Emerson MP announced that Medicare Australia (Medicare) will deliver the superannuation clearing house service, saying that Medicare is 'well placed as one of the Commonwealth Government's key service delivery agencies—with significant electronic and payment processing capacity whilst ensuring the privacy of information and the security of funds'.[7]

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2. Australian Government, *Budget Measures: Budget Paper No. 2: 2008–09*, Commonwealth of Australia, Canberra, 13 May 2008, p. 290, viewed 23 February 2010, http://www.budget.gov.au/2008-09/content/bp2/download/bp2.pdf

3. Treasury, *Superannuation clearing house: summary of consultation process*, departmental website, February 2010, viewed 23 February 2010, http://www.treasury.gov.au/documents/1675/PDF/Consultation_Summary.pdf

4. Ibid.

5. Ibid.

6. Ibid.

7. C Bowen MP (Minister for Financial Services, Superannuation and Corporate Law and Minister for Human Services) and Dr Craig Emerson MP (Minister for Small Business, Independent Contractors and the Service Economy, Minister for Competition Policy and Consumer Affairs and Minister Assisting the Minister for Finance on Deregulation), *Cutting Red Tape for Small Business - Superannuation Clearing House Service*, media release,

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No explanation was given as to why a private clearing house or indeed a different government department/authority (such as the Australian Taxation Office) was not chosen.[8] However, Mr Bowen and Dr Emerson provided some details about how the clearing house is intended to operate, including:

- Medicare will develop an online system for registration and ongoing payments, with payments initially being made via electronic funds transfer (EFT)
- eligible small businesses (those with fewer than 20 employees) will need to register online for the service, which will be offered free of charge
- the businesses will then pay their superannuation contributions to the clearing house (regardless of the number of separate superannuation funds for which the payments are ultimately intended) and the clearing house will forward the funds to the nominated superannuation fund(s)
- employers can also forward 'choice of fund' nominations to the clearing house for processing, and
- the legal obligation of small businesses to make superannuation contributions is discharged when they make payment of the correct amount to the clearing house.[9]

The clearing house will be available to eligible small businesses from 1 July 2010—one year after the originally intended start date. Businesses will be able to register from May 2010. The Government estimates that 1.6 million small businesses will use the facility.[10]

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no. 35, 6 November 2009, viewed 23 February 2010, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressrel%2FZD5V6%22

8. Note that these issues are the main reasons for the referral of the Bill to the Senate Economics Legislation Committee—see p. 29 of this Digest and footnote 116.

9. Ibid. The phrase '*choice of fund obligations*' refers to the fact that since 1 July 2005, an employee can choose the superannuation fund or retirement savings account to which his or her employer will make future superannuation contributions. For further details, see (for example) Australian Taxation Office, *Choice of superannuation fund: meeting your obligations*, June 2005, viewed 23 February 2010, http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/superchoice_obligations.pdf/$file/superchoice_obligations.pdf If a small business has 15 employees, and the employees choose different superannuation funds, the employer must make the superannuation contributions to each of the funds, with obvious adverse effects on the administration of the employer's business.

10. F Anderson, 'Tanner to ditch super admin', *Australian Financial Review*, 27 November 2009, p. 15 and W Swan MP (Treasurer), 'Address to the AEIOU Foundation's Business Leaders Lunch', speech, no. 32, 4 December 2009, viewed 23 February 2010, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressrel%2F9JEV6%22

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On 26 November 2009, the Minister released draft legislation for public comment.[11] Treasury received 10 submissions on the exposure draft.[12] Some submissions noted that the legislation should specify that the approved clearing house service will only be available to 'eligible small businesses' and that this term should be defined in the legislation.[13] However, Treasury is of the view that restricting eligibility in this way is unnecessary and 'would create additional complexity'.[14]

On 10 February 2010, the current Bill was introduced. The provisions in Part 1 of Schedule 1 to the Bill are in substantially the same terms as the exposure draft, although some provisions (such as **proposed section 23B** of the *Superannuation Guarantee (Administration) Act 1992*) have been redrafted with greater particularity.

Press commentary

The media reports a mixed response to the clearing house facility proposal within the superannuation industry. For example, major provider, Mercer (Australia) Pty Ltd, was apparently seeking government action in December 2009 on 'a central clearing house and greater use of tax file numbers', and Pauline Vamos, Chief Executive of the Association of Superannuation Funds of Australia (ASFA), was also quoted in the *Australian Financial Review* at that time as saying that the superannuation industry needs the Government's support (through avenues such as the current Cooper Review of Australia's superannuation system)[15] 'to become more technologically adept, achieve greater scale through mergers and through shared services'.[16] (The clearing house facility could be seen as part of the solution to these problems, particularly given the indication that the transfer of funds will happen by EFT, at least initially.) However, leading actuarial firm

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11. C Bowen MP (Minister for Financial Services, Superannuation and Corporate Law and Minister for Human Services), *Superannuation clearing house—release of draft legislation*, media release, no. 040, Canberra, 26 November 2009, viewed 23 February 2010, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressrel%2F9OBV6%22 The exposure draft of the amendments is available electronically at http://www.treasury.gov.au/documents/1675/PDF/exposure_draft.pdf, viewed 23 February 2010.

12. Treasury, *Superannuation clearing house: summary of consultation process*, op. cit.

13. Ibid.

14. Ibid.

15. Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System (the Cooper Review), commenced in May 2009. For issue papers and reports issued by the Cooper Review, see www.SuperSystemReview.gov.au, viewed 23 February 2010.

16. B Dunstan, 'Fund managers defend turf', *Australian Financial Review*, 21 December 2009, p. 40.

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Rice Warner suggested there would be no need for a clearing house if employers were required to make contribution payments electronically.[17]

The clearing house proposal seems more generally to be regarded as an improvement on the current, somewhat 'antiquated', way in which up to 80 per cent of employers remit superannuation contributions by cheque in the ordinary mail.[18] Apparently superannuation contributions can take up to 81 days after payday to reach an employee's superannuation account, including an average delay of 21 days from the time employers make the contributions to the time the contributions are invested by the superannuation fund.[19] The fact there is more than $13 billion of lost superannuation could be attributed to this non-technological way of doing business and bureaucratic red tape.[20]

The proposal to offer the services of the clearing house to small business free-of-charge offers considerable cost and time savings to small businesses too. Journalist Fleur Anderson stated: 'Many businesses face hours of paperwork if they distribute workers' super by themselves, while others pay up to $3.50 a transaction to use private sector clearing houses to distribute employee super'.[21]

Nonetheless, journalist Adele Ferguson reported that the announcement of the Government's decision to use Medicare as the superannuation clearing house 'stopped the $1.1 trillion [superannuation] industry in its tracks', saying:

> This left-field decision to let Medicare become the new super clearing house was seen by some as a knee-jerk reaction to a multibillion-dollar problem screaming out to be fixed, and by others as a more sinister plot to one day revive the unpalatable access card/national ID card.[22]

In this regard, Pauline Vamos (ASFA) was quoted as saying that the choice of Medicare 'was a surprise to the industry that usually dealt with the Tax Office on transaction issues'.[23]

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17. S Patten and D Hughes, 'Super funds want risk targeted', *Australian Financial Review*, 14 December 2009, p. 1 at p. 6.

18. A Ferguson, 'Losing the super paper trail', *The Age*, 9 November 2009, p. 16, citing a 2009 report compiled by Rice Warner Actuaries.

19. Ibid.

20. Ibid.

21. F Anderson, 'Clearing house role for Medicare', *Australian Financial Review*, 6 November 2009, p. 10. Apparently big businesses pay nothing to use the private clearing house services: see F Anderson, 'Super pledge goes missing', *Australian Financial Review*, 3 November 2009, p. 60.

22. A Ferguson, op. cit.

23. F Anderson, 'Clearing house role for Medicare', op. cit.

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Main provisions

Item 1 amends the *Retirement Savings Accounts Act 1997* (RSA Act) to insert **proposed subsection 183(2A)**. Section 183 is found in Part 16 of that Act (which sets out miscellaneous provisions) and is an offence provision.[24] It applies if an employer is authorised (by an employee or law or otherwise) to:

- deduct an amount from salary or wages payable by the employer to the employee, and
- contribute the amount to a retirement savings account (RSA) held by the employee

and the employer makes such a contribution.[25]

The employer must contribute the deducted amount to the RSA within 28 days of the end of the month when the deduction was made.[26] Intentional or reckless failure to remit the deduction within this time frame is an offence punishable on conviction by a fine not exceeding 100 penalty units (that is, $11 000).[27]

Proposed subsection 183(2A) amends section 183 to provide that the employer is not required to remit the deducted amount to the RSA within the stipulated time frame if:

(a) the employer pays the deducted amount to an 'approved clearing house' before the end of the period mentioned in existing subsection 183(2A) (being within 28 days of the end of the month when the deduction was made), and

(b) the approved clearing house accepts the payment.

The term 'approved clearing house' is defined in **proposed subsection 79A(3)** of the *Superannuation Guarantee (Administration) Act 1992* (SGA Act) to mean 'a body specified in the regulations for the purposes of this subsection'.[28] As mentioned earlier in

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24. The full text of section 183 is available electronically at http://www.austlii.edu.au/au/legis/cth/consol_act/rsaa1997310/s183.html, viewed 24 February 2010.

25. Subsection 183(1) of the RSA Act.

26. Subsection 183(2) of the RSA Act.

27. Subsection 183(3) of the RSA Act. Subsection 4AA(1) of the *Crimes Act 1914* (Cth) defines 'penalty unit' as $110. See http://www.austlii.edu.au/au/legis/cth/consol_act/ca191482/s4aa.html, viewed 24 February 2010. Section 4B of that Act provides that where a body corporate if convicted of an offence, a court may impose a penalty up to five times that which could be imposed on a natural person. See http://www.austlii.edu.au/au/legis/cth/consol_act/ca191482/s4b.html, viewed 24 February 2010.

28. See item 5 of Schedule 1 to the current Bill.

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this Digest, the Government intends to specify Medicare for the purposes of subsection 79A(3).

Note that there is a minor typographical drafting error in **proposed paragraph 183(2A)(a)**. The word 'the' should appear after the words 'before the end of' and before the word 'period'.

Items 2–5 amend the SGA Act.[29] **Item 2** inserts the term '*approved clearing house*' in existing section 6 (being the general interpretation section for the Act) and defines it by reference to **proposed subsection 79A(3)** of the Act (which is inserted by **item 5**).

Item 3 inserts **proposed section 23B** into the SGA Act dealing with the situation where contributions to a superannuation fund or RSA are made through an approved clearing house. It provides that for the purposes of sections 23 and 23A of the Act:

- treat an employer that, at a particular time pays an amount to an approved clearing house for the benefit of an employee, as having made a contribution of the same amount to a complying superannuation fund or RSA for the employee's benefit, if the clearing house accepts the payment, and
- disregard any contribution that the clearing house makes to a complying superannuation fund or RSA as a result of the payment.[30]

Item 4 inserts **proposed subsection 32C(2B)** into section 32C, which sets out the contributions that satisfy the choice of fund requirements.[31] **Proposed subsection 32C(2B)** makes it clear that a contribution made through an approved clearing house complies with the choice of fund requirements if:

- **proposed section 79A** applies to the contribution[32]
- the employee gives the employer written notice to the effect that the employee wants a particular fund to be the employee's 'chosen fund'

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29. The text of this Act is available at http://www.austlii.edu.au/au/legis/cth/consol_act/sga1992430/, viewed 24 February 2010.

30. Section 23 of the SGA Act sets out how the superannuation guarantee (SG) charge payable by an employer is calculated if a superannuation guarantee contribution is made on behalf of an employee to an RSA or to a superannuation fund (other than defined benefit superannuation scheme) within 28 days of the end of each quarter. (Ordinarily, the employer is liable to pay a minimum charge of 9 per cent, but this percentage is reduced if the contributions are made within 28 days of the end of the quarter.) Section 23A deals with how to offset late payments of superannuation guarantee contributions against the charge.

31. See Part 3A of the SGA Act which sets out the choice of fund requirements, particularly Division 4, which sets out the rules on choosing a fund.

32. See item 5 of Schedule 1.

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- the employer passes to the approved clearing house the information contained in the employee's written notice (and any other prescribed information) within 21 days of the employee giving the notice and before (or at the time) the contribution is made, and
- the approved clearing house accepts the information.

Item 5 inserts **proposed section 79A**, which deals solely with the approved clearing house facility. The section will apply if:

- an employer pays an amount to an approved clearing house for the benefit of an employee, and
- as a result, the approved clearing house makes a contribution to an RSA, superannuation fund or superannuation scheme for the employee's benefit.

Where the approved clearing house makes the contribution to the RSA or superannuation fund/scheme, the contribution is made as the employer's agent.[33] **Proposed subsection 79A(3)** defines the term '*approved clearing house*' to mean 'a body specified in the regulations for the purposes of this subsection'.

Item 6 amends the *Superannuation Industry (Supervision) Act 1993* (SIS Act) to insert **proposed subsection 64(2A)**. It is in the same terms as proposed subsection 183(2A) of the RSA Act discussed in item 1 above (without the typographical error). Section 64 of the SIS Act provides that employers are to remit deductions from salary or wages of superannuation contributions promptly.

There are two amendments contained in Part 2 of Schedule 1 to the Bill (**items 7 and 8**). The purpose of both **items 7 and 8** is to facilitate the flow of information from the Australian Taxation Office (ATO) to the clearing house. The heading to Part 2 states that the amendments are 'conditional on the *Tax Laws Amendment (Confidentiality of Taxpayer Information) Act 2010*' (the Taxpayer Confidentiality Act)—but the heading can be regarded as somewhat misleading in the case of **item 7**. This is because the amendment in **item 7** is only required if the Taxpayer Confidentiality Act is <u>not</u> enacted.[34] If **item 7**

33. Proposed subsection 79A(2) of the SGA Act.

34. See items 3 and 4 in the table in clause 2 to the current Bill for the relevant commencement dates for **items 7 and 8**. The Bill for the Taxpayer Confidentiality Act was introduced in the House of Representatives on 19 November 2009 but at the time of writing had not been read a third time in that House. The Bill's homepage is at http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fbillhome%2Fr4238%22, viewed 24 February 2010. For details about the content of the Bill, see also B Pulle and P Darby, *Tax Laws Amendment (Confidentiality of Taxpayer Information) Bill 2009*, Bills Digest, no. 96, 2009–10, Parliamentary Library, Canberra, viewed 24 February 2010, http://www.aph.gov.au/library/pubs/bd/2009-10/10bd096.pdf

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commences, **item 8** will not commence. **Item 8** is only required (and will only commence) if the Taxpayer Confidentiality Act is enacted.[35]

Item 7 inserts **proposed paragraph 16(4)(hbb)** into the *Income Tax Assessment Act 1936* (ITAA 1936). However, item 32 of Schedule 2 to the Bill for the Taxpayer Confidentiality Act repeals section 16 of the ITAA 1936 in its entirety. Currently, section 16 of the ITAA 1936 makes it an offence for an officer of the Commonwealth (or a state) to make a record of, or divulge or communicate to any person, any information respecting the affairs of another person acquired by the officer (or disclosed by the person) under the provisions of the ITAA 1936 or any previous Commonwealth law relating to income tax.[36] However, if the Taxpayer Confidentiality Act is successfully enacted, section 16 will be repealed, because it will effectively be made redundant by the insertion of proposed (revised) Division 355 into Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953), dealing at length with confidentiality of taxpayer information. Particularly, proposed section 355–25 of Schedule 1 to the TAA 1953 provides that is an offence for taxation officers to disclose tax information that identifies an entity, or is reasonably capable of being used to identify an entity, except in certain specified circumstances. Both the repeal of section 16 of the ITAA 1936 and the insertion of proposed Division 355 into the TAA 1953 commence the day after the Taxpayer Confidentiality Act receives Royal Assent.

Item 8 of Schedule 1 to the Bill inserts new item 9 into the table (known as 'Table 2') in **proposed section 355–65(3)** of Schedule 1 to the TAA 1953.[37] **Proposed section 355–65** sets out the exceptions to the general offence in proposed section 355–25 (mentioned in the discussion immediately above). **Proposed subsection 355–65(3)** provides that a taxation officer does not commit an offence if he or she makes a record (or makes a disclosure) relating to superannuation or finance. Specifically the amendment in **item 8** provides that no offence is committed if:

- a taxation officer makes a record for (or a disclosure to) an approved clearing house (as defined in the SGA Act), and
- the record (or disclosure) is for the purposes of the clearing house performing its functions in relation to superannuation contributions.

35. See item 4 in the table in clause 2 to the current Bill.

36. The text of section 16 of the ITAA 1936 is available electronically at http://www.austlii.edu.au/au/legis/cth/consol_act/itaa1936240/s16.html, viewed 24 February 2010.

37. Section 355–65 does not appear in the current version of the TAA 1953, but will form part of that Act following the passage of the proposed Taxpayer Confidentiality Act. **Item 8** will only commence if the Taxpayer Confidentiality Act commences.

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Schedule 2—Forestry managed investment schemes

Schedule 2 revises provisions of the ITAA 1936, the *Income Tax Assessment Act 1997* (ITAA 1997) and the TAA 1953 to protect the right of a taxpayer to claim and retain a deduction for investment in forestry managed investment schemes (MIS) where the 'four-year holding rule' is breached for reasons outside the taxpayer's control.[38]

Under the four-year holding rule, a taxpayer cannot claim and retain a deduction for certain forestry expenditure if a capital gains tax event (CGT event) happens within four years after the end of the income year in which the investment is first made. The rule was introduced by Schedule 8 to the *Tax Laws Amendment (2007 Measures No. 3) Act 2007* and applies to CGT events that occur on or after 1 July 2007.[39] As the Minister explained in his second reading speech for the current Bill, the four-year holding rule is 'an integrity measure designed to prevent taxpayers from disposing of their interest shortly after claiming their upfront tax deduction'.[40]

However, sometimes a CGT event happens within the four-year holding period for reasons outside the taxpayer's control, such as where the MIS is cancelled (as occurred in the case of a number of schemes following the financial collapse of two agribusiness investment managers, Timbercorp Limited and Great Southern, in 2009).[41] Under the current law,

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38. Note that the four-year holding rule applies only to investments in *forestry* managed investment schemes. It does not apply to agribusiness (non-forestry) managed investment schemes generally.

39. The text of Schedule 8 is available at http://www.austlii.edu.au/au/legis/cth/num_act/tla2007mn3a2007314/sch8.html, viewed 23 February 2010. The ITAA 1936 applies to investments made between 2 October 2001 and 30 June 2008, and the ITAA 1997 applies to investments made on or after 1 July 2007. The relevant provisions are section 82KZMGA of the ITAA 1936, which deals with deductions for certain forestry expenditure, and section 394–10 of the ITAA 1997, which deals with deduction for amounts paid under forestry managed investment schemes.

40. C Bowen MP (Minister for Financial Services, Superannuation and Corporate Law and Minister for Human Services), 'Second reading speech: Tax Laws Amendment (2010 Measures No. 1) Bill 2010', House of Representatives, *Debates*, 10 February 2010, p. 11.

41. For details of tax implications when operators of non-forestry managed investment schemes becoming insolvent, see Australia Taxation Office (ATO), *Are you a participant in a Managed Investment Scheme run by either Timbercorp or Great Southern that have gone into administration?*, ATO website, 2 November 2009, viewed 26 February 2010, http://www.ato.gov.au/print.asp?doc=/Content/00193782.htm, where the ATO says at the end of Question 1 (on the tax consequences that may flow from the collapse of MIS managers): 'Non-forestry MIS and pre-1 July 2006 forestry MIS do not appear to be affected by these issues'. See also ATO, *Draft Taxation Determination: TD 2009/D9: Income tax: does a change of Responsible Entity of a registered agricultural managed investment scheme affect the tax outcomes for participants if the arrangement continues to be implemented in accordance with the relevant product ruling?*, ATO website,

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this can result in some investors being unfairly penalised because the Commissioner of Taxation has no discretion to allow a deduction if the four-year holding rule is breached for any reason.

On 21 October 2009, the Rudd Government announced that it would amend the four-year holding rule so that it is not breached by events outside the taxpayer's control.[42] The deduction will stand 'where the four-year holding rule is failed due to events beyond the control of the investor'.[43]

On 18 December 2009, the Assistant Treasurer released draft legislation for public comment by 15 January 2010.[44] Treasury received four submissions, the effect of which it summarised as follows:

> Submissions in response to the draft legislation were supportive of the approach taken in the draft legislation. Submissions suggested only minor changes to the draft legislation and explanatory material.
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> As a result of consultation, minor changes were made to the explanatory memorandum to improve its clarity and readability. No changes were made to the legislation.[45]

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30 September 2009, viewed 26 February 2010, http://law.ato.gov.au/atolaw/view.htm?Docid=DXT/TD2009D9/NAT/ATO/00001&PiT=99991231235958 Public comment on the draft closed on 30 October 2009, but the draft ruling does not yet appear to be have been finalised.

42. Senator N Sherry (Assistant Treasurer), *Government to provide tax certainty to investors in forestry managed investment schemes*, media release, no. 74, 21 October 2009, viewed 25 February 2010, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressrel%2F6SZU6%22 The exposure draft is available at Treasury, *Forestry Managed Investment Scheme Amendments: Exposure Draft Legislation and Explanatory Material*, departmental website, 18 December 2009, viewed 26 February 2010, http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1700

43. Ibid.

44. Senator N Sherry (Assistant Treasurer), *Draft legislation to protect forestry managed investment scheme investors*, media release, 18 December 2009, viewed 26 February 2010, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressrel%2FPWIV6%22

45. Treasury, *Forestry Managed Investment Schemes: Summary Of Consultation Process*, departmental website, February 2010, viewed 26 February 2010, http://www.treasury.gov.au/documents/1700/PDF/Consultation_Summary.pdf Note that an electronic comparison of the draft Bill and the Bill as introduced into the House of representatives on 10 February 2010 shows that the heading to item 4 of Schedule 2 to the Bill was amended by the addition of the word 'provision' after 'Application'.

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Press commentary

There has been very little media coverage of the proposed amendments in **Schedule 2** to the Bill. The National Farmers Federation's manager of economics and trade, Charlie McElhone, was reported in October 2009 as saying that the new rules 'offered some assurance for taxpayers caught up in the collapse of Timbercorp and Great Southern' while at the same time asking whether the upfront tax deductions should be available at all.[46] Particularly, McElhone was reported as saying: 'The NFF acknowledges that not all, but a large proportion, of investors buying into investments for tax purposes [instead of normal investment purposes]'.[47] Tax Counsel at the Institute of Chartered Accountants, Yasser El-Ansary, was reported as agreeing with the tenor of these remarks, saying that 'the Henry [tax] review and the federal government should consider abolishing the upfront tax deduction in favour of a different approach whereby losses were quarantined and could only be claimed against future income'.[48]

Main provisions

Item 1 of **Schedule 2** inserts **proposed subsection 82KZMGA(1A)** into the ITAA 1936 to provide that the four-year holding rule (in existing paragraph 82KZMGA(1)(b)) does not apply to a CGT event if:

- the event happens because of circumstances outside the taxpayer's control, and
- when the taxpayer acquired the interest, 'the taxpayer could not reasonably have foreseen the CGT event happening'.

Item 2 inserts **proposed subsection 394–10(5A)** into the ITAA 1997 to provide that the four-year holding rule (in existing paragraph 394–10(5)(b)) does not apply to a CGT event if:

- the event happens because of circumstances outside the taxpayer's control, and
- when the taxpayer acquired the interest, 'the taxpayer could not reasonably have foreseen the CGT event happening'.

Item 3 inserts **proposed subsection 290–50(2A)** into Schedule 1 to the TAA 1953 to provide that proposed subsection 82KZMGA(1A) of the ITAA 1936 and proposed subsection 394–10(5A) of the ITAA 1997 (see **items 1 and 2** above) are to be disregarded for the purposes of subsection 290–50(2) of the TAA 1953. That provision contains a civil penalty offence which is committed by an entity that engages in conduct 'that results in a scheme that has been promoted on the basis of conformity with a product ruling

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46. F Anderson, 'Tax rule change a break for hapless MIS investors', *Australian Financial Review*, 22 October 2009, p. 3.

47. Ibid.

48. Ibid.

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[issued by the ATO] being implemented in a way that is materially different from that described in the product ruling'.[49] As Note 1 to **proposed subsection 290–50(2A)** states (emphasis added):

> The effect of this subsection is that a scheme will have been implemented in a way that is materially different from that described in the product ruling **if the tax outcome for participants in the scheme is the same as that described in the ruling only because of the operation of the subsections mentioned in paragraphs (a) and (b)**.

In other words, where the forestry MIS is implemented in a way that is materially different from that described in the product ruling due to circumstances outside the taxpayer's control (which the taxpayer could not have reasonably foreseen and which result in the occurrence of a CGT event within the four-year holding period), the entity that initially promoted the scheme remains liable for the civil penalty contained in section 290–50 of the TAA 1953 *notwithstanding the fact the four-year holding rule does not apply to the taxpayer*.

Schedule 3—Managed investment trusts

Schedule 3 amends the ITAA 1936, ITAA 1997 and TAA 1953 to allow managed investment trusts (MITs) to make an irrevocable election to apply the CGT regime to gains and losses on disposals of certain assets (primarily shares, units and real property).[50] If a MIT makes the election, then income from the sale of assets will be taxed at a concessional rate as a capital gain. However, if a MIT does not make the election, gains (and losses) on the disposal of shares and units will usually be treated on revenue account (as opposed to capital account) and the gain will be taxed as ordinary income (at a higher rate of tax than CGT).

The tax arrangements applying to managed investment trusts were the subject of a review by the Board of Taxation (the Board) in 2008.[51] Ordinarily, the beneficiary of a trust is taxed on his or her share of the net income of the trust, and the trustee is 'only taxed on income that is not taxable in the hands of beneficiaries'.[52] However, following public consultation on reform options, the then Assistant Treasurer (Chris Bowen MP) announced in May 2009 that the Government would implement the Board's recommendation 'to provide deemed capital account treatment for gains and losses made

49. Section 290–50 of the TAA 1953 is found in Division 290 of the Act and deals with the promotion and implementation of schemes.
50. C Bowen MP, 'Second reading speech', op. cit., p. 12.
51. Board of Taxation, *Review of the tax arrangements applying to managed investment trusts*, agency website, 2009, viewed 1 March 2010, http://www.taxboard.gov.au/content/managed_investment_trusts.asp
52. Ibid.

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on disposal of investment assets by managed investment trusts (MITs), subject to appropriate integrity rules'.[53]

The measure provides greater certainty for MITs than at present because it means that:

> … where an Australian MIT makes an irrevocable election to apply the capital gains tax (CGT) regime to disposals of eligible assets, resident investors will be entitled to the CGT discount on eligible taxable gains distributed by MITs and non-resident investors will be exempt from Australian tax on distributions of gains on disposal of eligible MIT assets unless the assets are taxed Australian property.[54]

The measure will apply to Australian MITs (and to unit trusts that are 100 per cent owned and controlled by MITs that meet the eligible investment business rules in Division 6C of Part III of the ITAA 1936).[55] It will not apply to public unit trusts or corporate unit trusts that are taxed like companies.[56]

If a MIT elects to apply the CGT regime to the disposal of eligible assets, the election is irrevocable and applies to all disposals of eligible investments in (and from) the 2008–09 income year. As the then Assistant Treasurer noted when announcing the measure as part of the 2009–10 Budget, the retrospective operation of the amendment 'will reduce the incentive for MITs to dispose of existing assets and claim deductions for losses on revenue account against other income before the measure is implemented or an election made'.[57]

On 1 June 2009, Treasury released a discussion paper on the capital account treatment of MITs.[58] It received 24 submissions, including three which are confidential.[59] On 10 December 2009, the Assistant Treasurer, Senator Nick Sherry, released an exposure

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53. C Bowen MP (then Assistant Treasurer), *Next major steps to promote Australia as a regional financial hub*, media release, no. 49, 12 May 2009, viewed 1 March 2010, http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/049.htm&pageID=003&min=ceb&Year=&DocType=0

54. Ibid.

55. Ibid. Part III of the ITAA 1936 deals with liability to taxation. Division 6C sets out the rules that apply to the income of certain public trading trusts.

56. See Division 6B of Part III of the ITAA 1936 which deals with the income of certain unit trusts, particularly sections 102G (Public unit trusts) and 102J (Corporate unit trusts).

57. C Bowen MP (then Assistant Treasurer), *Next major steps to promote Australia as a regional financial hub*, op. cit.

58. Treasury, *Discussion Paper: Managed Investment Trusts - Capital Account Treatment,* departmental website, 1 June 2009, viewed 1 March 2010, http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1551

59. Treasury, *Submissions: Discussion Paper: Managed Investment Trusts - Capital Account Treatment*, departmental website, 11 February 2010, viewed 1 March 2010, http://www.treasury.gov.au/contentitem.asp?ContentID=1730&NavID=037

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draft of the proposed, revised tax treatment of MITs.[60] It received 17 submissions, of which only one is confidential.[61] While the submissions broadly supported the amendments contained in the exposure draft, Treasury noted that the three main issues raised during consultation were:[62]

- extending the capital account treatment of MITs to other collective investment entities (including Listed Investment Companies)[63]
- expanding the scope of the definition of '*managed investment trust*' in Subdivision 12-H in Schedule 1 to the TAA 1953,[64] and

60. Treasury, *Exposure Draft - Managed Investment Trusts: Capital Account Treatment Legislation and Explanatory Material*, departmental website, 10 December 2009, viewed 1 March 2010, http://www.treasury.gov.au/contentitem.asp?NavId=&ContentID=1668

61. Treasury, *Submissions: Exposure Draft - Managed Investment Trusts: Capital Account Treatment Legislation and Explanatory Material*, departmental website, 11 February 2010, viewed 1 March 2010, http://www.treasury.gov.au/contentitem.asp?ContentID=1729&NavID=

62. Treasury, *Managed Investment Trusts—Election to allow Capital Gains Tax to be the primary code for disposals of shares, units and real property: Summary Of Consultation Process*, departmental website, February 2010, viewed 2 March 2010, http://www.treasury.gov.au/documents/1668/PDF/Consultation_Summary.pdf

63. The term '*Listed Investment Company*' (LIC) simply means an investment company that is listed on the Australian Securities Exchange (ASX) (and which must therefore operate within the ASX's corporate governance and reporting rules). An LIC is a vehicle through which an investor can invest in a diverse but managed portfolio of assets including shares and property. LICs distribute income to investors as fully franked dividends (having already paid company tax of 30 per cent on the income). If the investor's marginal tax rate is lower than 30 per cent, no further tax is payable by the investor, thus making LICs an attractive investment vehicle. For further details about LICs, see ASX, *Listed Investment Companies: Fact Sheet*, 2010, viewed 2 March 2010, http://www.asx.com.au/products/pdf/listed_investment_companies.pdf

64. **Subdivision 12-H** is found in Division 12 of Schedule 1 to the TAA 1953, which deals with payments from which amounts must be withheld. It is located in Chapter 2 of Schedule 1, which deals with the collection, recovery and administration of income tax, specifically in Part 2-5 which deals with pay as you go (PAYG) withholding. **Subdivision 12-H** deals with distributions of managed investment trust income. The term '*managed investment trust*' is defined in **section 12–400** of Schedule 1 to the TAA 1953, where a number of conditions necessary to meet the definition are set out, including the requirements that (i) the trustee was an Australian resident or the central management and control of the trust was in Australia at the time the payment from the trust was made; (ii) the trust is a managed investment scheme (as defined by section 9 of the *Corporations Act 2001*) and is operated by a financial services licensee (as defined by section 761A of that Act) whose licence covers operating such a managed investment scheme; and (iii) at the time the payment is made: (a) units in the trust are listed for quotation in the official list of an approved stock exchange in Australia; or (b) the trust has at least 50 members (ignoring objects of a trust);

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- expanding the types of assets covered by the capital account election.

In response, Treasury stated that:

- the definition of '*managed investment trust*' has been expanded to include 'Australian regulated wholesale investment trusts, widely held investment trusts operated or managed under the *Corporations Act 2001* by state owned entities and trusts wholly owned by MITs'
- the list of eligible assets has been expanded to include 'rights or options in respect of shares, units or real property and non-share equity (including put and call options and convertible notes over shares and units) that are equity interests', and
- other minor legislative amendments were made to ensure that the legislation correctly reflects the Government's policy intention behind the measure.[65]

Treasury also noted that:

> The alignment of the definition of MIT in Subdivision 12-H in Schedule 1 to the *Taxation Administration Act 1953* with the definition used for this measure is being examined by Treasury.
>
> The inclusion of Listed Investment Companies is outside the policy parameters of the measure. This issue will be examined, more broadly, as part of the response to the Board of Taxation's review of the tax arrangements applying to MITs.
>
> Certain proposals made in submissions were also not adopted as they were not consistent with the policy intent of the measure.[66]

Press commentary

The media reported a generally positive reaction by the MIT industry to the draft legislation in late 2009—although some commented negatively on the limited scope of the amendments (such as the fact the revised definition of '*managed investment trust*' for the purpose of the capital tax treatment rules differs from that which applies in the context of MITs withholding payments to investors) and the shortness on the consultation period.[67]

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or (c) one of the entities covered by a paragraph of subsection 12–400(2) is a member of the trust (including life insurance companies and complying superannuation funds).

65. Ibid. Treasury also noted that 'Certain assets, such as Division 230 financial arrangements and real property or an interest in real property that is held for development and/or re-sales at a profit, are excluded from the list of eligible assets'. This is confirmed by **proposed subsection 275–105(2)** of the ITAA 1997.

66. Ibid.

67. See, for example, J Kehoe and J Searle, 'Managed funds get more clarity', *Australian Financial Review*, 11 December 2009, p. 5.

For example, Malleson Stephen Jacques tax partner, Richard Snowden, is reported as welcoming the changes in the interests of certainty but also noting that the amendments could 'adversely affect some funds', saying:

> Funds that don't make an election will be deemed to treat their eligible assets such as shares on revenue account, meaning the prospect of funds not electing and arguing capital treatment has been removed … Further those funds will not get the protection from tax audit for their prior year treatment, leaving them exposed to the uncertainty that existed before the changes.[68]

Katherine Woodthorpe, Chief Executive of the Australian Private Equity and Venture Capital Association, was also quoted as drawing attention to the 'gap' in the definition of '*managed investment trust*' (which requires trusts to have more than 50 direct members) and the fact that while the legislation will apply only to Australian trusts, 'some overseas funds could set up an Australian trust to overcome this'.[69]

However, generally the tax treatment of investment gains on revenue account rather than capital account can be seen to support the 'clear direction of bipartisan government policy, which is to narrow the scope of Australia's tax laws to the extent they affect non-residents and so encourage foreign investment'.[70]

Main provisions

Item 4 of **Schedule 3** to the Bill inserts **proposed Part 3–25** into the ITAA 1997 dealing with particular kinds of trusts. It will appear in Chapter 3 of the Act, which sets out specialist liability rules. At this stage, **proposed Part 3–25** will comprise only one division: **proposed Division 275**, which deals solely with Australian MITs.

Proposed section 275–1 is the guide to **proposed Division 275**. It states that:

- the trustee of certain Australian MITs may choose for certain assets of the trust to be dealt with under CGT rules
- if no choice is made, the assets will be treated as revenue assets[71]
- gains and profits from 'carried interests' held in entities that are or were Australian MITs are included in the assessable income of the holder of the interests,[72] and

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68. Ibid.
69. Ibid.
70. M Stevens, 'Cut to the chase on avoidance claim', *The Australian*, 17 November 2009, p. 19 at p. 20.
71. **Proposed Subdivision 275–B** of the ITAA 1997.
72. The term '*carried interest*' is defined in section 104–255 of the ITAA 1997 to mean (a) the entitlement of a partner in a venture capital limited partnership or an Australian venture

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- the holder is entitled to a deduction from losses for such interests.[73]

Proposed Subdivision 275–A extends the concept of 'managed investment trust' (in Subdivision 12–H of Schedule 1 to the TAA 1953) to certain widely-held trusts (especially wholesale trusts) that do not otherwise meet the definition of '*managed investment trust*' in Subdivision 12–H.[74] As a result, these trusts will be eligible to be treated in the same way as MITs for the purposes of the new capital account treatment in **proposed Division 275**.

Different requirements apply depending on whether the trust is operated or managed by a financial services licensee (**proposed section 275–5**) or not (**proposed section 275–10**).[75]

Proposed section 275–15 states that every member of a trust is a 'managed investment trust'. This means, for example, that where a unit trust is an Australian resident trust and the individual unit holders/beneficiaries are also trusts, every member of the trust will be treated as MITs under **proposed Division 275**, regardless of whether each individual trust currently meets the definition of 'managed investment trust' in Subdivision 12–H of Schedule 1 to the TAA 1953.

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capital fund(s) to a distribution from partnership or fund, to the extent that the distribution is contingent upon the attainment of profits for the limited partners in the entity, or (b) the entitlement of a limited partner in a venture capital management partnership to a distribution from the venture capital management partnership, to the extent that the distribution is contingent upon the attainment of profits for the limited partners in certain specified venture capital entities in which the venture capital management partnership is a general partner. See section 104–255 at http://www.austlii.edu.au/cgi-bin/sinodisp/au/legis/cth/consol_act/itaa1997240/s104.255.html, viewed 3 March 2010. CGT event K9 arises when an entitlement to receive a payment of a 'carried interest' arises. The amount of capital gain payable on the carried interest is the amount of capital proceeds. It is not possible to make a capital loss. See *Australian Master Tax Guide*, 44th edition (2009), ¶12–350.

73. **Proposed Subdivision 275–C** of the ITAA 1997.

74. As the Explanatory Memorandum for the current Bill explains, a wholesale trust 'is a MIS [Managed Investment Scheme] that has wholesale clients and is not required to be registered under the *Corporations Act 2001*'. See Explanatory Memorandum, Tax Laws Amendment (2010 Measures No. 1) Bill 2010, p. 30.

75. See footnote 64. The term '*financial services licensee*' is defined in section 761A of the Corporations Act 2001 to mean a person who holds an '*Australian financial services licence*' (which is defined in section 761A to mean 'a licence under section 913B that authorises a person who carries on a financial services business to provide financial services'). Section 913B sets out when the Australian Securities and Investments Commission (ASIC) must (and must not) grant an Australian financial services licence: see http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s913b.html, viewed 2 March 2010.

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If the trust makes no payment during an income year, then it will not meet the definition of '*managed investment trust*' in section 12–400 of Schedule 1 to the TAA 1953. However, under **proposed section 275–20** the trust will be treated as a MIT if the trust would otherwise be a MIT if it had made a payment on the first or last day of the income year.

If the trust is held by a small group (that is, 20 or fewer individuals), the 'closely held' trust is not to be treated as a MIS despite **proposed sections 275–5 to 275–20** if at any time in the income year the small group directly or indirectly:

- holds or has the right to acquire interests representing 75 per cent or more of the value of the interests in the trust
- controls, or has the ability to control, 75 per cent or more of the rights attaching to membership interests in the trust, or
- has the right to receive 75 per cent or more of any distribution of income that the trustee may make.[76]

Even if a trust does not meet the requirements in **proposed Subdivision 275–A** to be treated as a MIT, **proposed section 275–30** states that the trust can still be treated as a trust if:

- the reason for failing to meet the requirements is a particular, temporary circumstance that arose outside the trustee's control, and
- it is fair and reasonable to treat the trust as a MIT having regard to:
  - the nature of the circumstance
  - any action taken by the trustee to address or remove the circumstance (and the speed with which the action is taken)
  - the extent to which treating the trust as a MIT will increase or reduce the amount of tax otherwise payable by the trustee, the beneficiaries of the trust or any other entity, and
  - any other relevant matter.

Proposed Subdivision 275–B deals with the ability of a MIT to choose CGT/capital treatment of gains and losses made by the MIT. As a consequence of making a CGT choice under **proposed section 275–115**, CGT becomes the primary code for calculating MIT gains or losses under **proposed section 275–100**.[77] The choice must be made in the

76. **Proposed section 275–25**.

77. Some capital gains and losses are not eligible to be treated on capital account. For example, revenue account tax treatment will continue to apply where the asset is land that is trading stock or was acquired before 20 September 1985 (when CGT came into effect in Australia) and is part of a profit-making undertaking or plan.

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approved form and once made, is irrevocable.[78] If the trust is eligible to make a choice but does not do so, any gain or loss made on the disposal of eligible assets (excluding land, interests in land or an option to acquire or dispose of such an asset) is taxed on revenue account.[79] This means that certain ordinary and statutory income and deduction provisions in the income tax law will continue to apply to the gains or losses.[80]

Only the types of assets listed in **proposed section 275–105** are 'covered' assets that are eligible for CGT tax treatment:

- shares in a company (including shares in a foreign hybrid company)
- a non-share equity interest in a company
- a unit in a unit trust
- land (including an interest in land), or
- a right or option to acquire or dispose of an asset mentioned earlier in this list.

Neither a financial arrangement under Division 230 of the ITAA 1997 nor a debt interest is a covered asset.[81] As mentioned earlier in this Digest, corporate unit trusts and trading trusts are not eligible to elect to be treated as MITs.[82]

Proposed Subdivision 275–C deals with '*carried interests*' in MITs.[83] Distributions to carried interest holders (and proceeds from CGT events of a carried interest held in an entity that is (or was) an eligible MIT) in the relevant income year will be included in the holder's assessable income.[84] The taxpayer must have acquired the asset because of services he or she (or an associate) provided or will provide to the MIT as either:

- manager of the MIT
- associate of the manager
- employee of the manager, or
- associate of an employee of the manager.[85]

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78. **Proposed subsections 275–115(2) and (4)**.
79. **Proposed section 275–120**.
80. Explanatory Memorandum, op. cit., p. 39.
81. **Proposed subsection 275–105(2)**.
82. **Proposed section 275–110**. See also section 102J of the ITAA 1936 (corporate unit trusts) and Division 6C of that Act (trading trusts).
83. See footnote 72.
84. **Proposed subsection 275–200(1)**.
85. **Proposed paragraphs 275–200(1)(d)–(e)**.

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The amount of the distribution is not included in the taxpayer's assessable income in the relevant income year to the extent that:

- it represents a return of capital that the taxpayer (or an associate) contributed in order to acquire the asset[86]
- the amount of gain or profit on the CGT event is already included in the taxpayer's assessable income as ordinary income (section 6–5) or statutory income under another section of the ITAA 1997 (other than Parts 1–3 or 3–3)[87]
- the source of the amount of distribution (or gain or profit) on the CGT event is outside Australia,[88] or
- the taxpayer is entitled to deduct the amount of any loss on the CGT under another provision of the ITAA 1997.[89]

Item 9 of **Schedule 3** to the Bill inserts **proposed section 45–286** into Schedule 1 to the TAA 1953. It provides that '*instalment income*' for a period includes distributions by certain MITs (where the trust either meets the definition of '*managed investment trust*' in Subdivision 12–H of Schedule 1 to the TAA 1953 or it is treated as a MIT for the purposes of **proposed Division 275** of the ITAA 1997). This amendment applies to CGT events that happen on or after the start of the 2008–09 income year.[90]

Schedule 4—25% entrepreneurs' tax offset

Schedule 4 introduces an income test into the eligibility requirements for the entrepreneurs' tax offset in Subdivision 61–J of the ITAA 1997.

The entrepreneurs' tax offset was introduced into the ITAA 1997 by the *Tax Laws Amendment (2004 Measures No. 7) Act 2005* to honour a Howard Government election commitment to promote entrepreneurial spirit in Australia, as the Revised Explanatory Memorandum for the relevant Bill explains:

> 1.3 In the 2004 election policy statement *Promoting an Enterprise Culture*, the Government announced a number of measures designed to foster the entrepreneurial spirit of small businesses. The Government stated that it would provide further incentive and encouragement to small businesses – particularly those that set up and operate from home – through the introduction of a tax offset for entrepreneurs. This

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86. **Proposed paragraph 275–200(2)(a)**.
87. **Proposed subsection 275–200(3)**.
88. **Proposed subsection 275–200(4)**.
89. **Proposed subsection 275–200(6)**.
90. **Item 10** of **Schedule 3** to the Bill.

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> proposal is targeted at very small, micro and home-based businesses that are in the [Simplified Tax System (STS)].[91]

The offset applies to business income for small businesses in the simplified tax system (STS) that have an annual turnover of $75 000 or less. Where the business' turnover is greater than $50 000, the offset is phased out and ceases once STS turnover reaches $75 000.[92] The maximum tax offset that may be claimed is 25 per cent of a taxpayer's income tax liability that is attributable to his or her net small business income for the relevant income year. Any income that the taxpayer might earn from sources other than the small business is currently irrelevant for the purposes of the tax offset.

However, as part of the 2008–09 Budget, the Rudd Government announced that the tax offset would be made subject to an income test, commencing on 1 July 2008:

> The Government will introduce an income test for the entrepreneurs' tax offset (ETO), with effect from 1 July 2008. The measure reduces the existing concession and tax expenditure through better targeting. This measure has an ongoing gain to revenue which is estimated to be $90.0 million over the forward estimates period.
>
> The ETO provides a 25 per cent tax offset for small businesses with annual turnover of less than $75,000, which begins to phase out for turnover greater than $50,000.
>
> The income test will focus the benefit of the ETO towards genuine small businesses, by restricting eligibility for singles from $75,000 and families from $120,000 adjusted taxable income per year.
>
> This delivers on the Government's commitment to responsible economic management.[93]

In the event, the commencement date was later deferred to 1 July 2009,[94] and the adjusted income threshold level contained in the current Bill has been set at a slightly lower threshold for individuals than that announced in the 2008–09 Budget ($70 000 instead of $75 000). The threshold for families ($120 000) remains unchanged. The reduction in the individual threshold level (albeit only $5000) seems a little odd, given events such as CPI increases since that time, but no explanation is given in the current Explanatory

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91. Revised Explanatory Memorandum, Tax Laws Amendment (2004 Measures No. 7) Bill 2005, p. 13, viewed 6 March 2010, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fems%2Fr2245_ems_fcf052ca-9a5b-483e-9fc2-208976d1ccf4%22

92. Ibid., p. 3.

93. Australian Government, *Budget Measures: Budget Paper No. 2: 2008–09*, op. cit., p. 21.

94. Australian Government, *Budget Measures: Budget Paper No. 2: 2009–10*, Commonwealth of Australia, Canberra, 12 May 2009, p. 14, viewed 6 March 2010, http://www.budget.gov.au/2009-10/content/bp2/download/bp2_Consolidated.pdf

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Memorandum. Under the aggregated turnover test, the entrepreneurs' tax offset will phase out at the rate of 20 cents for every dollar a taxpayer's adjusted income exceeds the threshold.

While the proposed income test may fairly limit the availability of the tax offset in some circumstances, it may also unfairly (and perhaps inadvertently) target some individuals (and families) who are engaged in employment outside their own small business in order to fund the ongoing liabilities of the business and make ends meet in the family's household budget. This may occur, for example, where the business is in the start-up phase (or has suffered a downturn in the current economic climate) and is not producing sufficient income to meet its own liabilities, let alone providing sufficient return to enable the family to focus solely on the business without resorting to outside employment in order to fund ongoing liabilities such as loan or rent payments (on the business premises, plant and equipment or the family home), childcare fees or indeed even tax payments.

Press commentary

There has been little recent commentary in the media about the proposed changes to the entrepreneurs' tax offset. However, several articles mentioned the proposed changes as part of wider commentary about the 2008–09 and 2009–10 Budgets. For example, in May 2008, Ali Noroozi (then tax counsel for the Institute of Chartered Accountants) was reported as saying that 'the decision to means test various benefits [including the entrepreneurs' tax offset] could be costly and become a disincentive to join the workforce'. More specifically, Noroozi said that while some means-testing 'may be justified on equity grounds', such tests 'have administrative costs and may also result in disincentives to workforce participation as income increases and benefits decline'.[95]

Similarly, Helen Meredith, reporting on the negative effects of the 2008–09 Budget on Australia's IT industry, quoted the chairman of Software Queensland, Grant Cause, as saying: 'For small business and innovation in this country the budget represented death by a thousand cuts'.[96]

More specifically, in May 2009, financial journalist, Mark Fenton-Jones, suggested that introducing an income test into the eligibility criteria for the entrepreneurs' tax offset means that 'the rebate will focus more on individuals who are trying to get a business off the ground, rather than running it alongside existing employment'.[97]

95. N Khadem, 'It's suddenly tougher at the top as loopholes are plugged', *The Age*, 14 May 2009, p. 5. Note that on 18 September 2008, Ali Noroozi was appointed as the Inspector–General of Taxation for a term of five years.

96. H Meredith, 'Investor doom in budget', *The Age*, 29 July 2008, p. 9.

97. M Fenton-Jones, 'Offset change aims to help home-based entrepreneurs', *Australian Financial Review*, 19 May 2009, p. 46.

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In an article highlighting ways that taxpayers could reduce their tax bills for the 2008–09 income year, financial journalist John Kehoe suggested that the tax offset may be beneficial 'for people running part-time businesses, even if they earn income from mainstream employment'. [98] However, Kehoe also noted that the offset would be means-tested from the 2009–10 financial year and stated that the tax offset 'can only reduce tax payable and cannot be claimed as a tax refund'.[99]

Main provisions

Items 1–7 of **Schedule 4** make consequential amendments to existing sections 61–500, 61–505, 61–510 and 61–520 of the ITAA 1997 to include reference in those provisions to **proposed section 61–523**(see **item 8**) and the reduction of the entrepreneurs' tax offset (ETO) for income from sources other than the taxpayer's small business.

Item 8 inserts **proposed section 61–523** into the ITAA 1997. It sets out the formula used to calculate the taxpayer's 'non-ETO small business income', being:

$$\frac{\text{Non-ETO small business income for the income year} - \text{threshold amount}}{5}$$

where '*non-ETO small business income*' includes the taxpayer's taxable income, reportable fringe befits total, reportable superannuation contributions, and total net investment loss. It does not include certain amounts of net small business income, but does include the taxpayer's spouse's taxable income, reportable fringe befits total, reportable superannuation contributions, and total net investment loss.

The term '*threshold amount*' means $120 000 if either the taxpayer has a dependant (other than a spouse) on any day during the income year, or the taxpayer has a spouse on the last day of the relevant income year.[100] Otherwise it means $70 000.

The amendments in **Schedule 4** apply in relation to assessments for income years that commenced on or after 1 July 2009.[101]

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98. J Kehoe, 'Clock is ticking on ways to save cash', *Australian Financial Review*, 10 June 2009, p. 2.

99. Ibid.

100. See the definition of '*dependant*' in subsection 159P(4) of the ITAA 1936 at http://www.austlii.edu.au/au/legis/cth/consol_act/itaa1936240/s159p.html, viewed 6 March 2010. There it is defined to mean a spouse, children under 21 years, a student, an invalid relative and a parent of the taxpayer, but spouses fall outside the definition of '*dependant*' for the purposes of the definition of '*threshold amount*' in proposed subparagraph 61–523(a)(i).

101. Item 9 of Schedule 4.

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Schedule 5—Consolidation

Schedule 5 to the Bill amends provisions of the ITAA 1997 dealing with (or affecting) the consolidation regime.

The consolidation regime was introduced in 2002 and 'applies primarily to a group of Australian resident entities wholly-owned by an Australian resident company that choose to form a consolidated group'.[102] Specific rules provide for the membership of certain resident wholly owned subsidiaries of a foreign holding company which can choose to form a multiple entry consolidated group (MEC group).[103] Members of a consolidated group are treated as a single entity for income tax purposes, and subsidiary entities are treated as part of the head company.[104]

The amendments in **Schedule 5** mainly clarify the operation of the existing law, and so it is probably unnecessary to discuss the amendments in detail here.[105]

The amendments were first announced by the Howard Government as part of various measures designed to clarify and improve the operation of the consolidation regime, but they were not given effect prior to the proroguing of the 41st Parliament on 15 October 2007.[106]

On 28 April 2009, the then Assistant Treasurer, Chris Bowen MP, released exposure draft legislation aimed at improving the income tax consolidation regime.[107] Public comment on the draft closed on 25 May 2009. There were two main issues in the draft:

102. Explanatory Memorandum, op. cit., p. 55.

103. Ibid.

104. Ibid.

105. For further details about the proposed amendments, the reader is referred to the Explanatory Memorandum, particularly the comparison of the proposed law with the existing law at pp. 57–64.

106. W Swan MP (Treasurer) and C Bowen MP (then Assistant Treasurer), *The way forward on tax measures announced, but not enacted, by the previous government*, joint press release, no 53, 13 May 2008, viewed 6 March 2010, http://parlinfo.aph.gov.au/parlInfo/download/media/pressrel/9LGQ6/upload_binary/9lgq63.pdf;fileType=application/pdf#search=%22consolidation%20regime%20%20media%22

107. C Bowen MP (then Assistant Treasurer), *Release of draft legislation to improve the consolidation regime*, media release, no. 33, 28 April 2009, viewed 6 March 2010, http://parlinfo.aph.gov.au/parlInfo/download/media/pressrel/1KIT6/upload_binary/1kit60.pdf;fileType=application/pdf#search=%22consolidation%20regime%20%20media%22 The draft legislation is available on the Treasury's website at http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1522, viewed 6 March 2010.

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- proposed amendments to the income tax law 'to clarify the operation of certain aspects of the consolidation regime and improve interactions between the consolidation regime and other parts of the law', and
- the 'application of losses with nil available fraction'.

Treasury dealt with the second issue separately—by Schedule 4 to the *Tax Laws Amendment (2009 Measures No 4) Bill 2009* which was introduced into the House of Representatives on 25 June 2009. That measure was designed 'to ensure losses transferred to the head company of a consolidated group or a multiple entry consolidated group by a joining entity that is insolvent at the joining time can be used by the head company in certain circumstances'.[108]

Treasury received 16 key submissions on the twin issues of the clarification of the operation of the consolidation regime and the interaction between the consolidation regime and other parts of the law. Four of the key submissions were made in-confidence. The submissions dealt mainly with application dates for the various provisions, and technical aspects of the provisions, and resulted in modifications to the draft legislation (as now found in **Schedule 5** to the current Bill).[109]

Notably, on 3 June 2009, the then Assistant Treasurer announced that the Board of Taxation would conduct a post-implementation review into certain aspects of the consolidation regime, including the interaction between the consolidation provisions and other parts of the income tax law (which, as just mentioned, is the main subject of **Schedule 5** to the current Bill).[110] On 9 December 2009, the Board released a discussion paper on the post-implementation review into certain aspects of the consolidation regime for public comment by 26 February 2010.[111] It is yet to release a report.

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108. The *Tax Laws Amendment (2009 Measures No 4) Act 2009* received Royal Assent on 18 September 2009. It is available electronically at http://www.austlii.edu.au/au/legis/cth/num_act/tla2009mn4a2009314.txt, viewed 6 March 2010.

109. Treasury, *Consolidation: Summary Of Consultation Process*, departmental website, February 2010, viewed 6 March 2010, http://www.treasury.gov.au/documents/1522/PDF/Consultation_Summary_2.pdf

110. C Bowen MP (then Assistant Treasurer), *Board of Taxation to conduct two post implementation reviews*, media release, no. 58, 3 June 2009, viewed 6 March 2010, http://parlinfo.aph.gov.au/parlInfo/download/media/pressrel/YART6/upload_binary/yart60.pdf;fileType=application/pdf#search=%22consolidation%20regime%20%20media%22

111. The review's homepage is at http://www.taxboard.gov.au/content/post_imp_consolidation.asp, viewed 6 March 2010. For a copy of the discussion paper, see Board of Taxation, *Post-implementation review into certain aspects of the consolidation regime*, discussion paper, 9 December 2009, viewed 6 March 2010,

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Given that the Board's review deals directly with issues that are the subject of amendments contained in Schedule 5 and related issues, it is not clear why the introduction of Schedule 5 was not delayed pending the delivery and consideration of the Board's report.

Press commentary

There seems to be bipartisan and industry support for any amendments to the consolidation regime which have the effect of reducing confusion and compliance/administrative costs, particularly for small business.[112]

In September 2009, taxation lawyer John Storey drew attention to the inequities of the consolidation regime for small business:

> … the 'consolidation regime', contained in 200 pages of legislation introduced in 2002 and accompanied by thousands of pages of explanatory memoranda, rulings and other Tax Office guidance. It was meant to allow all companies in a corporate group to be treated as one company to simplify the tax affairs of big businesses. They can now choose to lodge only one tax return (instead of one per company) and intra-group transactions within the group can be ignored for tax purposes (greatly assisting in corporate restructuring).
>
> The catch is there are extremely complex rules that apply in forming a consolidated group, or when a subsidiary company exists a consolidated group. The high administrative cost associated with these rules is worth it for big business as they benefit most from only having to lodge one return and the flexibility that the consolidation regime allows.
>
> Such costs are prohibitive for a small business. Despite this, many small businesses or family groups are effectively forced to bear the costs. This is because when the consolidation rules were introduced, former simple rules allowing companies to restructure or move assets between company groups without triggering tax were removed. So small businesses that also need the benefits of tax-neutral restructuring must undertake the costly process of consolidating. This may be for things as simple as paying profits to a holding company or moving assets between subsidiaries.[113]

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http://www.taxboard.gov.au/content/downloads/Consolidation_Post_Implementation_Review_DP.pdf

112. See, T Smith MP (then Shadow Assistant Treasurer), *Tax Laws Bill passes the Parliament with Coalition support*, media release, 11 September 2009, viewed 6 March 2010, http://parlinfo.aph.gov.au/parlInfo/download/media/pressrel/56OU6/upload_binary/56ou60.pdf;fileType=application/pdf#search=%22consolidation%20regime%20%20media%22 and J Storey, 'Tax needs new and fewer pages', *The Age*, 23 September 2009, p. 14.

113. J Storey, op. cit.

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Schedule 6—Miscellaneous amendments

Schedule 6 to the Bill contains a raft of miscellaneous amendments to the tax laws which primarily involve:

- the correction of technical or typographical errors
- the removal of ambiguities, and
- ensuring provisions are consistent with their original policy intent.[114]

Some of the amendments are the product of input from members of the public and tax professionals via the Tax Issues Entry System (TIES).[115]

The provisions are detailed in the Explanatory Memorandum at pp. 195–213.

Committee consideration

On 24 February 2010, the Selection of Bills Committee resolved to refer the Bill to the Senate Economics Legislation Committee for inquiry and report by 15 March 2010.[116] There are three main reasons for the referral:

- Whether the legislation will have unintended consequences for the superannuation market;
- Whether the legislation is anti-competitive in relation to privately operating Clearing Houses;
- Whether Medicare is an appropriate agency to operate the Clearing House under the legislation.[117]

Financial implications

According to the Explanatory Memorandum for the Bill, the Bill has the following financial implications:

- Schedule 1—Approved superannuation clearing house: **nil** (noting that the Government allocated funding of $16.1 million over the forward estimates period in the 2008–09 Budget)[118]

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114. Explanatory Memorandum, p. 193.

115. TIES is a government initiative managed jointly by the ATO and the Treasury, and which enables tax professionals and the general public 'to raise issues relating to the care and maintenance of the tax system'. See Explanatory Memorandum, p. 193 and the TIES website at www.ties.gov.au, viewed 6 March 2010.

116. Selection of Bills Committee, *Report No. 2 of 2010*, 24 February 2010, viewed 25 February 2010, http://www.aph.gov.au/senate/committee/selectionbills_ctte/reports/2010/rep0210.pdf

117. Ibid., p. 9.

- Schedule 2—Forestry managed investment schemes: **negligible**[119]
- Schedule 3—Managed investment trusts: **unquantifiable revenue implications from the 2009–10 income year**[120]
- Schedule 4—25% entrepreneurs' tax offset: a saving of **$66 million over the forward estimates period** (being exactly $22 million a year for three years starting 2010–11)[121]
- Schedule 5—Consolidation: **generally unquantifiable**, with the exception of Part 20, which is expected to result in a revenue gain of $150 million over the forward estimates period[122]
- Schedule 6—Miscellaneous amendments: **generally nil to minimal**, with the exception of items 7–11 (amendments to the small business retirement exemption) which are expected to have an unquantifiable but small cost to revenue and items 58–105 (amendments to the administrative penalties for false or misleading statements) which are expected to result in an unquantifiable but small gain to revenue.[123]

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118. Explanatory Memorandum, op. cit., p. 7.
119. Ibid., p. 8
120. Ibid., p. 9.
121. Ibid.
122. Ibid., p. 10.
123. Ibid., p. 11.

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