The Senate

Standing Committee on Economics

Tax Laws Amendment (2008 Measures No. 5) Bill 2008 [Provisions]

November 2008

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Senate Standing Committee on Economics

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Chapter 1

The conduct of the inquiry and recommendation

1.1 On 25 September 2008, the Senate referred the Tax Laws Amendment (2008 Measures No. 5) Bill 2008 to the committee. The bill has five schedules (discussed in each of the following chapters):

- Schedule 1 amends the GST tax base to correct an anomaly with real property;
- Schedule 2 modifies the thin capitalisation regime to adjust for certain impacts of the adoption of International Financial Reporting Standards;
- Schedule 3 extends the eligibility for exemption from interest withholding tax to bonds issued in Australia by state and territory central borrowing authorities;
- Schedule 4 removes an anomaly in the fringe benefits tax law concerning benefits for investment properties held jointly by an employee and associates;
- Schedule 5 amends the eligible investment business rules for managed investment trusts.

1.2 The committee was due to report by 13 October. However, the Senate granted an extension to the committee permitting it to report by 10 November 2008.

Submissions and public hearings

1.3 The committee advertised the inquiry in *The Australian* and on the committee's website from 26 September 2008. It also wrote to a number of organisations and government agencies alerting them to the inquiry and calling for submissions to be lodged by 3 October 2008. In total, the committee received six submissions. They are listed in Appendix 1 and are available at: http://www.aph.gov.au/Senate/committee/economics_ctte/tlab_5_08/submissions/sublist.htm.

1.4 The submissions received by the committee focused on two measures: Schedule 1—GST and the sale of real property and Schedule 3—interest withholding tax and exemption for state government bonds. One submission offered a brief comment on Schedule 5—managed funds. Schedules 2 and Schedule 4 were not addressed. The committee held a public hearing in Canberra on 28 October 2008.The committee thanks those who assisted with the inquiry.

1.5 Only Schedule 1 attracted any significant criticism, which the committee found unconvincing.

Recommendation 1

The committee recommends that the Senate pass the bill.

Chapter 2

Schedule 1—GST and the sale of real property, integrity measure

2.1 The provisions relating to the goods and services tax (GST) and the sale of real property were announced in the 2008–09 Budget and clarify whether a supplier, when buying or selling a business (or real property), will incur a liability for GST.

2.2 Special rules exist for real property that allow taxpayers an alternative means of calculating GST.[1] These rules are known as the 'margin scheme'. The margin scheme is generally used for new residential property developments.

2.3 The bill seeks to maintain the integrity of the GST tax base by ensuring that property sales cannot be structured in a way that GST does not apply to the value added to real property. These amendments:

- ensure that where the margin scheme is used, the value added is included in determining the GST subsequently payable;
- ensure that eligibility to use the margin scheme cannot be reinstated by interposing a GST-free or non-taxable supply; and
- confirm that the GST general anti-avoidance provisions can apply to contrived arrangements entered into to avoid GST.[2]

2.4 The Department of the Treasury claims that if the measure does not proceed the 'risk to revenue will increase substantially as more property developments are structured to take advantage of the tax minimisation opportunities'.[3]

Operation of the margin scheme in the existing provisions

2.5 Under the margin scheme provisions, GST is generally payable only on the value added to property on or after 1 July 2000. It levies GST only on the margin by which the value of the property increases each time it is sold by a registered entity.

2.6 While the margin scheme was designed to ensure that GST is payable only on the incremental value added to land by each party in a series of transactions, the

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1 In the common law, real property refers to land and land improvements including buildings and machinery sited on land.

2 Explanatory memorandum, p. 11.

3 The Department of the Treasury, *Submission 6*, p. 2.

interaction between the margin scheme provisions and the going concern provisions has given rise to an anomaly.

2.7 A supply of a going concern occurs when a business is sold, and that sale includes all of the things that are necessary for the business to continue operating; and the business is carried on, up until the day of sale. Real property may be acquired GST-free under the going concern or farmland provisions, or acquired from a registered associate without consideration.

2.8 Under the current legislative arrangements, as a result of the interaction of these provisions, GST is only paid on the margin between the final sale price and the amount paid to acquire the land before improvements have been undertaken (i.e. they do not include the value added by the supplier of the property as part of a going concern or the value added by an associate). This is illustrated by the diagram and table supplied by Treasury reproduced on the following two pages.

2.9 The Treasury considers that the interaction between these provisions has created a loophole which allows entities registered for GST to minimise the GST they pay on real estate transactions. As the explanatory memorandum states:

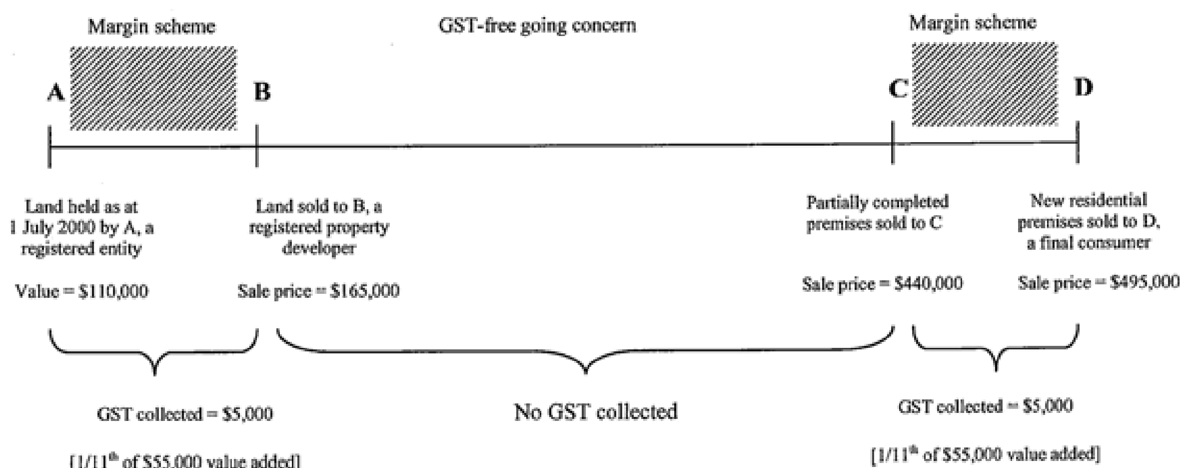
> A registered entity that supplies real property as part of a GST-free going concern, as GST-free farmland, or as a non-taxable supply to a registered associate for no consideration does not pay GST on its value added. If the entity that acquires the real property later sells it under the margin scheme, it only pays GST on its own value added in these circumstances. The value added by the entity from which it acquired the property is not taxed.[4]

4 Explanatory memorandum, p. 15.

ILLUSTRATION 1 - reduced GST liabilities from the interaction of the margin scheme and the GST free going concern and farm land provisions

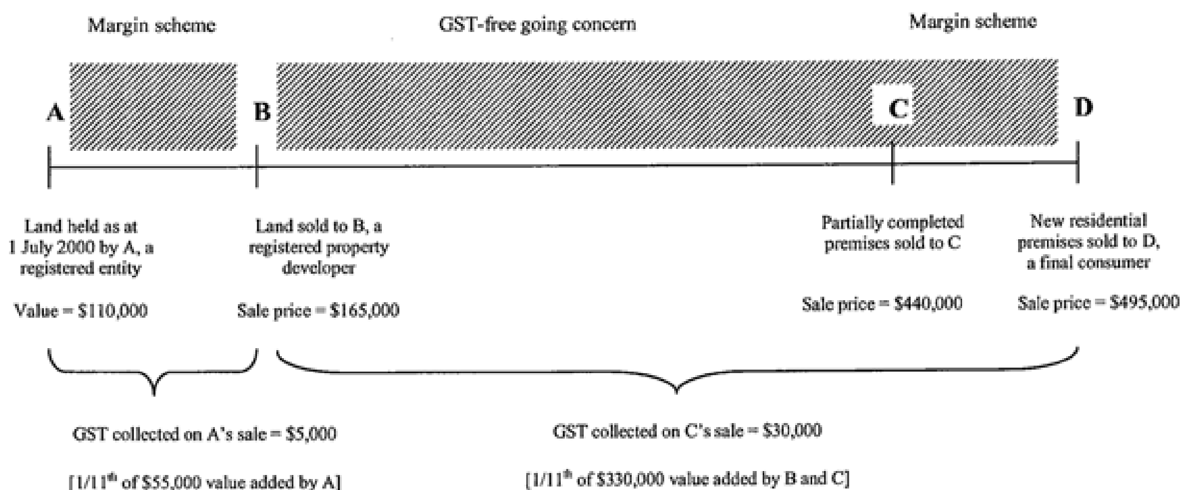
A, a GST-registered entity, holds land on 1 July 2000 valued at $110,000
A sells land under the margin scheme to B, a GST-registered property developer, for $165,000
B partially constructs new residential premises on the land, sells to C as a GST-free going concern for $440,000
C completes construction and sells to a final consumer under the margin scheme for $495,000.

Outcome under current law



Total GST Collected $10,000

Outcome under measure



Total GST Collected $35,000

Summary table

	Current law	Proposed Outcome	Difference
GST payable by Entity A	$5,000	$5,000	-
GST payable by Entity B	$0	$0	-
GST payable by Entity C	$5,000	$30,000	$25,000
Total GST collected	$10,000	$35,000	$25,000

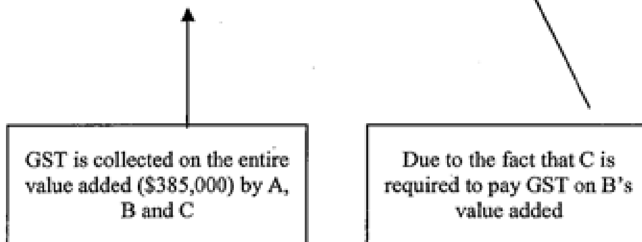


Illustration and table supplied by the Department of the Treasury, *Submission 6*, p. 9

Proposed legislation

2.10 Under the proposed legislation there will be changes to the margin scheme, requiring the final owner to pay GST on the full value added to the site.[5] This ensures that each registered supplier in a series of transactions remits the GST applicable to the value added by them.[6]

2.11 Schedule 1 ensures that a supply that is ineligible for the margin scheme continues to be ineligible for the margin scheme after it is supplied as part of a GST-free sale of a going concern. This is achieved by specifying that a supply is ineligible for the margin scheme if the previous supplier acquired the entire interest through a taxable supply on which the GST was worked out without applying the margin scheme.

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5 The full value added is the difference between its initial value when the GST was introduced (1 July 2000) and the ultimate transaction value.

6 The Department of the Treasury informed the committee that 'amendments to address similar integrity issues were withdrawn from the Tax Laws Amendment (2005 Measures No.2) Bill. These were withdrawn in light of industry concerns over-taxation and retrospective application. The previous measure was intended to tax the increase in value from 1 July 2000 even though property may not have been in the GST system until after that time. The new integrity measure will only look back through one sale prior to the final sale under the margin scheme and not back through one sale prior to the final sale under the margin scheme and not back to 1 July 2000'. The Department of the Treasury, *Submission 6*, p. 1.

Housing affordability

2.12 Both the Urban Development Institute of Australia (UDIA) and the Property Council of Australia (PCA) expressed concern that the proposed legislation will act as 'an increased tax on new housing developments' and these will ultimately be passed on to the home buyer.[7]

2.13 UDIA suggested that the changes 'will have a significant impact on the future costs of housing developments', while PCA claimed that the proposed margin scheme will affect housing supply:

> The businesses that are developing property will face significant increases in the cost of developing that property. Straight away this increase in the cost of development means that there will be a reduced supply of viable future residential developments. Essentially, what we are saying is it will cost more to develop property, which will mean fewer houses will be built.[8]

2.14 The Urban Development Institute of Australia suggested that a major developer has calculated that the cost of the measure to be in order of:

- $11,000 per lot on a 60 lot infill development; and
- $4,800 per lot on a 717 lot mixed townhouse and land development.[9]

2.15 Both UDIA and PCA further argued that the proposed changes are at odds with the Federal Government's commitment to improving housing affordability and that the cost impact will exceed the benefit of the new first home buyers grant:

> Increased costs for new housing will affect the price of all houses in the market. This will work against the government's initiative to boost the first home [buyers] grant.[10]
>
> It is, in effect, an increased tax on new housing developments which will be passed on to homebuyers through increased prices—and by this we note that on Treasury's estimates the revenues that will be raised by this measure are more than what the government will be spending on its Housing Affordability Fund.[11]

2.16 By contrast, the Department of the Treasury suggested that groups like UDIA and PCA had overstated the effect that the proposed changes would have on house

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7 See, for example, Urban Development Institute of Australia, *Submission 3*, p. 2.

8 Mr Andrew Mihno, Property Council of Australia, *Proof Committee Hansard*, 28 October 2008, p. 2.

9 Urban Development Institute of Australia, *Submission 3*, p. 3.

10 Mr Andrew Mihno, Property Council of Australia, *Proof Committee Hansard*, 28 October 2008, p. 2.

11 Mr Richard Lindsay, Urban Development Institute of Australia, *Proof Committee Hansard*, 28 October 2008, p. 4.

prices and housing supply. The Treasury argued that the current (tax minimisation) scheme had simply resulted in 'above-normal profits' for property developers.[12] Furthermore:

> The section of the housing market directly affected by the integrity measure is relatively small compared to the whole housing market.[13]

2.17 In estimating the proportion of the market likely to be affected by the changes the Treasury stated:

> Based on ABS data of building activity in Australia, Treasury estimates the total taxable value of new residential property in 2008/09 will be around $30 billion rising to around $35 billion in 2011–12. New residential property represents about 12 per cent of the total value of the market. Treasury estimates that the value of property potentially affected in 2008/09 is around $3.7 billion or about 1.5 per cent of all residential property sales.[14]

2.18 In refuting the claims of industry bodies, the Treasury further suggested that they believed 'closing the loophole' would have 'no impact on prices' and that the amendments would 'ensure a level playing field for participants in the property industry'.[15]

2.19 The financial impact of the proposed changes is estimated at: 2008–09 $43m; 2009–10 $135m; 2010–11 $160m; 2011–12 $185m; giving a total of $523 million over the next 4 years.[16]

2.20 This total of $0.5 billion needs to be placed within the context of the total taxable value of new residential property. As outlined above, the Treasury estimated that the value of the market is around $30 billion per year, or at least $120 billion over four years.

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12 The Department of the Treasury, *Submission 6*, p. 3.

13 The Department of the Treasury, *Submission 6*, p. 1.

14 The Department of the Treasury, *Submission 6*, p. 3.

15 The Department of the Treasury, *Submission 6*, pp. 1, 3.

16 Explanatory memorandum, p. 7.

Application of the measure

2.21 While there was some concern expressed by UDIA over whether the measure would be applied retrospectively—largely because of the way that this would affect existing developments—the explanatory memorandum clearly states: 'The measure has effect from the date of Royal Assent'.[17]

2.22 This was further reinforced by the submission by the Department of the Treasury which claimed that the changes will only apply from the date of Royal Assent so as not to affect existing contractual arrangements.[18] Because the measure will be applied prospectively, the Treasury argued that 'property developers will be able to take the new provisions into account when examining the feasibility of future development proposals'.[19]

Anti-avoidance provisions

2.23 In its submission UDIA expressed concerns about the Schedule's anti-avoidance provisions (Div 165), claiming that the proposed amendment will make the anti-avoidance provisions of the *A New Tax System (Goods and Services Tax) Act* more stringent than those applicable to the *Income Tax Assessment Act*. UDIA argues:

> The extension of the anti-avoidance provisions in the manner intended will create significant uncertainty for any taxpayer (not merely those that are involved in dealing with real property) where they are considering invoking one of the elections that is specifically provided for in the current GST law.[20]

2.24 The Department of the Treasury explained that during the consultations they undertook with key stakeholders concerns were raised about the amendments to the GST anti-avoidance provisions. It suggested that such concerns were unwarranted as the proposed amendments introduce a concept that is already contained in the income tax anti-avoidance provisions and are intended to clarify the operation of the GST anti-avoidance provisions and eliminate '*contrived* behaviour'.[21]

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17 Urban Development Institute of Australia, *Submission 3*, p. 3; Explanatory memorandum, p. 7. This is reiterated in paragraph 1.21 of the explanatory memorandum which, when referring to the anti-avoidance provisions in the bill, states: 'this measure will apply prospectively so that arrangements already entered into will not be impacted'.

18 The Department of the Treasury, *Submission 6*, p. 1.

19 The Department of the Treasury, *Submission 6*, p. 3.

20 Urban Development Institute of Australia, *Submission 3*, p. 5.

21 The Department of the Treasury, *Submission 6*, p. 3.

Date of acquisition

2.25 The UDIA also recommended that the proposed legislation clarify the meaning of 'date of acquisition':

> Under a real property scenario I can sign an agreement with you to sell the property, but the date at which you acquire that property can be some significant time later. And when I say significant, it can be years later. When we are dealing with the date of acquisition there is now uncertainty as to whether that is the date on which you sign the contract for the acquisition of the property, or whether it is the date on which you actually take settlement of that property.[22]

Committee view

2.26 The committee agreed with the Treasury that the proposed changes to the legislation would not have a significant impact on the cost of housing. The measures only affected a very small proportion of the housing market. Moreover, only a proportion of the cost would be passed onto homebuyers, with some passed back to the suppliers of land and some borne by the property development sector in reduced profits.

2.27 The committee also agreed with Treasury that if the current provisions were not changed, there was a risk that future property development transactions would be structured in such a way as to give rise to a significant and inequitable loss of GST revenue.

2.28 The committee notes the UDIA's uncertainty about the interpretation of 'date of acquisition' and they should be given an explanation or the definition clarified in the legislation.

22 Mr Bruce Hamilton, Urban Development Institute of Australia, *Proof Committee Hansard*, 28 October 2008, p. 5.

Chapter 3

Schedule 2—modification of the thin capitalisation regime

Background

3.1 On 24 January 2005, the former Treasurer announced a three-year transitional period in respect of the application of Australian equivalents to International Financial Reporting Standards (AIFRS) under the thin capitalisation rules in Division 820 of the *Income Tax Assessment Act 1997*.

3.2 In the period following this announcement, entities would elect, on an annual basis, to use either AIFRS or the previous accounting standards, the Australian Generally Accepted Accounting Principles, to make thin capitalisation calculations.[1]

3.3 When making this announcement, the former Treasurer also indicated that the Government would examine whether the existing thin capitalisation rules, following the adoption of AIFRS, were appropriate.

3.4 On 13 May 2008, the Treasurer and the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs jointly announced that the government will amend the thin capitalisation regime to accommodate certain impacts arising from the adoption of the AIFRS accounting standards. For example, certain assets and liabilities will not be permitted to be recognised by particular entities for thin capitalisation purposes.

3.5 In adopting globally accepted standards, Australia more closely aligns itself with international accounting practice. In addition, through adopting such standards, Australia can facilitate comparisons of cross-jurisdictional financial information and reduce the complexity for investors when making investment decisions.

Thin capitalisation

3.6 A non-financial company is said to be thinly capitalised when its liabilities are made up of a much greater proportion of debt than equity.

3.7 This is perceived to create problems for two classes of people:

- consumers and creditors bear the solvency risk of the company; and
- revenue authorities, who are concerned about excessive interest deductions.

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1 See the Hon. Peter Dutton MP, Minister for Revenue and Assistant Treasurer, Media Release 12 September 2007, no. 114.

3.8 Thin capitalisation rules are applied to determine an upper level of debt above which income tax deductions for interest payments are denied. They are designed to ensure that Australian and foreign-owned multi-national entities do not allocate an excessive amount of debt to their Australian operations. It operates to limit the deductibility of interest payments when debt exceeds certain thresholds.[2] As the explanatory memorandum states, the thin capitalisation regime:

> …is designed to ensure that Australian and foreign-owned multinational entities do not allocate an excessive amount of debt to their Australian operations. It does this by disallowing a proportion of otherwise deductible finance expenses (eg, interest) where the debt used to fund the Australian operations exceeds certain limits.[3]

Proposed modifications

3.9 Under the existing income tax arrangements there exists an incentive to use debt over equity for financing investment and business activity, and to maximise debt deductions in Australia.

3.10 Under the modified thin capitalisation rules a threshold will be established beyond which an entity will be subject to the denial of debt deductions. However, this threshold does not represent an absolute limit as entities can maintain higher gearing ratios where they are prepared to forgo debt deductions for that proportion of their debt in excess of the statutory gearing limits.

3.11 Assets and liabilities which will not be recognised for thin capitalisation purposes include: deferred tax assets and liabilities (within the scope of Australian accounting standard *AASB 112 Income Taxes*) and assets and liabilities arising from defined benefit plans (within the scope of Australian accounting standard *AASB 119 Employment Benefits*).

3.12 There are circumstances in which particular entities may choose to recognise or revalue certain intangible assets, contrary to the relevant accounting standard. This primarily relates to intangible assets within the scope of Australian accounting standard *AASB 138 Intangible Assets*.

3.13 The committee did not receive any submissions relating to this Schedule.

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2 Australian Treasury, 'Discussion paper—Thin Capitalisation: application of accounting standards', 1 November 2006, http://www.treasury.gov.au/documents/1179/PDF/Discussion%20paper%20-%20final.pdf

3 Explanatory memorandum, paragraph 2.7.

Chapter 4

Schedule 3—interest withholding tax, extension of eligibility for exemption to state government bonds

4.1 Schedule 3 to this bill amends section 128F of the *Income Tax Assessment Act 1936* (ITAA 1936) to allow bonds issued in Australia by state and territory central borrowing authorities to be eligible for exemption from interest withholding tax (IWT).

4.2 The schedule extends the eligibility for exemption from IWT to bonds issued in Australia by state and territory central borrowing authorities (semi-government bonds).

4.3 The proposed amendment represents the implementation of a policy announced by the Treasurer on 14 May 2008.

Background

4.4 IWT is imposed on the payment of interest from Australia to non-residents, at a rate of 10 per cent of the gross amount of interest. The obligation for collecting (withholding) the IWT is on the person making the payment (i.e. the borrower).

4.5 Section 128F of the *ITAA 1936* provides that where an Australian resident company, or a non-resident company carrying on business at or through a permanent establishment in Australia, issues a debenture or certain specified debt instruments and the issue satisfies the public offer test, an exemption from IWT will apply.

4.6 In 1999, the requirement that these debentures be issued outside Australia was removed for most borrowers. However, the liberalisation was not extended to the state central borrowing authorities. As a consequence, the interest paid to non-residents on bonds issued in Australia by state central borrowing authorities is liable to IWT (unless exempt under a treaty or another arrangement).

4.7 Consequently, the state central borrowing authorities have continued to issue their bonds offshore to remove the liability to IWT and attract non-resident investors.

4.8 Because of the state central borrowing authorities' concerns—that this practice had resulted in a segmented market, reduced liquidity and efficiency, and hampered the role of the state government bond market—the Federal Government announced its decision to extend eligibility for exemption from IWT to domestically issued state government bonds.

Proposed amendments

4.9 Submitters to the inquiry were supportive of the arrangements to remove interest withholding tax from semi-government bonds.

4.10 Arguing that 'the Commonwealth IWT on domestic semi government bonds is counterproductive to the development of an improved financial system', the New South Wales Treasury Corporation (TCorp) claimed that it will correct the disadvantage that affected the states after 1999.[1]

4.11 TCorp submitted that the 1999 decision not to extend the liberalisation to state central borrowing authorities resulted in:

- fragmenting the semi government bond market;
- reducing liquidity in semi government bonds;
- raising the cost of borrowing by Australian State governments;
- creating inefficiencies in financial markets that raise the total cost of capital in Australia;
- discouraging international bond investors from allocating money to Australia; and
- raising almost no revenue for the Commonwealth.[2]

4.12 TCorp believes that the abolition of IWF on these bonds will increase state government liquidity and help to finance—and lower the costs of—major infrastructure projects, projects that will in turn boost Australia's long-term productivity and export capacity. In addition, TCorp argues that the proposed changes have the potential to lower borrowing costs for all bond issuers while having no negative consequences for Commonwealth revenue.

4.13 The Australian Financial Market Association (AFMA) also supports this measure, believing that the changes 'are well-timed to assist debt market development, improve the efficiency of the fund raising process for states and facilitate innovation in debt security offerings to investors'.[3] AFMA also agreed with TCorp that Schedule 3 would allow for greater flexibility in funding infrastructure investment.

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1 Queensland and New South Wales are the two largest semi-government issuers. Between them they have over $29bn of global exchangeable bonds on issue, and $38bn of domestic bonds outstanding. New South Wales Treasury Corporation, *Submission 5*, p. 2.

2 New South Wales Treasury Corporation, *Submission 5*, p. 1.

3 Australian Financial Market Association, *Submission 4*, p. 1.

4.14 TCorp and AFMA both supported the reform because it would unify the offshore and domestic semi-government bond market. Unification, they contend, would strengthen Australia's presence in the global bond market, increase liquidity and lower the cost of borrowing.[4] In evidence to the committee AFMA stated:

> The measures in Schedule 3 of the bill will enable unification of the domestic and offshore segments into a single market…It will add liquidity and depth to the domestic market. The associated benefits include a larger and more diverse market for investors, greater product innovation and a more effective state government yield curve. In essence, it will also strengthen Australia's presence in the global bond market indices and enhance our standing as an international financial centre.[5]

4.15 In evidence provided to the committee, TCorp also suggested that the proposed changes would assist Australian markets survive the current instability in international financial markets:

> …given the challenges of the current global crisis, I think it makes this initiative even more important in terms of its improvement of market efficiency and improved liquidity of markets at a time when markets are challenged.[6]

4.16 One submission received by the committee expressed concern about the effect of the proposed legislation on the authorities of the Commonwealth. This submission contends that because the amendments to section 128F do not extend to them, such authorities remain disadvantaged by the proposed legislation.[7] The submitter therefore recommended that the government consider extending the proposed amendment to include authorities of the Commonwealth 'so as to ensure that these authorities can operate on a level playing field with their commercial counterparts'.[8]

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4 Australian Financial Market Association, *Submission 4*, p. 2; Mr David Lynch, Australian Financial Markets Association, *Proof Committee Hansard*, 28 October 2008, p. 11.

5 Mr David Lynch, Australian Financial Markets Association, *Proof Committee Hansard*, 28 October 2008, p. 11.

6 Mr Stephen Knight, New South Wales Treasury Corporation, *Proof Committee Hansard*, 28 October 2008, p. 13.

7 *Submission 1* (Confidential), p. 2.

8 *Submission 1* (Confidential), p. 2.

Chapter 5

Schedule 4—fringe benefit tax, jointly held assets

5.1 Schedule 4 to this bill amends the *Fringe Benefits Tax Assessment Act 1986* (FBTAA 1986) to ensure that where a fringe benefit is provided jointly to an employee and their associate, the employer's fringe benefits tax (FBT) liability on the taxable value of the fringe benefit will only be reduced to the extent the employee's share of the fringe benefit is used for income producing purposes.

Background

5.2 The proposed change to the legislation results from a Federal Court ruling over the 'otherwise deductible' rule as considered in *National Australia Bank Ltd v FC of T93 ATC4914*. In this case, the employer provided low interest loans jointly to the employee husband and his wife which were invested in a jointly held investment property (a loan fringe benefit). The Federal Court held that as a result of subsection 138(3), the employee was the sole recipient of the loan fringe benefit. It further held that as sole recipient of the loan and sole investor of the proceeds, if the employee husband had incurred and paid unreimbursed interest on the loan, he would have been entitled to a deduction for the expense. Thus, under the otherwise deductible rule in section 19 of the FBTAA 1986, the taxable value of the loan fringe benefit is reduced to nil so that the employer had no FBT liability arising from the loan fringe benefit provided to both the employee and his spouse.[1]

5.3 As a result of the National Australia Bank case, an employer can reduce the taxable value of a fringe benefit provided jointly to an employee and their associate in relation to an income earning asset owned by both the employee and their associate.

5.4 This outcome was inconsistent with the operation of the otherwise deductible rule as it would apply where a benefit is provided solely to an associate.

5.5 This outcome was also in conflict with the income tax position as determined by the courts that income and deductions arising from jointly owned rental property should be allocated between joint owners in accordance with their interest in the property (e.g. joint tenants in a rental property would include 50 per cent of the rental income in their assessable income and claim 50 per cent of the rental property expenses).

Proposed amendments

5.6 Under the proposed legislation an employer must adjust the taxable value of a fringe benefit provided jointly in relation to an income earning asset jointly owned by

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1 Explanatory memorandum, paragraphs 4.4–4.5.

an employee and their associate, so that the taxable value of the fringe benefit is reduced only by the employee's percentage of interest in the asset.

5.7 Schedule 4 inserts a new provision into the otherwise deductible rule for loan fringe benefits, expense payment fringe benefits, property fringe benefits and residual fringe benefits in subsections 19(1), 24(1), 44(1) and 52(1) of the *FBTAA 1986* which will provide a different calculation for the application of the otherwise deductible rule where because of subsection 138(3) of the *FBTAA 1986* a fringe benefit is provided jointly to an employee and their associate and is deemed to be provided solely to the employee. [Schedule 4, items 7, 17, 30 and 39].

5.8 The explanatory memorandum provides the following example to illustrate the proposed changes:

> Neena and her husband Marek are jointly provided with a $100,000 low interest loan by Neena's employer which they use to acquire shares. The loan fringe benefit has a taxable value of $10,000. Neena and Marek use the loan to purchase $100,000 of shares which they will hold jointly with a 50 per cent interest each. Neena and Marek return 50 per cent of the dividends derived from the shares as assessable income in each of their income tax returns. Under the current law (and as a result of the NAB case) the otherwise deductible rule would apply to reduce the taxable value of the loan fringe benefit ($10,000) (i.e., in respect of both Neena and Marek's share of the benefit) to nil and consequently the employer would have no FBT liability. As a result of new paragraph 19(1)(i) and new subsection 19(5) the notional deduction of $10,000 is reduced by Neena's percentage of interest in the shares (i.e., 50 per cent so that the taxable value of the loan fringe benefit of $10,000 is reduced by $5,000). The employer has an FBT liability on $5,000 which reflects the share of the loan fringe benefit that was provided to Marek.[2]

5.9 Part 2 of Schedule 4 to this bill also makes some minor technical corrections to the FBT law. The amendments will correct certain cross references and in line with current drafting practice, improve the readability of these provisions [Schedule 4, Part 2, items 42 to 75].

5.10 The committee did not receive any submissions on the proposed changes contained in Schedule 4.

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2 Explanatory memorandum, p. 54.

Chapter 6

Schedule 5—managed funds

6.1 Schedule 5 to this bill amends Division 6C of the *Income Tax Assessment Act 1936* (ITAA 1936) to streamline and modernise the eligible investment business rules for managed funds.

6.2 These amendments aim to:

- clarify the scope and meaning of investing in land for the purpose of deriving rent;
- introduce a 25 per cent safe harbour allowance for non-rental, non-trading income from investments in land;
- expand the range of financial instruments that a managed fund may invest in or trade; and
- provide a 2 per cent safe harbour allowance at the whole of trust level for non-trading income.

6.3 The introduction of these amendments will make it easier for managed funds, in particular property trusts, to comply with the law by reducing the scope for them to breach inadvertently Division 6C.

6.4 These amendments will clarify the scope and meaning of 'investing in land for the purpose of deriving rent'. It achieves this by ensuring that this clause is taken to include investing in fixtures on the land and movable property (i.e. chattels) customarily supplied, incidental and relevant to the renting of the land and ancillary to the ownership and utilisation of the land.

6.5 These amendments will introduce a 25 per cent safe harbour allowance for non-rental, non-trading income from investments in land. The allowance is to operate as a safe harbour in conjunction with the existing rental purpose tests on an overall land portfolio basis. If a trust does not meet this safe harbour, it can assess whether it is investing in land for the purpose, or primarily for the purpose of deriving rent under the existing law (i.e. paragraph (a) of the definition of 'eligible investment business' in section 102M).

6.6 The explanatory memorandum provides the following example of the proposed law:

> A public unit trust invests in land used as a shopping centre. The property includes some fittings and moveable furnishings in the common areas that

> are for use by centre customers. The investment in the fittings and moveable property are included as part of the investment in land.[1]

6.7 The Property Council of Australia submitted that these proposed changes will help modernise Australia's Real Estate Investment trust rules:

> The new safe harbour framework provides clearer boundaries regarding the types of income a trust can earn, which makes it easier to understand the ground rules for distributing untaxed income to beneficiaries.[2]

6.8 Beyond the comment offered by the Property Council of Australia, the committee received no submissions on the proposed changes contained in Schedule 5.

Senator Annette Hurley

Chair

1 Explanatory memorandum, p. 60.

2 Property Council of Australia, *Submission 2*, p. 2.

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	CONFIDENTIAL
2	Property Council of Australia
3	Urban Development Institute of Australia (UDIA National)
4	Australian Financial Markets Association
5	NSW Treasury Corporation
6	Treasury (Commonwealth)

APPENDIX 2

Public Hearings and Witnesses

CANBERRA, TUESDAY 28 OCTOBER 2008

- CROOKE, Mr Matthew, Manager,
  Domestic Demand Unit, Department of the Treasury
- HAMILTON, Mr Bruce, Spokesman,
  Indirect Tax, Urban Development Institute of Australia
- HARMS, Mr Michael, Manager,
  GST, Property and Government Unit, Department of the Treasury
- KNIGHT, Mr Stephen William, Chief Executive,
  New South Wales Treasury Corporation
- LEGGETT, Mr Christopher Murray, Senior Adviser,
  Philanthropy and Exemptions Unit, Personal and Retirement Income Division,
  Department of the Treasury
- LILLEY, Ms Louise, Policy Analyst,
  Department of the Treasury
- LINDSAY, Mr Richard James, Chief Executive Officer,
  Urban Development Institute of Australia
- LYNCH, Dr David, Head of Policy and Markets,
  Australian Financial Markets Association
- MIHNO, Mr Andrew, National Policy Manager,
  Property Council of Australia
- POTTS, Mr William, Manager,
  International Tax Unit, Department of the Treasury