client alert | explanatory memorandum

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Tax Consequences of Collapsed Managed Investment Schemes

The Tax Office has released three draft taxation determinations which set out the Commissioner's preliminary views on the tax consequences that may flow from collapsed managed investment schemes (MISs).

Change of responsible entity

In Draft Taxation Determination TD 2009/D9, the Commissioner says a change of responsible entity of a registered agricultural MIS does not affect the tax outcomes for participants, provided the scheme continues to be implemented in accordance with the relevant product ruling. However, the participants will not be able to rely on the ruling if any change results in a material difference in the implementation of the scheme.

Scope of draft determination

The draft determination applies to participants in schemes that are either subject to a current product ruling, or were subject to a product ruling that was withdrawn before any material difference occurred.

Date of effect

When finalised, the determination will apply to income years both before and after its date of issue.

Deductions previously claimed

According to Draft Taxation Determination TD 2009/10, the disposal or termination of an interest in a non-forestry MIS that arises as a result of circumstances outside the control of participants does not result in the denial of deductions previously allowed under s 8-1 of ITAA 1997. For example, where a scheme is wound up on the basis that its purpose cannot be accomplished. This is because there are no rules in Subdiv H of Div 3 in Pt III of ITAA 1936 (which relates to the period of deductibility of certain advance expenditure) that operate to deny deductions that have been claimed if a non-forestry scheme is discontinued.

However, the draft determination says that where there is evidence a participant intends, at the time of entering into the scheme, to exit the scheme once deductions for the initial fees are claimed and the resultant tax savings obtained or before income is due to flow to the participant, or where there is evidence a participant intends not to maintain the scheme interest beyond the initial years, then the inference may be drawn that the investor entered the scheme for the sole or dominant purpose of obtaining a tax deduction.

In such a case the total anticipated allowable deductions will far exceed the total assessable income reasonably expected to be derived until the time of termination. Accordingly, the rule in *Fletcher v FCT* (1991) 173 CLR 1, 22 ATR 613 may have application. Alternatively, the general anti-avoidance rule in Pt IVA of ITAA 1936 may apply.

Date of effect

When finalised, the determination will apply to income years both before and after its date of issue.

Proceeds from disposal of interest in MIS

In Draft Taxation Determination TD 2009/D11, the Tax Office says that payments received by participants in a non-forestry MIS upon the winding-up of the scheme, which do not involve the disposal of the participants' interests to another persons, may constitute assessable ordinary income or statutory income depending on the nature of the payments. The draft determination says that while a participant's interest may be the subject of a CGT event, this does not necessarily mean that any money received will be capital proceeds from the ending of the interest. Rather, it is more likely to be a distribution of the remaining scheme property to investors as a result of the participant's business endeavours, even though these have been conducted under contractual arrangements with a responsible entity. As such, any payment is also unlikely to be the capital proceeds from the ending of the taxpayer's business.

The following example from the draft determination explains the Commissioner's preliminary views:

> *Nane invested in a horticultural managed investment scheme in 2007, and claimed deductions in her 2007 and 2008 taxation returns. In 2009, the scheme assets (being unsold stock on hand) were sold by a liquidator. Nane's interest in the scheme came to an end. Nane will remain entitled to the relevant deductions previously claimed. She will also be assessed on her share of the proceeds of sale of the assets disposed of.*

Date of effect

When finalised, the determination will apply to income years both before and after its date of issue.

Frequently asked questions

The Tax Office has compiled a list of frequently asked questions about the tax consequences for MIS participants. Questions of interest include:

> ***Question 2***
> *If I continue to make payments under the agreements, will these expenses be tax deductible?*
>
> *Answer*
> *This depends upon two issues.*
>
> *Firstly, if the amounts you incur are in accordance with the arrangement set out in an issued product ruling, then the expenses will be tax deductible. The appointment of an administrator and even the replacing of a Responsible Entity will not in themselves represent material changes to the scheme described in a product ruling.*
>
> *Secondly, if the scheme is wound-up or the implementation of the scheme otherwise changes in a material way, the relevant tax laws will apply (and the product ruling will no longer apply). Therefore, the tax deductibility of future expenses will depend upon the character of those expenses. We will issue guidance on the tax effects if this occurs or you may wish to apply for a private ruling on your individual circumstances to provide you with certainty on the tax effects.*
>
> ***Question 3***
>
> *If I make payments under the agreements and they are refunded, will these expenses still be tax deductible?*
>
> *Answer*
> *Deductions will be still be allowed in the way set out in question 2 but the refunds will be included in assessable income in the year that you receive them.*

Question 4

Will the Commissioner continue to exercise his discretion under the non-commercial loss rules (Division 35 of the Income Tax Assessment Act 1997) to allow losses from my participation in MISs to be offset against my other assessable income in each income year referred to in the relevant product ruling?

Answer
Yes, provided the following conditions are met:

- *the Commissioner has exercised his discretion in the relevant product ruling*
- *the discretion has not expired, and*
- *the arrangement is carried on as described in the product ruling.*

Where the product ruling is subsequently withdrawn because the scheme is wound up, the discretion will cease to apply. Where the withdrawal is part way through an income year the discretion will continue to apply for that income year, but only in respect of deductions incurred and paid prior to the date that the scheme was wound up. Expenses after winding up (for example, interest) will not be subject to the deferral provisions of the non commercial loss rules (Division 35) because your participation ceased to be a business activity at the time the scheme was wound up.

Question 5

My deductions have been or are going to be deferred because the non-commercial loss discretion has expired – see tables of affected MIS below. When can I offset my deductions?

Answer
Generally, deductions must be deferred (under non-commercial loss provisions) until such time as the project produces a net amount of assessable income in an income year. If the projects are terminated, your deductions remain deferred, but can be carried forward indefinitely to be offset at some future time if the activity recommences or you begin to conduct a business of a 'similar kind'.

Question 7

Will ongoing interest expenses on loans used to acquire my interest in the MIS continue to be deductible?

Answer
Generally, yes. Such expenses will continue to be deductible where the financing was included in the arrangement ruled upon in the relevant product ruling and the interest has actually been incurred. This will continue to apply even if the projects have been wound-up.

In cases where the financing was not within the scheme ruled upon in the relevant product ruling, then the deductibility of any interest expenses will need to be determined under the tax laws. Loans to acquire income producing property generally result in interest expenses being deductible. However, where there are uncommercial features to the loan arrangement or the arrangement involves pre-payments of interest, then the tax rules may prevent deductibility or limit the amount of deductions that may be claimed in a single year. If you think that you may fall into either of these cases, you should seek independent advice or

contact us for a private ruling on your individual circumstances to provide you with certainty on the tax effects.

Refer to <www.ato.gov.au/atp/content.asp?doc=/content/00193782.htm> for the remaining questions and answers.

Note: The list was compiled prior to the release of the three draft determinations. Therefore, some of the questions contained in the list have since been formalised by the draft determinations.

No Deductions for Advance to Partnership

The AAT has affirmed that an advance of money to a partnership was a capital contribution and, therefore, deductions claimed by the taxpayers for interest and loan service costs were not deductible: *Re Jones and FCT* [2009] AATA 744.

The taxpayers are husband and wife, but they are also business partners. In February 1994, the wife advanced $40,000 to the partnership from her own account. The taxpayers claimed the advance was a loan and they each claimed deductions in respect of interest and other loan servicing costs in the 1996, 1997 and 1998 years of income. However, the Commissioner said the taxpayers were not entitled to the deductions. Alternatively, the Commissioner said there was no evidence the interest was payable and the loan service fees were not a loss or outgoing incurred by the taxpayer under s 8-1 of ITAA 1997.

The Tribunal accepted the advance was a business transaction. Nevertheless, it was satisfied the advance was a contribution to the capital of the partnership. It said there was no agreement as to the rate of return, or the term of the advance. In addition, the Tribunal noted the taxpayers' accountant did not record the advance as a loan in the books of the partnership but rather as being of a capital nature. While the Tribunal acknowledged the taxpayers used the word 'loan', it said that word was not decisive given that they also described the advance as an 'investment'. In conclusion, the Tribunal held that the taxpayers were not entitled to the deductions claimed.

Discussion

The Tribunal's decision highlights the importance of formally documenting a loan between a borrower and a lender, especially where the parties are related. In addition, it is important to ensure the parties are dealing at arm's length basis. Whether a loan satisfies the 'arm's length' test will ultimately be determined by reference to the facts of each particular case and the outcome that might have been expected to arise between independent parties in comparable circumstances. When drafting the terms of a loan agreement, consideration should be given to the following issues:

- the period of the loan;
- the rate of interest;
- the repayment frequency; and
- whether the loan will be secured or unsecured.

Where the loan will be secured over an asset (eg by a mortgage over real property), consideration should also be given to whether a charge over the asset is required.

Trading Stock and Trade Incentives

In Taxation Ruling TR 2009/5, the Tax Office clarifies the tax treatment for buyers and sellers of trading stock where a seller provides a trade incentive to a buyer. Broadly, the ruling deals with:

- the application of Div 70 of ITAA 1997 to trade incentives;
- the timing of when assessable income is derived under s 6-5 of ITAA 1997; and
- the timing of when deductible outgoings or losses are incurred for the purposes of s 8-1 of ITAA 1997.

Application of ruling

The ruling applies to a buyer who purchases trading stock from a seller where the seller pays the buyer:

- trade incentives in the form of discounts, rebates or other incentives in connection with the buyer's purchase of trading stock; or
- trade incentives or other payments not directly connected with the buyer's purchase of trading stock:
  - — in consideration for the buyer providing a service in relation to the trading stock; or
  - — to secure a real commercial benefit for the seller in relation to its brand or the future sale of its goods.

The term 'payment' of a trade incentive includes a credit allowed by a seller against a current or future liability of a buyer, or any application of an incentive amount by the seller at the direction of, or for the benefit of, the buyer.

Tax consequences for buyers

According to the ruling, a buyer will reduce its cost of acquisition for trading stock for the purposes of s 8-1 and Div 70 if a trade incentive relates directly to the purchase of the stock. However, if the incentive is subject to a condition that has not been satisfied at the time of the purchase, the incentive does not relate directly to the purchase and, therefore, does not reduce the cost of acquisition.

If a seller provides a trade incentive that subsidises, compensates, reimburses or rewards a buyer for carrying out an activity (eg promotional services), the incentive does not relate directly to the purchase of the trading stock and, therefore, does not reduce the cost of acquisition for the buyer. Similarly, if the incentive is provided to secure a real commercial benefit for the seller in relation to its brand or future sales of its goods, the buyer does not reduce the cost of acquisition. In these situations, the trade incentive is ordinary income of the buyer. The timing of when the income is derived depends on whether the buyer reports its income on an accrual or a cash basis. If the buyer returns income using an accrual basis, the income will be derived in the income year in which it is earned. Conversely, if the buyer returns income using a cash basis, the income will be derived in the income year in which it is received.

Where a trade incentive is provided in respect of future acts and/or services to be performed by a buyer, and the buyer is required to repay the incentive if the acts and/or services are not performed, the incentive will be derived by the buyer for the purposes of s 6-5 at the time the acts and/or services are performed.

Tax consequences for sellers

The ruling states that where a trade incentive relates directly to the sale of trading stock, so as to reduce the sale price, it is treated as a reduction of the sale proceeds for the seller for the purposes of s 6-5 and Div 70. If the incentive is subject to a condition that has not been satisfied at the time of the sale, it does not relate directly to the sale of trading stock and, therefore, does not reduce the sale proceeds for the seller. However, where there is certainty at the time of the sale that the condition will be satisfied (eg a settlement discount) the seller's assessable income from the sale will be reduced.

If a seller provides a trade incentive that subsidises, compensates, reimburses or rewards a buyer for carrying out certain activities (eg promotional services) or securing a real commercial benefit for its brand or future sales of its goods, the incentive does not relate directly to the sale of trading stock and, therefore, does not reduce the selling price and the proceeds of disposal for the seller.

Where a trade incentive does not reduce the selling price of trading stock for a seller, the seller deducts the amount of the trade incentive as a business expense in the income year in which it is incurred.

Whether trade incentives directly relate to trading stock

The ruling says that factors relevant to whether a trade incentive reduces the cost of acquiring trading stock for a buyer and the proceeds of disposal for a seller include:

- the terms of trading between the parties and other sales and transaction documents (eg invoices, incentive claim forms and credit notes);
- the intention of the parties which is based on an objective assessment; and
- the consideration of any other relevant circumstances surrounding the payment of the incentive.

The ruling also says where, in substance, a trade incentive is paid for more than one purpose, each purpose is considered in determining the extent to which the payment reduces the cost of acquiring trading stock for a buyer and the proceeds on disposal of the stock for the seller. If an apportionment cannot be accurately measured, the buyer should return the full amount of the trade incentive as income and the seller should return the full amount of the incentive as a business expense.

Standard trade incentives

The ruling explains the Commissioner's view in relation to three standard trade incentives. These incentives are:

- upfront volume rebate not subject to aggregate volume threshold;
- promotional incentives; and
- bundled incentives.

Upfront volume rebate not subject to aggregate volume threshold

The Commissioner says if a buyer purchases trading stock that is subject to a volume rebate, at the time of purchase, based on the quantity purchased, the purchase/sale price of the trading stock is the net amount. In the Commissioner's view, the rebate is not a condition that has been satisfied at the time of the purchase/sale. Rather, the Commissioner says the rebate:

- relates directly to the purchase/sale and the price of the trading stock;
- is a benefit provided to the buyer at the time of purchasing for entering into a contract to purchase a particular quantity; and
- is, essentially, a reduction in the contract price.

Promotional incentives

The ruling states that the fact a buyer must undertake promotions as part of its ordinary retail operations in order to remain competitive does not affect the nature of promotional incentive payments. The ruling also states that if the buyer claims an incentive payment from a seller in association with the buyer's promotional activities, it is reasonable to conclude that the buyer is being rewarded by the seller for services performed in relation to the seller's goods from which the seller is benefiting.

The ruling says the seller's purpose in paying an incentive is to increase its sales and revenue. Therefore, the incentive lacks the necessary connection to a sale (of trading stock) to be categorised as an adjustment to the sale price. Accordingly, the incentive does not reduce the proceeds from the sale for the seller or the outgoing incurred by a buyer in acquiring the trading stock.

Where a promotional incentive is calculated as a percentage of the selling price of goods, the ruling says a more careful consideration of the real purpose for the payment is required. However, this does not prevent the characterisation of the incentive as a promotion payment, that is, as a

payment for services that does not reduce the purchase/sale price of the goods. Broadly, the Commissioner says that where:

- the trade incentive is paid to promote sales of the seller's products;
- the buyer and the seller have a mutual understanding that increased sales will not occur unless the buyer carries out a certain level of promotional activity or a certain promotional program; and
- the buyer carries out that level of promotional activity or that promotional program,

it is reasonable to conclude the seller pays the incentive as consideration for the buyer promoting the seller's products with a view to increasing sales.

Bundled incentives

According to the ruling, a bundled incentive can be described as a consolidated or combined incentive that relates to a number of types of incentive. If the component parts of a bundled incentive are not valued, a buyer and seller must determine on an objective basis the proportions of the bundled incentive that relate to each type of incentive. In determining the proportions, they need to have regard to the reasons for the payment of the bundled incentive including any services performed by the buyer for the seller and the benefits obtained by the seller in consideration for making the payment. Where the component cannot be accurately measured, the buyer should return the full amount of the bundled incentive as income and the seller should return the full amount of the bundled incentive as a business expense. In addition, where no component of a bundled trade incentive can be quantified and attributed to 'acquiring an item of trading stock', the bundled incentive will be income of the buyer and a business expense of the seller.

Examples

The ruling contains 12 examples covering the following:

- volume rebate not subject to aggregate volume threshold;
- volume rebate subject to aggregate volume threshold;
- ullage allowance;
- prompt payment discount where buyer always pays within discount period;
- prompt payment discount always allowed;
- promotional rebate calculated as a percentage of the sale price of goods purchased;
- promotional rebate derived upfront;
- promotional rebate derived when services performed;
- apportioned bundled rebate;
- unapportioned bundled rebate;
- advertising allowance; and
- transport rebate.

Date of effect

The ruling applies to income years commencing both before and after its date of issue (ie 9 September 2009).

SMSF Non-compliance Notice Upheld

The AAT has affirmed the Commissioner's decision to issue a non-compliance notice to a self-managed superannuation fund (SMSF) because the fund did not satisfy the definition of a 'complying superannuation fund' under s 42A(1) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act): *Re CBNP Superannuation Fund and FCT* [2009] AATA 709.

The fund was a single member SMSF with a corporate trustee. The member was the sole director of the company. However, to satisfy the requirements of the *Corporations Act 2001*, the member's brother was also appointed a director of the company in January 2006. Since 1 July 2000, the member ceased to be an Australian resident for tax purposes and all decisions in relation to the management and control of the SMSF were made overseas.

For the income year ended 30 June 2004, the auditor of the SMSF advised the Commissioner that the fund had breached the in-house asset rules. Following an audit of the fund, the Commissioner advised the trustee that he proposed to issue the notice for the year ended 30 June 2004 under s 40(1) of the SIS Act because the SMSF was not then an Australian resident superannuation fund. Subsequently, the Commissioner determined the SMSF did not meet the requirements of s 42A(1) and issued the notice. The Commissioner also issued an amended assessment to the SMSF which increased its taxable income for the year ended 30 June 2004.

The Tribunal was not satisfied the SMSF was a 'resident superannuation fund' for the year ended 30 June 2004 pursuant to former s 6E of ITAA 1936. It found that the central management and control (CM&C) test contained in the section was not fulfilled because the member was outside Australia for more than two years. Therefore, in the Tribunal's view, the SMSF was not a resident regulated superannuation fund at all times for the income year ended 30 June 2004. Accordingly, the Tribunal held that the SMSF was not a complying superannuation fund for that income year.

Legislative framework

As a prerequisite, a fund must be an Australian superannuation fund in order to be considered a resident regulated superannuation fund and, hence, a complying superannuation fund. The term 'resident regulated superannuation fund' is defined in s 10 of the SIS Act as a regulated superannuation fund that is an Australian superannuation fund within the meaning of ITAA 1997. Since 1 July 2007, the definition of 'Australian superannuation fund' in s 295-95 of ITAA 1997 replaced the definition of 'resident superannuation fund' in former s 6E of ITAA 1936. Under the current definition contained in s 295-95, an SMSF will be an Australian superannuation fund if:

1. the fund is established in Australia, or any asset of the fund is situated in Australia;
2. the CM&C of the fund is ordinarily in Australia; and
3. either the fund has no active member or at least 50% of the total market value of the fund's assets attributable to superannuation interests held by active members (the sum of the amounts that would be payable to or in respect of active members if they voluntarily ceased to be members) is attributable to superannuation interests held by active members who are Australian residents.

An SMSF must satisfy all of the above requirements before it can be considered to be an Australian superannuation fund.

The Commissioner's interpretation of the definition of an 'Australian superannuation fund' is explained in Taxation Ruling TR 2008/9. In particular, the Commissioner explains the three requirements prescribed by s 295-95.

The first requirement: Location of fund or assets

In the Commissioner's view, a fund that was established in Australia will satisfy the first requirement at all relevant times, even where the fund has no assets situated in Australia. Where a fund was not established in Australia, it will still satisfy this requirement if at least one asset of the fund is situated in Australia. However, if the fund ceases to have an asset in Australia, it will no longer satisfy this requirement. The ruling states that the location of an asset is determined by reference to the type of asset and the common law rules. For example, the location of land is, generally, determined with reference to the place where the land is situated.

The second requirement: Central management and control

Under this requirement, the CM&C of an SMSF fund must ordinarily be in Australia. The determination of who is exercising the CM&C of the SMSF is a question of fact. In the Commissioner's view, the CM&C of the fund involves a focus on the 'who, when and where of the

strategic and high level decision making processes and activities of the fund'. These activities and processes include:

- formulating the investment strategy for the fund;
- reviewing and updating the fund's investment strategy;
- monitoring and reviewing the performance of the fund's investments;
- determining how the assets of the fund are to be used to fund members' benefits; and
- if the fund has reserves, formulating a strategy for the prudential management of the reserves.

The ruling states that formalistic or administrative activities or processes do not constitute CM&C. Examples of these activities or processes include the payment and portability of benefits, and the actual investment of a fund's assets.

Whether the CM&C of a fund is 'ordinarily' in Australia is determined with reference to the relevant facts and circumstances of each case. This involves establishing whether, in the ordinary course of events, the CM&C of the fund is regularly, usually or customarily exercised in Australia. There must be some element of continuity or permanence if the CM&C of the fund is to be regarded as being 'ordinarily' in Australia.

The determination of whether a period of absence is 'temporary' requires an objective assessment of all the relevant facts and circumstances on a 'real time' basis. Importantly, the ruling states this assessment cannot be established retrospectively. The following example from the ruling explains the Commissioner's views:

> *Joseph and his wife Marian are the trustees and members of their SMSF 'The J&M Superannuation Fund'. The J&M Superannuation Fund was established in Australia in August 2006. Joseph and Marian exercise the CM&C of the fund at meetings of the trustees at their home in Sydney.*
>
> *Joseph, who is a chartered accountant, was seconded to his employer's London office on 1 July 2008 for a period of two years. It was always the intention of both Joseph and his employer that the duration of his secondment would actually be two years and that Joseph would return to working in Australia at the expiration of that period. However, due to unforseen business pressures, Joseph was required to remain in London for an extra 12 months.*
>
> *His wife accompanied Joseph for the duration of his secondment. They rented out the family home in Australia via their real estate agent and lived in a furnished house in London which was provided by Joseph's employer. Both Joseph and Marian continued to maintain bank accounts and private health insurance cover in Australia during the period of Joseph's secondment. They travelled back to Australia for a holiday during the Christmas 2009 period.*
>
> *During the period of Joseph's secondment, the CM&C of the J&M Superannuation Fund was exercised at trustee meetings at the house in London.*
>
> *In these circumstances, it is considered that the CM&C of the fund remains ordinarily in Australia during the period of Joseph's secondment as the trustees' absence from Australia was temporary. The factors that support this conclusion include the facts that:*
>
> - *Joseph and Marian intended to return to Australia at the expiration of Joseph's 2 year period of secondment and never abandoned that intention,*
> - *the entire period of the absence, including the additional 12 months, was related to the fulfilment of a specific purpose,*
> - *they did not establish a home outside Australia and*

- *they continued to maintain their home and other assets in Australia which indicates a durability of association with Australia.*

Accordingly, the CM&C of the J&M Superannuation Fund remained ordinarily in Australia within the meaning of s 295-95(2)(b) of ITAA 1997 during the period that the trustees were in London.

Section 295-95(4) provides a 'safe harbour rule' where the CM&C of a fund is temporarily outside of Australia. That is, the fund's CM&C will be considered to be ordinarily in Australia provided the absence is not more than two years. In the Ruling, the Commissioner says that the CM&C of the fund can still be outside Australia for a period of more than two years and still satisfy the CM&C test provided that the fund satisfies the 'ordinarily' requirement in s 295-95(2)(b) and the absence is 'temporary'.

The third requirement: Active members

This requirement prescribes that either the fund has no active member or the accumulated entitlements of resident active members at the relevant time must amount to at least 50% of the total entitlements of all active members.

A member of an SMSF is an 'active member' if the member is:

- a contributor to the fund at a particular time; or
- an individual on whose behalf contributions have been made.

However, the member is not an active member if:

- the member is a foreign resident;
- the member is not a contributor at that time; or
- the only contribution made to the fund on the member's behalf after the member became a foreign resident was made in respect of a time when the member was an Australian resident.

In the Commissioner's view, the concept of a 'contributor' applies to attribute to a member a status as a contributor. This is determined with regards to the relevant circumstances, in particular, the member's intention established by objective evidence.

Commissioner's discretion

The Commissioner has the discretion under s 42A(5) of the SIS Act to treat an SMSF as a complying superannuation fund, even if the trustees of the fund have contravened one or more provisions of the SIS Act. However, in the *CBNP* case discussed on page 12, the Tribunal said the Commissioner's discretion only applied where the SMSF was a resident regulated superannuation fund.

➢ The Tax Office has highlighted that one of its focus areas for its 2009/10 Compliance Program is ensuring SMSFs satisfy the definition of an 'Australian superannuation fund'. In particular, it says trustees of SMSFs who travel and work overseas for extended periods of time need to ensure their SMSFs meet the definition.

Proposed Tax Law Amendments

On 16 September 2009, the Government introduced Tax Laws Amendment (2009 Measures No 5) Bill 2009 in the House of Representatives. The Bill seeks to:

- amend the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) to ensure that a representative of an incapacitated entity is responsible for the GST consequences that arise during his or her appointment;
- address a number of PAYG issues arising from the *Tax Law Amendments (Taxation of Financial Arrangement) Act 2009*;
- ensure the outer regional and remote payments made under the Helping Children with Autism package are not subject to income tax;

- ensure the payments made under the Continence Aids Payment Scheme are not subject to income tax;
- exempt a debt issued in Australia by the Commonwealth or Commonwealth authorities from interest withholding tax; and
- provide the Victorian Bushfire Appeal Fund Independent Advisory Panel with greater scope to support communities and individuals affected by the 2009 Victorian bushfires.

A discussion of the proposed amendments follows.

GST and incapacitated entities

Broadly, the Bill seeks to ensure that any supply, acquisition or importation by a representative of an incapacitated entity in their representative capacity will be treated as that of the entity. The Bill also seeks to ensure the GST consequences arising from an action performed by the representative are the same as those that would have arisen had the action been performed by the incapacitated entity. This will be achieved by inserting new Div 58 into the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) and repealing current Div 147 of the GST Act.

Main amendments

The Bill proposes that a supply, acquisition or importation by a representative of an incapacitated entity is taken, for GST purposes, to be a supply, acquisition or importation by the entity. In addition, it is proposed any act or omission of the representative be taken as an act or omission of the entity for the purposes of applying any provisions in the GST law in determining:

- whether a supply or importation is a taxable supply or taxable importation (or the amount of GST payable on the supply or importation);
- whether an acquisition or importation is a creditable acquisition or creditable importation (or the amount of input tax credit (ITC) for the acquisition or importation); or
- whether an adjustment arises in relation to a supply, acquisition or importation (or the amount of the adjustment).

The Bill also seeks to ensure a representative of an incapacitated entity will be:

- liable for any GST the entity would have been liable to pay on a taxable supply or taxable importation;
- entitled to any ITC the entity would be entitled to for a creditable acquisition or creditable importation; and
- required to perform any adjustments the entity would have been required to make.

The above only applies to the extent the making of the supply, importation or acquisition is made within the scope of the representative’s responsibility or authority for managing the entity’s affairs: proposed s 58-10.

However, under proposed s 58-15, a representative is not liable for GST (or entitled to any ITCs) where:

- the incapacitated entity received consideration for a taxable supply (or creditable acquisition) that was received (or produced) before the appointment of the representative;
- the GST is payable by the recipient of a supply under Divs 83 or 84 of the GST Act that the entity provided before the representative’s appointment; or
- the supply is a voucher (under Div 100 of the GST Act) provided before the representative’s appointment, to the extent the consideration provided for the representative’s supply does not exceed the consideration provided for the entity’s supply of the voucher.

Other main amendments include:

- *Adjustments for bad debts* – the Bill proposes that bad debt adjustments cannot arise under Div 21 of the GST Act where GST has not been paid (or an ITC has not been claimed) during the period of a representative’s appointment: proposed s 58-15.

- *Attribution rules* – under proposed s 58-40, if a representative accounts for GST using the accruals basis, and he or she is liable for GST (or entitled to ITCs) under proposed s 58-10, and the liability (or entitlement) would be attributable to a tax period that ended prior to his or her appointment, the GST (or ITCs) is instead attributable to the first tax period applying to the representative in that capacity.

Date of effect

It is proposed the main amendments commence from 1 July 2000.

Consequential amendments

The following amendments are proposed to commence from the date of Royal Assent.

Tax periods – The Bill proposes if an entity becomes incapacitated, the entity's tax period (the first tax period) is taken to have ceased at the end of the day before it became incapacitated. The entity's next tax period starts on the following day and ends when the first tax period would have ended.

The Bill also proposes that if a representative of an incapacitated entity is required to be registered, the tax periods applying to the representative are the same tax periods that applied to the entity. The amendments will ensure all incapacitated entities will be required under s 33-5 of the GST Act to pay any net GST liability for their concluding tax period on or before the 21st day of the month following the end of that period.

GST groups and tax periods – The Bill provides that if a member of a GST group becomes incapacitated, the representative member of the group may elect to have the tax period that applies to the group members cease at the same time as the incapacitated entity. If the representative member elects to do so, it must lodge a GST return and pay any net GST liability on or before the 21st day of the month following the end of the tax period.

Indemnity – The Bill seeks to indemnify a representative of an incapacitated entity for any payment they make to meet their GST obligations. It also seeks to provide the representative protection against civil or criminal proceedings in relation to an act done (or omitted to be done) in good faith in the performance (or purported performance) of their duties under the GST law.

Registration – The Bill seeks to ensure a representative of an incapacitated entity is required to be registered as the representative of the incapacitated entity if the entity is registered (or required to be registered). It is proposed the representative must notify the Commissioner within 21 days of the end of their appointment. In addition, the Commissioner will be required to cancel the representative's registration if the Commissioner is satisfied the representative is not required to be registered in that capacity.

GST returns and notifications – The Bill allows a representative who is appointed to two or more incapacitated entities that are members of a GST group to give the Commissioner one combined return for the entities in a tax period.

The Bill proposes that a representative of an incapacitated entity must furnish a GST return for a tax period if the entity has failed to give such a return and the Commissioner directs, in writing, the representative to provide one. The Commissioner may give a direction in relation to any tax period both before and after the representative's appointment. It would not, however, include a tax period that occurs after the appointment has ended. In deciding whether to give a direction, the Commissioner must take into account the following four factors:

(i) the prospect for, and likely size of, a dividend being paid to unsecured creditors;

(ii) the likelihood the return would, if lodged, reveal a liability to pay an amount to the Commissioner;

(iii) the availability of books and records which would make it possible to prepare the return; and

(iv) the likelihood the representative's cost of preparing the return would be covered by the assets of the incapacitated entity without resulting in an unreasonable impact on other creditors.

The direction by the Commissioner will be a reviewable decision.

The Bill also proposes that a representative must notify the Commissioner of certain liabilities of the incapacitated entity if the representative could reasonably be expected to become aware of amounts for which a GST return has not been given to the Commissioner. The representative is required to notify the Commissioner of such amounts prior to declaring a dividend to unsecured creditors. If the representative does not comply with this requirement, a penalty may arise under s 286-75 of Sch 1 to the *Taxation Administration Act 1953* (TAA).

Transitional provisions

The following transitional provisions will commence from Royal Assent of the Bill.

Protection for representatives from liabilities arising from retrospective application – Representatives of incapacitated entities will be provided protection from liabilities in limited circumstances up until 6 February 2009, which is the date of announcement by the Government to amend the GST law. The protection will be available in circumstances where GST obligations arising during the period of a representative's appointment have been reported and paid in full by the incapacitated entity (and not the representative). The protection will also be available in circumstances where, due to insufficient funds, the relevant GST obligations arising during the period of a representative's appointment have only been paid in part by the incapacitated entity or not at all. In such cases, the protection will be limited to cases where the representative no longer had access to company assets or an indemnity by which the outstanding liability may be satisfied at the time of the announcement of the proposed retrospective amendments on 6 February 2009.

Time limit on recovery by the Commissioner – The Bill proposes to extend the four year time limit within which the Commissioner can recover an unpaid amount of indirect tax pursuant to s 105-50 of the TAA. In particular, the four year period within which the Commissioner may recover unpaid tax will be extended to four years from the date on which the refund was claimed. This is designed to ensure the Commissioner has the ability to recover the liabilities imposed by the retrospective amendments in circumstances where refunds may have been paid since the Federal Court's decision on 12 December 2008 in *DCT v PM Developments Pty Ltd* (2008) 173 FCR 247; 70 ATR 741.

*Refunds of amounts wrongly paid by incapacitated entitie*s – the Bill seeks to ensure that if an amount is payable by a representative of an incapacitated entity to the Commissioner, but was paid by the entity after the appointment of the representative, the entity is not entitled to a refund of the amount unless the representative has paid the amount to the Commissioner.

PAYG instalments and TOFA

The Bill seeks to reverse the changes the *Tax Law Amendments (Taxation of Financial Arrangement) Act 2009* (TOFA Act) made to the PAYG instalment system, thus preventing a potential decrease in the amount of PAYG instalments paid by an entity. The Bill also seems to ensure that where the entity has become liable to pay a decreased amount of PAYG instalments prior to the commencement of this Bill, there will be a catch-up payment of the decreased amount in the quarter that ends after the commencement of this Bill.

The changes made by the TOFA Act in relation to the PAYG instalments provisions gave rise to two issues. Firstly, where an entity has a Div 230 financial arrangement, the entity calculates its PAYG instalment amount on a net basis. This could have the effect of reducing the entity's instalment basis. Secondly, the TOFA Act unintentionally repealed the former version of s 45-120(2B) of the TAA. The former version operated to ensure that only the net amount of the gains (or losses) on financial arrangements subject to Subdiv 250-E of ITAA 1997 (which sets out the tax treatment of a financial arrangement that is deemed as a loan) that are attributable to an instalment period, are included in the instalment income for that period.

In order to address the two issues, the Bill proposes to:

- repeal the current version of s 45-120(2B);
- reinstate the former version of s 45-120(2B); and
- provide for a 'catch-up' payment where a PAYG instalment is underpaid by an entity as a result of current s 45-120(2B) applying to an entity.

'Catch-up' payment

In addition, the amendments will ensure that where an entity has become liable to pay a decreased amount of PAYG instalments prior to the commencement of this Bill, there will be a catch-up payment of the decreased amount in the quarter that ends after the commencement of this Bill. This catch-up payment will only be of relevance to a taxpayer if:

- the taxpayer has elected to apply the TOFA Act early (ie from 1 July 2009)
- the proposed amendments commence after 30 September 2009;
- the taxpayer is a quarterly PAYG instalment payer; and
- the taxpayer's first instalment quarter for the income year starting on or after 1 July 2009 must end before the commencement of the proposed amendments.

Date of effect

The measures will, generally, commence on Royal Assent to the Bill.

Helping Children with Autism payments

The Bill seeks to ensure that outer regional and remote payments made under the Helping Children with Autism package are not subject to income tax. The payment is provided to families living in outer regional and remote areas when a child is diagnosed with autism spectrum disorder.

Date of effect

It is proposed the amendment applies to amounts received in the 2008/09 and later income years.

Continence Aids Payment Scheme

The Bill seeks to exempt payments made under the Continence Aids Payment Scheme from income tax.

Date of effect

It is proposed the amendment applies to amounts received in the 2009/10 and later income years.

Interest withholding tax and Commonwealth issued debt

The Bill proposes to amend s 128F of ITAA 1936 to allow debentures and debt interests issued in Australia by the Commonwealth or an authority of the Commonwealth to be eligible for an exemption from interest withholding tax in accordance with the public offer rules. In particular, the proposed amendments will repeal ss 128F(5A) and (5B). The requirements of the public offer test contained in s 128F(3) will continue to apply. Accordingly, the exemption will only apply for interest payments on current debt issues where the debt issue would have satisfied the public offer test when made. The Bill also seeks to make a technical change to s 128F(7) to clarify that any debt issued by the Commonwealth in its own right will also be eligible for the exemption.

Date of effect

The amendments will commence the day after Royal Assent.

Victorian Bushfire Appeal Fund Panel

The Bill seeks to provide the Victorian Bushfire Appeal Fund Independent Advisory Panel with greater scope to support communities and individuals affected by the 2009 Victorian bushfires. The amendments will permit funds in the appeal fund to be used for a broader range of purposes than the law considers charitable, without jeopardising the charitable status of the Australian Red Cross Society, which is the charity that collected the donations.

Under the amendments proposed, the charitable status of the Red Cross will be protected so long as the appeal fund undertakes activities for one of the following purposes:

- Australian disaster relief fund purposes;

- providing broad public benefits that are:
  - consistent with the purposes of one or more exempt entities;
  - widely and publicly accessible; and
  - commercial or private only to an incidental and ancillary extent, if at all;
- reimbursing payments made by individuals or organisations for eligible charitable or public benefit activities;
- providing long-term assistance to orphans who are less than 18 years old;
- providing assistance to individuals whose main residence was destroyed in the bushfires (ignoring the actual legal ownership of the residence), even if the residence was held in a trust, company or other legal structure;
- providing assistance of up to $15,000 to individuals who, because of the bushfires, have lived or are living in transitional housing; or
- providing up to $10,000 assistance to individuals who carry on primary production businesses.

Date of effect

It is proposed the amendments apply to payments made by the Red Cross to the appeal fund after 28 January 2009 and before 6 February 2014.

Contributions Caps and Reserves

The Commissioner has provided his preliminary views on the use of contributions reserves within a self-managed superannuation fund (SMSF) and the excess contributions tax implications under s 292-90 of ITAA 1997: see NTLG Superannuation Technical Sub-group meeting minutes for June 2009.

The Tax Office states that where a non-concessional contribution is credited to a fund's contribution reserve before being credited to the member's account in the following financial year (but within 28 days of the end of the month that the contribution was received by the trustee), the contribution will count towards the member's cap for the financial year that it is allocated to the member's account. That is, the contribution will not count towards the member's cap for the financial year that the contribution was made (but the following year when it is allocated). In this respect, the Commissioner accepts that the non-concessional contribution does not need to be paid into a 'reserve' but may be paid into an account, such as a 'suspense account' set up for recording contributions prior to allocation to fund members.

The Tax Office also notes that 'double counting' of non-concessional contributions may arise due to the general provision and specific provision contained in s 292-90. However, the Tax Office says that it will interpret the specific provision as applying rather than the general provision.

In the meeting, the Tax Office warns that it is aware the use of contribution reserves leaves some scope for the manipulation of the excess contributions caps. The Tax Office also noted that it has previously raised concerns with Treasury as to the operation of this provision.

➢ Trustees and members should be aware a degree of legislative risk remains with contribution reserving strategies.

Contribution reserves strategy

The use of a contribution reserve is a strategy where a trustee of a superannuation fund allocates contributions it receives on behalf of a member to the reserve instead of the member's account and, thereby, delays the timing of the contribution. This strategy may provide temporary relief where the member may breach their limit near the end of an income year.

Trustees must ensure the deed of an SMSF permits the use of reserves. If the deed does not permit the use of reserves, the trustees must also ensure the governing rules provide a power of

amendment before any changes to the deed is made. Care should be exercised when amending the fund's deed to avoid triggering any adverse tax consequences.

The *Superannuation Industry (Supervision) Act 1993* (SIS Act) does not prohibit a superannuation fund from having reserves. However, s 52(2) of the SIS Act requires the trustee of the fund 'to formulate and to give effect to a strategy for prudential management [of the reserves], consistent with the entity's investment strategy and its capacity to discharge its liabilities (whether actual or contingent) as and when they fall due'.

Allocation of contributions

Regulation 7.08(2) of the Superannuation Industry (Supervision) Regulations 1994 (SIS Regs) stipulates that a trustee must allocate a contribution to a member's account within 28 days after the end of the month that the contribution is received. Where it is not reasonably practicable to allocate the contribution to the member within that period, the trustee can allocate the contribution within a longer period as is reasonable in the circumstances. However, neither the SIS Regs nor the Commissioner (in his role as Regulator of SMSFs) provides an explanation of the word 'reasonable'.

It is also equally important to understand the interaction between the SIS Act and the income tax legislation. That is, while the SIS Act contains the provisions governing the allocation of contributions regardless of the nature of the contributions, it is the income tax legislation that specifies when a contribution is allocated for the purposes of determining whether a member has breached the concessional (or non-concessional) contributions limit for an income year.

The provisions governing when concessional and non-concessional contributions are recognised for an income year are contained in Subdivs 292-B and 292-C of ITAA 1997, respectively. Generally, a contribution is counted towards either the concessional or non-concessional contribution limit of a member in the income year in which the contribution was made (the general provisions): see ss 292-25(2) and 292-90(2) of ITAA 1997.

In addition to the general provision, s 292-25(3) (for concessional contributions) and s 292-90(4) (for non-concessional contributions) state that the Income Tax Assessment Regulations 1997 (ITA Regs) may prescribe specific timing rules governing when a contribution is recognised for the purposes of the annual contribution caps (the specific provisions).

The specific provision relating to the allocation of concessional contributions is contained in ITA reg 292-25.01(2). The regulation states that a contribution is counted towards a member's concessional contribution limit for an income year if the contribution is allocated in accordance with Div 7.2 of the SIS Regs and is an assessable contribution under Subdiv 295-C of ITAA 1997 (which sets out the different types of assessable contributions). While ITA reg 292-25.01(4) stipulates specific timing rules in the recognition of amounts allocated from a reserve, this subregulation does not apply to contributions. This is because ITA reg 292-25.01(5) states that ITA reg 292-25.01(4) does not apply to an amount that is required to be allocated under ITA reg 292-25.01(2) or would be assessable income of a fund if it was made as a contribution.

The specific provision relating to the allocation of non-concessional contributions is contained in ITA reg 292-90.01(2). The regulation states that an amount will be counted towards a member's non-concessional contribution limit for an income year if the amount is allocated under Div 7.2 and is not an assessable contribution under Subdiv 295-C.

Mail-out to Superannuation Fund Members

In September 2009, the Tax Office commenced sending letters directly to superannuation funds members who are most at risk of exceeding the concessional contributions cap for the 2009/10 income year. According to the Tax Office, the aim of the letters is to get the members to review the amount of their concessional contributions for that income year. The Tax Office says the letters list some of the common reasons that can cause members to exceed their concessional contributions cap. The mail-out will be spread across a two-month period.

For the 2009/10 income year, the concessional contributions cap is $25,000 or $50,000 for individuals aged between 50 and 74.

GIC and SIC Rates Released

The Tax Office has released the general interest charge (GIC) and shortfall interest charge (SIC) rates for the second quarter of the 2009/10 income year (ie 1 October 2009 to 31 December 2009). The rates are:

Rate	Annual (%)	Daily (%)
GIC	10.30	0.02821918
SIC	6.30	0.01726027

The Tax Office has also released the interest rate for overpayments, early payments and delays in refunds for the second quarter of the 2009/10 income year. The applicable interest rate is 3.30%.

Donations to Typhoon in Taiwan

The Government has announced that Typhoon Morakot, which hit Taiwan on 7 August 2009, has been recognised as a natural disaster for the purposes of allowing Australians to claim a tax deduction for donations made to charities for relief efforts.

Therefore, public funds can be established and maintained by public benevolent organisations solely to provide money for the relief of people in Taiwan who are in distress as a result of the typhoon. Donations to such funds are tax deductible for a period of two years from 7 August 2009.

An organisation must be endorsed by the Tax Office as a deductible gift recipient before a donation is deductible.

Tax Practitioner Update

Bill receiving Royal Assent

The Tax Laws Amendment (2009 Measures No 4) Bill 2009 received Royal Assent on 18 September 2009. The Bill passed all stages without amendment. As a result, the *Tax Laws Amendment (2009 Measures No 4) Act 2009*:

- increases the research and development (R&D) expenditure cap from $1 million to $2 million when determining a taxpayer's eligibility for the R&D tax offset;
- improves tax laws relating to the integrity of prescribed private funds;
- provides CGT relief to members and insured entities of friendly societies that have a life insurance business and/or private health insurance business when a friendly society demutualises to a for-profit entity;
- ensures losses transferred to the head company of a consolidated group by an insolvent joining entity can be used by the head company in certain circumstances; and
- makes minor technical corrections to tax laws, including the small business CGT concessions and the application of the *Fringe Benefits Tax Assessment Act 1986* to donations made through salary sacrifice arrangements.