

client alert | explanatory memorandum

April 2008

Income Tax Reforms

In the February 2008 issue, we highlighted some of the proposed changes to the income tax landscape in Australia, which were part of the Labor Government's election promises. The government has since introduced Tax Laws Amendment (Personal Income Tax Reduction) Bill 2008 into the House of Representatives to give effect to income tax rates cuts for the 2008/09, 2009/10 and 2010/11 income years. A brief discussion of the Bill follows.

Tax rates

The proposed personal tax rates and tax payable from 1 July 2008 for resident taxpayers are as follows:

Taxable income (\$)	Tax payable (\$)
0 – 6,000	Nil
6,001 – 34,000	15% of excess over 6,000
34,001 – 80,000	4,200 + 30% of excess over 34,000
80,001 – 180,000	18,000 + 40% of excess over 80,000
180,001 +	58,000 + 45% of excess over 180,000

A comparison of the proposed personal tax rates and thresholds for resident individuals (excluding Medicare levy) are summarised in the tax rates table below with key changes highlighted in bold:

Proposed personal tax rates and thresholds — Residents

Current		From 1 July 2008		From 1 July 2009		From 1 July 2010	
Taxable income (\$)	Rate (%)	Taxable income (\$)	Rate (%)	Taxable income (\$)	Rate (%)	Taxable income (\$)	Rate (%)
0 – 6,000	0	0 – 6,000	0	0 – 6,000	0	0 – 6,000	0
6,001 – 30,000	15	6,001 – 34,000	15	6,001 – 35,000	15	6,001 – 37,000	15
30,001 – 75,000	30	34,001 – 80,000	30	35,001 – 80,000	30	37,001 – 80,000	30
75,001 – 150,000	40	80,001 – 180,000	40	80,001 – 180,000	38	80,001 – 180,000	37
150,001 +	45	180,001 +	45	180,001 +	45	180,001 +	45

The proposed personal tax rates and thresholds for non-resident individuals are summarised in the tax rates table below with key changes highlighted in bold:

Proposed personal tax rates and thresholds — Non residents

Current		From 1 July 2008		From 1 July 2009		From 1 July 2010	
Taxable income (\$)	Rate (%)	Taxable income (\$)	Rate (%)	Taxable income (\$)	Rate (%)	Taxable income (\$)	Rate (%)
0 – 30,000	29	0 – 34,000	29	0 – 35,000	29	0 – 37,000	29
30,001 – 75,000	30	34,001 – 80,000	30	35,001 – 80,000	30	37,001 – 80,000	30
75,001 – 150,000	40	80,001 – 180,000	40	80,001 – 180,000	38	80,001 – 180,000	37
150,001 +	45	180,001 +	45	180,001 +	45	180,001 +	45

Low income tax offset

The changes to the income tax rates will result in an increase in the low income tax offset (LITO). However, the offset will still phase out at the rate of four cents in the dollar for every dollar of income over \$30,000. The maximum level of income that a taxpayer can earn is:

	Current	From 1 July 2008	From 1 July 2009	From 1 July 2010
Max taxable income	\$45,000	\$60,000	\$63,750	\$67,500
Offset amount	\$750	\$1,200	\$1,350	\$1,500

As a consequence of the increase in the LITO, senior Australians who are eligible for the senior Australian tax offset (SATO) will have no tax liability until their income reaches:

Current		From 1 July 2008		From 1 July 2009		From 1 July 2010	
Single (\$)	Couple (\$)	Single (\$)	Couple (\$)	Single (\$)	Couple (\$)	Single (\$)	Couple (\$)
25,867	21,680	28,867	24,680	29,867	25,680	30,685	26,680

Medicare levy threshold

The Medicare levy threshold amount for senior Australians who are eligible for the SATO will increase in line with the LITO:

	Current	From 1 July 2008	From 1 July 2009	From 1 July 2010
Threshold amount (\$)	\$25,867	\$28,867	\$29,867	\$30,685

The Medicare levy phase-in limit for senior Australians who are eligible for the SATO will also increase:

	Current	From 1 July 2008	From 1 July 2009	From 1 July 2010
Phase-in limit (\$)	\$30,431	\$33,961	\$35,137	\$36,100

The Medicare levy phase-in limit that applies to couples eligible for the SATO will also increase:

	Current	From 1 July 2008	From 1 July 2009	From 1 July 2010
Phase-in limit (\$)	\$44,647	\$49,412	\$51,177	\$52,353

Date of effect

The increases to the 30% threshold will apply to assessments for the 2008/09, 2009/10 and 2010/11 and future income years. The reductions of the 40% marginal tax rate will apply to assessments for the 2009/10 and the 2010/11 and future income years.

Amendments to the LITO and consequential amendments to the Medicare levy for senior Australians will apply to assessments for the 2008/09, the 2009/10 and the 2010/11 and future income years.

Tax Law Changes

The government has introduced Tax Laws Amendment (2008 Measures No. 1) Bill 2008 into the House of Representatives which seeks to amend:

- ITAA 1936 and ITAA 1997 to remove tax deductibility for contributions and gifts to political parties, members and candidates, including membership fees;
- ITAA 1997 and the *Income Tax (Transitional Provisions) Act 1997* so that a superannuation lump sum payment paid to a person who has a terminal medical condition is tax-free;
- Division 40 of ITAA 1997 to provide a deduction for capital expenditure for the establishment of trees in carbon sink forests;
- ITAA 1936 and ITAA 1997 by extending the eligibility for the beneficiary tax offset to individuals receiving the Equine Workers Hardship Wage Supplement Payment;
- ITAA 1997 to provide tax-free grants, under the Tobacco Growers Adjustment Assistance Programme 2006, to tobacco growers who undertake to exit all agricultural enterprises for at least five years; and
- ITAA 1936 to align the tax law with the guidelines for declaring either all primary producers in a geographical area, or specified classes of primary producers within a geographical area, to be in exceptional circumstances.

A brief discussion of some of the proposed amendments follows.

Abolishing tax deductions for political donations

This amendment will remove the tax deductibility for taxpayers, including business taxpayers, of political contributions and gifts to political parties, members and candidates. Membership fees paid to a political party by a taxpayer will also be non-deductible. The amendment will also prevent taxpayers from including the contributions or gifts in the cost base or reduced cost base of any capital gains tax (CGT) asset.

However, where the contribution is related to a taxpayer's employment and subject to the general deduction requirements of section 8-1 of ITAA 1997, the taxpayer will be allowed a deduction.

The examples below, which are from the Bill, illustrate the operation of the proposed amendment:

Example 1

A Member of Parliament pays a compulsory levy to retain their party membership. This would be generally deductible under section 8-1.

Example 2

Bob earns his income by being employed as an engineer and is a member of a political party that he pays \$50 a year to in membership fees. The membership payment is not incurred in earning his assessable income, and is therefore not deductible.

This amendment will apply to contributions and gifts made from 1 July 2008.

Current law

Currently, political donations of \$2 or more to political parties, independent candidates or membership subscriptions paid to registered political parties which satisfies the relevant rules in Subdivision 30–DA of ITAA 1997 are deductible under section 30–242.

Section 30–243 provides that the maximum amount deductible in an income year is \$1,500. The \$1,500 threshold applies separately to political parties (including membership subscriptions) and independent candidates (i.e. a taxpayer may, in the one income year, separately donate up to \$1,500 to political parties and independent candidates respectively).

Tax-free superannuation payment

The amendment, which will be achieved by inserting section 303–10 into Division 303 of ITAA 1997, will ensure that a superannuation payment to a person who has a terminal medical condition is tax free, i.e. non-assessable and non-exempt income where the following conditions are satisfied:

- (a) the payment is a superannuation lump sum;
- (b) the payment is paid from a complying superannuation fund, a superannuation guarantee payment, a small superannuation account payment, an unclaimed money payment, a superannuation co-contribution benefit payment or a superannuation annuity payment; and
- (c) the person is suffering from a terminal medical condition when the payment was received or within 90 days of receiving the payment.

This amendment will apply to payments made on or after 1 July 2007. A transitional provision will apply for the 2007/08 income year. Under the transitional provision, the 90-day period from when a payment is received can be extended to 30 June 2008.

Definition of terminal medical condition

A person is classified as suffering from a terminal medical condition where:

- two registered medical practitioners have certified, jointly or separately, that the person suffers from an illness, or has incurred an injury, that is likely to result in death of the person within a period (the certification period) that ends not more than 12 months after the date of the certification;
- at least one of the registered medical practitioners is a specialist practicing in an area related to the illness or injury suffered by the person; and
- for each of the certificates, the certification period has not ended.

Current law

Currently, the taxation treatment of a superannuation lump sum payment will depend on the age of the member, and whether the payment is from a taxed or an untaxed sourced.

Extension of tax offset

The amendment will extend the beneficiary tax offset to recipients of the Equine Workers Hardship Wage Supplement Payment (the supplement). Without the amendment, the supplement will be taxable in the hands of the recipient. This is because the general principle of income tax law provides that any payment received for lost salary, wages or other assessable income, is taxable.

This amendment will apply to supplement payments made during the 2007/08 income year and later income years.

Farm management deposits

The amendment will ensure that eligible primary producers will retain the tax advantage in the year the farm management deposits (FMD) is made, despite withdrawing all or part of their FMD within 12 months of depositing if the following conditions are satisfied:

- (a) the withdrawal is made in the income year following the income year in which the deposit occurs;
- (b) at the time of withdrawal, the taxpayer is eligible to be issued with an exceptional circumstances certificate in relation to their primary production business;
- (c) the taxpayer obtains an exceptional circumstances certificate no later than three months after the year of income of the withdrawal; and
- (d) the taxpayer made the deposit before the exceptional circumstances declaration relating to the primary production business was in force.

The amendment will apply retrospectively from 1 July 2002.

Current law

Currently, a FMD may be partially withdrawn within 12 months of deposit without losing the tax advantages if a taxpayer's primary production business is carried on in an exceptional circumstances area. However, an inconsistency exists in that this concession does not currently apply to primary producers covered by an area previously declared in exceptional circumstances, even though the exceptional circumstances declaration did not apply to them.

The proposed amendment seeks to remedy this inconsistency.

First Home Savers Accounts

The government has formally approved the establishment of First Home Savers (FHS) accounts to assist first home buyers and help fight inflation within the Australian economy. Further, a consultation schedule has also been approved to assist with the detailed design features of the FHS accounts.

The accounts will be offered through banks, building societies, credit unions and life insurers. It is anticipated that eligible first home buyers will benefit from the scheme, regardless of their marginal tax rate.

Individuals aged between 18 and 65 will be able to open an account, so long as they comply with the eligibility criteria for the First Home Owners Grant.

Couples may only open individual accounts under the scheme. Where both partners hold accounts, at least one partner will need to leave his or her savings in the account for a minimum of four years.

The minimum savings period will be four years.

Individual contributions of up to \$10,000 (indexed) may be made into an account each year. Savers will be eligible for a 15% tax rate on the first \$5,000 of income they deposit in their account each year — rather than their respective marginal tax applying. An additional \$5,000 a year may be contributed from after-tax income without paying any further tax on that contribution.

Investment earnings (or interest) will be taxed at a rate of 15%.

Withdrawals from the accounts will only be permitted for the purchase of an eligible first home and will be tax-free. Alternatively, individuals can roll-over the full amount to their superannuation fund at any time.

The First Home Owners Grant will remain unchanged, and using a First Home Saver Account will not preclude an individual from accessing the First Home Owners Grant.

The value of the account will not be included in the asset test for social security payments.

Co-contributions from the Government

Savers will receive a co-contribution from the government on after-tax contributions of up to \$5,000. The co-contribution level will be either 15% of the saver's contribution or the individual's marginal tax rate less 15%, whichever is greater.

Individual's marginal income tax rate	Maximum Government contribution	Maximum benefit based on \$5,000 of individual contributions
0%	15%	\$750
15%	15%	\$750
30%	15%	\$750
40%	25%	\$1,250
45%	30%	\$1,500

Early withdrawals

Early withdrawals will generally not be allowed before the minimum period of four years has elapsed, other than in exceptional circumstances (defined similarly to those which apply to superannuation such as severe financial hardship or illness).

Amounts not used for an eligible first home purchase can only be accessed after a minimum of four years, less the tax concessions that an individual has received. Tax concessions will be recovered from the savings before its release.

CGT on Holiday Unit

The Administrative Appeals Tribunal (AAT) has affirmed that a holiday unit that was used for short-term holiday accommodation was not an active asset for the purposes of the CGT small business concessions: *Re Carson and FCT* [2008] AATA 156.

The taxpayers were seeking a review of a decision of the Commissioner to disallow an objection to a private ruling, where he had ruled that the holiday unit sold during the year ended 30 June 2007 was not an active asset and therefore did not qualify for the small business CGT concession.

The taxpayers had based their contention on Taxation Determination TD 2006/78 (and in particular the holiday apartment example) issued by the Commissioner in December 2006, which stated that 'premises used in a business of providing accommodation for reward will satisfy the active asset test'.

However, the Tribunal was of the opinion that the main use of the holiday unit was to derive rent and therefore excluded from being an active asset. In arriving at its decision, the tribunal found that the activities of the taxpayers, which included appointing a real estate agent to arrange rentals and minor repairs and spending two weeks in a year servicing the unit, had 'all the earmarks of maintaining and deriving income from an investment rather than the carrying on of a business'. The activities of the taxpayers could 'hardly be categorised as sustained, repetitive commercial activities which could be seen as the carrying on of a business activity', the Tribunal said. Rather, the activities of the taxpayers were 'the monitoring and maintenance of an investment from which income is derived'. Further, the AAT was unable to distinguish the taxpayers' activity from the facts in *FCT v. McDonald* (1987) 18 ATR 957 and AAT Case [1999] AATA 937, *Re Cripps v. FCT* (1999) 43 ATR 1202.

The AAT also noted that, as a matter of procedure, the matter (an application against an adverse private ruling decision) highlighted the difficulty of objecting to a private ruling and being limited to facts identified in the ruling.

What is an active asset?

For a capital gain derived by a taxpayer to qualify for the small business CGT concessions, two basic conditions must be met:

1. the taxpayer who owns the CGT asset must be a small business entity or a partner in a small business entity. Alternatively, the taxpayer must satisfy the maximum net asset value test, and
2. the CGT asset that gives rise to the gain must be an active asset.

Depending on the concession being accessed, further conditions will need to be satisfied.

An active asset, which may be of an intangible or tangible nature, is defined in section 152–40 of ITAA 1997 as:

- an asset which is used or held ready for use by a taxpayer in the course of carrying on a business; or
- an asset which is used or held ready for use in the course of carrying on a business by an affiliate of the taxpayer, or an entity that is connected with the taxpayer; or
- if the asset is an intangible asset, the taxpayer owns it and it is inherently connected with a business that the taxpayer, an affiliate of the taxpayer or an entity that is connected with the taxpayer carries on.

Active assets can also include shares in a resident company and trust interests in a resident trust if the market value of the active assets of the company or trust is 80% or more of the market value of all the assets of the company or trust (the 80% active asset test).

However, section 152–40(4) specifically excludes certain assets from being active assets:

- share and trust interests in connected entities, other than those where the company or trust passes the 80% active asset test;
- certain shares and trust interests in widely held entities;
- financial instruments such as loans, debentures and bonds; and
- an asset whose main use in the course of carrying on a business is to derive interest, an annuity, rent, royalties or foreign exchange gains. However, this exclusion does not apply where the asset is an intangible asset and has been substantially developed, altered or improved by the taxpayer so that its market value has been substantially enhanced or where the main use of the asset for deriving rent was only temporary.

The example below, which is from section 152–40(4), clearly states that an investment property will not be an active asset:

A company uses a house purely as an investment property and rents it out. The house is not an active asset because the company is not using the house in the course of carrying on a business. If, on the other hand, the company ran the house as a guest house, the house would be an active asset because the company would be using it to carry on a business and not to derive rent.

Carrying on a business

Whether or not a taxpayer is carrying on a business is a question of fact and degree, rather than a question of law. In Taxation Ruling TR 97/11, the Tax Office states the main indicators of when a taxpayer is carrying on a business. Further, the ruling states that a taxpayer cannot obtain a private ruling on whether he or she is carrying on a business.

Indicators which suggest a business is being carried on	Indicators which suggest a business is not being carried on
a significant commercial activity	not a significant commercial activity
purpose and intention of the taxpayer in engaging in the activity	no purpose or intention of the taxpayer to carry on a business activity
an intention to make a profit from the activity	no intention to make a profit from the activity
the activity is or will be profitable	the activity is inherently unprofitable
repetition and regularity of activity	little repetition or regularity of activity
activity is carried on in a similar manner to that of the ordinary trade	activity carried on in an ad hoc manner
activity organised and carried on in a businesslike manner and systematically – records are kept	activity not organised or carried on in the same manner as the normal ordinary business activity – records are not kept
size and scale of the activity	small size and scale
not a hobby, recreation or sporting activity	a hobby, recreation or sporting activity
a business plan exists	there is no business plan
commercial sales of product	sale of products to relatives and friends
taxpayer has knowledge or skill	taxpayer lacks knowledge or skill

Shed Qualifies as Main Residence

In a bizarre decision by the AAT, it was held that a shed used by a taxpayer qualified as a main residence despite the fact that the taxpayer only moved her bed into the premises albeit mains water and a toilet were connected to the shed: *Re Summers and FCT* [2008] AATA 152.

The taxpayer who occupied a shed on her land for four months after the contract to build a house on the land fell through has been successful in obtaining a partial main residence exemption on the basis that the shed qualified as her home. However, the taxpayer was unsuccessful in using the concession for building a house on vacant land to obtain a full exemption.

In reaching its decision, the tribunal took into account the taxpayer's prior history of occupying rented premises in a similar manner, and her working and social habits that, among other things, involved her working 14-hour days, showering at her work premises and always buying meals.

However, the AAT found that the taxpayer could not apply the concession in section 118–150 of ITAA 1997 for building a house on vacant land in order to obtain a full main residence exemption as she did not occupy the shed 'as soon as practicable' after its completion as required under the section.

In terms of calculating the partial exemption, the tribunal also accepted that she was entitled to use the absence concession under section 118–145 from the time she moved out of the shed until its sale. The tribunal also allowed the cost of mowing, fence repairs, agent's commission and soil testing (as requested by the purchaser) to be included in the cost base for the purposes of calculating the partial exemption. In this regard, the tribunal found that it was reasonable to accept the costs of the mowing and the agent's commission even though they had not been fully substantiated.

Qualification as a main residence

To be entitled to the main residence exemption, the taxpayer must either own or acquire a dwelling. The term 'dwelling' includes:

- a unit of accommodation that is a building or is contained in a building, and consists wholly or mainly of residential accommodation;
- a caravan, houseboat or other mobile home; and
- any land immediately under the unit of accommodation.

The exemption also extends to land adjacent to a dwelling if the land was used primarily for private or domestic purposes. However, the maximum area of land that is covered by the exemption, including the area of land on which the dwelling is built, cannot exceed two hectares. Further, the adjacent land must be sold with the dwelling for the exemption to apply.

It is a requirement of the exemption that the dwelling must be the main residence of a taxpayer. In Taxation Determination TD 51, which discusses whether or not a dwelling is a taxpayer's sole or principal residence, the Tax Office provides its view of the factors to be taken into account. These factors include but are not limited to:

- the length of time the taxpayer has lived in the dwelling;
- the place of residence of the taxpayer's family;
- whether the taxpayer has moved his or her personal belongings into the dwelling;
- the address to which the taxpayer has his or her mail delivered;
- the taxpayer's address on the electoral roll;
- the connection of services such as telephone, gas and electricity; and
- the taxpayer's intention in occupying the dwelling.

The mere intention to construct a dwelling or to occupy a dwelling as a main residence will not attract the CGT exemption.

The legislation does not stipulate a minimum time frame for occupancy before a dwelling can be considered a main residence. However, where a taxpayer builds, repairs or renovates a dwelling, he or she must live in the 'new' dwelling for a minimum of three months before it can be considered the main residence. If a taxpayer does not live in the 'new' dwelling for a minimum of three months, the dwelling still can be considered his or her main residence if that period was immediately succeeded by a period in which the taxpayer treated the dwelling as a main residence under the 'six years rule'.

A taxpayer is also required to move into the dwelling when first practicable to do so. This requires consideration of situations where, for example, there is a delay in moving in because of illness or other unforeseen circumstances. However, a taxpayer must move into the dwelling as soon as the cause of the delay has ended.

Simplified Tax System

The Tax Office has released a fact sheet outlining the eligibility criteria for the small business entity concessions and how the changes will affect former simplified tax system (STS) taxpayers.

The small business entity regime replaced the STS with effect from 1 July 2007. Under the small business entity regime, a taxpayer does not need to elect to enter into the regime. Instead, it will be apparent from a small business entity's tax return whether the entity has used the tax concessions.

The concessions, which were previously available under the STS, have been incorporated into the small business entity regime. These concessions are:

- the simpler depreciation rules;
- the simpler trading stock rules;

- the entrepreneurs' tax offset;
- the prepaid expenses rules; and
- the two-year period of review.

In addition, a small business entity will be able to access other various concessions (subject to any additional criteria set out in the particular concessions themselves). These are:

- the CGT 15-year exemption, CGT 50% active asset reduction, CGT retirement exemption and CGT rollover;
- using the gross domestic product-adjusted (GDP) notional tax method to work out pay-as-you-go (PAYG) instalments;
- the fringe benefits tax (FBT) car parking exemption; and
- choosing to account for goods and services tax (GST) on a cash basis, annual apportionment of GST input tax credits and choosing to pay GST by instalments.

Definition of a small business entity

An entity will be classified as a small business entity for an income year if:

- it is carrying on a business in the current year (see 'CGT on holiday unit' for a list of factors which the Tax Office states are indicative of when a taxpayer is carrying on a business), and
- had an aggregated turnover for the previous year of less than \$2 million or the aggregated turnover for the current year is likely to be less than \$2 million.
- The aggregated turnover is the annual turnover of the entity's business plus the annual turnover of any businesses that the entity is connected to or affiliated with. The aggregated rules are similar to the former STS grouping rules.

An entity satisfies the aggregated turnover test where:

- its aggregated turnover for the previous income year was less than \$2 million;
- its aggregated turnover for the current income year, worked out as at the first day of the income tax year, is likely to be less than \$2 million; or
- its aggregated turnover for the current income year, worked out as at the end of the current income year is actually less than \$2 million.
- (Note: The definitions of a connected entity and an affiliate have changed with the introduction of the small business entity regime.)

Transitional provisions

Transitional provisions apply for any entity that, in an income year before 2007/08, was an STS taxpayer and stopped carrying on any business. Such an entity can continue to use the pre-1 July 2007 concessions (i.e. the capital allowance, trading stock, prepayment and amending assessment concessions) in 2007/08 and later income years if they are winding up the business they previously carried on.

An entity, that is determining whether it is a small business entity for the 2007/08 and 2008/09 income years, can work out its aggregated turnover for 2005/06 and / or 2006/07 on the basis that current small business entity rules were in force in relation to those years. If the entity's aggregated turnover for 2006/07 is not under \$2 million, it will be taken to have an aggregated turnover of less than \$2 million if its STS group turnover (for 2005/06 is less than \$2 million).

In-house Assets

In a recent fact sheet, the Tax Office explains to self managed superannuation fund (SMSF) trustees what an in-house asset is, the transitional rules that apply to certain assets owned before 11 August 1999 and the changes that will apply after 30 June 2009.

The fact sheet alerts trustees of SMSFs that have assets affected by the transitional rules to review their funds investment structure to ensure complying with the in-house asset rules after 30 June 2009.

What is an in-house asset?

The in-house assets rule stipulates the proportion of a superannuation fund's assets that the trustee may lend to or invest in an employer-sponsor of the fund or an associate of the employer. The rule states that a trustee of a superannuation fund must not acquire in-house assets if to do so would increase the ratio of such assets to over 5% of total assets, or if the ratio already exceeds 5%.

An in-house asset is defined as:

- loans to, or investment in a related party of the fund;
- an investment in a related trust of the fund; and
- an asset of the fund that is subject to a lease or lease arrangement between the trustee of the fund and a related party of the fund.

However, section 71(1) of the SIS Act excludes certain assets from the definition of an in-house asset. Excluded assets include a life policy issued by a life insurance company and a business real property. Where a SMSF breaches the in-house assets rule, the penalties range from being made non-complying to prosecution.

What will change after 30 June 2009?

After 30 June 2009, if a SMSF has investments with related parties or related trusts that are made on behalf of your SMSF before 11 August 1999, the fund will no longer be able to:

- reinvest any earnings;
- pay up any partly paid shares or units; or
- make any additional investments.

If the fund continues to reinvest earnings or make additional investments or loans after 30 June 2009, the additional investments or loans will be as in-house assets that count towards the 5% limit. This will apply even if there is an outstanding debt.

What will remain the same after 30 June 2009?

Investments entered into before 11 August 1999, or additional investments or loans made between 11 August 1999 and 30 June 2009, are not treated as in-house assets. Further, any lease arrangements which are entered into before 11 August 1999 are not considered in-house assets. Therefore, the lease arrangements do not need to unwind and any related entities do not need to be wound up.

Transitional provisions

Notwithstanding that the prescribed percentage of in-house assets which a SMSF may acquire cannot exceed 5%, transitional provisions apply for investments in existing related party assets that the fund acquired between 11 August 1999 to 30 June 2009. These transitional provisions, which are contained in sections 71A to 71F of the SIS Act, are:

- reinvested earnings;
- geared investments;

- pre-11 August 1999 investments and loans; and
- pre-11 August 1999 leases and lease arrangements.

IRA and Assessable Income

In ATO ID 2008/36, the Tax Office states that a lump sum distribution paid to a resident individual taxpayer upon closing a traditional Individual Retirement Account (IRA) held in the United States (US) is included in the taxpayer's assessable income under section 99B of ITAA 1936 subject to any exclusions under section 99B(2) and less any amounts that were previously assessed under the foreign investment fund (FIF) measures. The traditional IRA is a foreign trust and a FIF for the purposes of Part XI of ITAA 1936.

The taxpayer had previously declared in their Australian income tax return notional FIF income attributed to their interest in the traditional IRA. The lump sum distribution on closing the traditional IRA was included in the taxpayer's US income tax return on which US income tax has been paid.

Reasons for decision

The assessable income of an Australian resident includes any ordinary and statutory income derived from all sources, whether in or out of Australia: sections 6-5(2) and 6-10(4) of ITAA 1997. Whereas a non-resident is only subject to tax on ordinary and statutory income that has an Australian source: sections 6-5(3) and 6-10(5) of ITAA 1997.

A list of statutory income, which is assessable in Australia, is contained in section 10-5 of ITAA 1997. The list includes distributions received by a taxpayer from a trust under section 99B of ITAA 1936.

Broadly, section 99B states that the assessable income of a resident taxpayer who is a beneficiary of a trust estate will include an amount that is paid to, or applied for the benefit of the taxpayer by the trust. However, section 99B(2) states that the amount shall be reduced to the extent where it represents:

- a corpus of the trust estate;
- an amount that would not have been included in the assessable income of the taxpayer of a year of income;
- an amount that is assessable under section 97 of ITAA 1936 or which the trustee of the trust is liable pursuant to sections 98, 99 or 99A of ITAA 1936; or
- an amount that is assessable under section 102AAZD of ITAA 1936.

The amount is further reduced by any amounts previously reported by a taxpayer in their assessable income as notional income under the FIF measures: section 23AK of ITAA 1936.

Pursuant to the Double Tax Agreement between the US and Australia (the Agreement), the distribution paid to the taxpayer is considered to be 'other income'. Therefore, article 21 of the Agreement, which deals with 'other income' derived by a taxpayer, states that the distribution will be taxable only in Australia.

Accordingly, the distribution received by the taxpayer is assessable income in Australia pursuant to section 99B subject to the exclusions in sections 23AK and 99B(2). However, the taxpayer will be entitled to a foreign tax credit (FTC) if the eligibility requirements for the credit are satisfied. (Note: The FTC system will be replaced by the foreign income tax offset system will effect from 1 July 2008.)

Erratum

Please note that content under "**Rates and threshold**" in the *March 2008 FBT Return - Action Checklist*, has been clarified by the following:

Cents per kilometres for motor vehicle other than a car*
(where benefit is a residual benefit):

Engine capacity	Rate per kilometre	Rate per kilometre
0 – 2,500cc	41 cents	40 cents
Over 2,500cc	49 cents	48 cents
Motorcycles	12 cents	12 cents

Deemed depreciation rate – cars

Date car purchased	Depreciation rate	Depreciation rate
From 1 July 2002 [#]	18.75%	18.75%
Up to and including 30 June 2002	22.5%	22.5%

* The same rates will apply when a taxpayer is calculating the taxable value of a car under the minor fringe benefits exemption.

[#] For an asset purchased on or after 10 May 2006, the diminishing value rate increased from 150% to 200%. However, the FBT-deemed depreciation rate was not adjusted in line with the change. As such, the FBT rate for cars remained at 18.75% for the 2007/08 FBT year. The FBT rate, to reflect the increase, will only take effect from 1 April 2008. The rate to be used from 1 April 2008 is 25%.

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