

# client alert | explanatory memorandum

February 2008

## Labor's Tax Reforms

24 November 2007 ushered in a new era for the Australian political landscape with the Labor party winning the Federal election. As part of its election campaign, Labor promised various tax reforms, which included changes to personal income tax, and measures to assist families with the increasing cost of raising children. A brief discussion of the various reforms follows.

### Personal income tax reforms

Labor has stated that it will support the tax cuts outlined in the 2007/08 Budget. It will also provide tax cuts, which were proposed by the Howard Government, for individuals earning more than \$180,000. However, the proposed tax cuts for individuals earning more than \$180,000 will be deferred until the income year starting 1 July 2013.

The proposed personal tax rates and thresholds for resident individuals (excluding the Medicare levy) are summarised in the tax rate table below with key changes highlighted in bold.

#### Labor's proposed personal tax rates and thresholds

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 – <b>34,000</b>	15	6,001 – <b>35,000</b>	15	6,001 – <b>37,000</b>	15
30,001 – 75,000	30	<b>34,001</b> – 80,000	30	<b>35,001</b> – 80,000	30	<b>37,001</b> – 80,000	30
75,001 – 150,000	40	80,001 – 180,000	40	80,001 – 180,000	<b>38</b>	80,001 – 180,000	<b>37</b>
150,001 +	45	180,001 +	45	180,001 +	45	180,001 +	45
<b>Low income tax offset</b>							
<b>750</b>		<b>1,200</b>		<b>1,350</b>		<b>1,500</b>	

#### Labor's aspiration for 2013/14

Labor has proposed that the overhaul of the personal income tax regime will be fully implemented by the 2013/14 income year with the following features:

- reduction to three tax rates from the current four;
- reduction of the highest marginal tax rate to 40%; and

reduction of the current 40% tax rate (which by the 2010/11 income year would have been reduced to 37%) to 30%.

<b>Taxable income</b>	<b>Rate</b>
<b>(\$)</b>	<b>(%)</b>
0 – 6,000	0
6,001 – 37,000	15
37,001 – 180,000	30
180,001 +	40

### **Proposed changes to LITO and SATO**

Labor has proposed to increase the Low Income Tax Offset (LITO) from \$750 to \$1,200 from 1 July 2008. The LITO is proposed to further increase to \$1,350 (from 1 July 2009), \$1,500 (from 1 July 2010) and \$2,100 (from 1 July 2013). The changes to the LITO will result in the effective tax-free threshold increase from \$11,000 to \$16,000 by 1 July 2011 and \$20,000 by 1 July 2013.

The Senior Australians Tax Offset (SATO) will be adjusted in line with the changes to the LITO. From July 2008, senior Australians who are eligible for the SATO and LITO will not pay tax until they reach an annual income of \$28,867 for singles and \$24,680 for each member of a couple. From 1 July 2009, it is anticipated that these levels will increase to \$29,867 for singles and \$25,680 for each member of a couple. By 2010/11, it is anticipated that the income levels will be \$30,685 for singles and \$26,680 for each member of a couple.

These changes have not yet been legislated.

### **Abolishing tax deductions for political donations**

Labor has proposed abolishing tax deductions for all donations or contributions to political parties, including membership fees with effect from 1 July 2008.

Currently, political donations of \$2 or more to political parties, independent candidates or membership subscriptions paid to registered political parties which satisfy the relevant rules in Subdivision 30-DA of the *Income Tax Assessment Act 1997* (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).

### **Assisting families**

Labor has proposed the introduction of a range of 'family friendly' measures, which are summarised below.

#### **Child care tax rebate**

Under Labor's proposal, the rebate will be increased to 50% (from the current 30%) and be payable on a quarterly basis (instead of annually).

Labor has indicated that there will no changes to the eligibility requirements for the rebate.

The proposed date of effect is 1 July 2008.

#### **50% Education tax refund**

To assist families with the growing cost of educating their children, Labor has proposed introducing a 50% Education Tax Refund.

Families receiving Family Tax Benefit Part A payments or have school-attending children receiving Youth Allowance will be eligible for the refund.

Under the scheme, eligible families will be able to claim a refund for eligible education expenses incurred:

- a 50% refund every year for up to \$750 of education expenses for each child attending primary school (max \$375 per child, per year); and

- a 50% refund every year for up to \$1,500 of education expenses for each child attending secondary school (max \$750 per child, per year).

The term ‘eligible expenses’ has been defined as items that support a child during school and improve the quality of education being received. Items that qualify are:

- laptops;
- home computer and associated costs;
- home internet connection;
- printers;
- education software; and
- school text books.

School fees have been excluded as an eligible item.

If a taxpayer has insufficient tax liability, any unused amount of the refund can be transferred to their spouse. If both parents pay insufficient tax, the family will receive the refund as an equivalent transfer payment. A taxpayer will claim the refund from the Tax Office through their income tax return.

It is proposed that eligible expenses incurred from 1 July 2008 will be entitled to the refund.

### **Family Tax Benefit Part B**

Labor will limit eligibility to Family Tax Benefit Part B (FTB–B) for families with a combined adjusted taxable income of less than \$250,000. A complementary means test will also be applied to the other tax offsets that would otherwise be claimable if not for FTB–B eligibility.

The family adjusted taxable income is the sum of each member of a couple adjusted taxable income for the income year.

The adjusted taxable income of a taxpayer is calculated as:

$\text{taxable income} + \text{adjusted fringe benefits} + \text{net rental property losses} + \text{tax-free pensions or benefits} + \text{target foreign income} - \text{deductible child maintenance expenditure}$
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<b>Term</b>	<b>Definition</b>
taxable income	assessable income less allowable deductions
net rental property losses	rental expenses exceed gross rental income
tax-free pensions or benefits	payments from Centrelink, Department of Veterans’ Affairs and Military Rehabilitation and Compensation Commission
target foreign income	foreign income calculated in Australian dollars, from sources outside of Australia which has not been included in assessable income or reported as a fringe benefit
deductible child maintenance expenditure	amount of child maintenance paid

The intended date of implementation is 1 July 2008.

## **Reverse changes to family trusts**

Labor is proposing to reverse the changes made to family trusts as a result of *Tax Laws Amendment (2007 Measures No. 4) Act 2007*, which were introduced in September 2007.

The changes were:

- allowing the revoking of family trust elections and interposed entity elections in limited circumstances;
- allowing the test individual specified in the family trust election to be changed in limited circumstances;
- broadening of the definition of ‘family’ to include lineal descendants;
- ensuring that the death of a family member does not by itself result in another family member ceasing to be a member of the family;
- family trusts with the same test individual are included in the definition of family group; and
- former spouses, former widows/widowers and former step-children are included in the definition of family group.

The reversal means that taxpayers will only be able to benefit from the changes introduced in September 2007 in the 2007/08 income year.

## **DIS on *Dixon Consulting***

The Tax Office has released a Decision Impact Statement (DIS) on the Administrative Appeals Tribunal (AAT) decision in *Re Dixon Consulting Pty Ltd and FCT* [2007] AATA 1786 (21 September 2007). The case concerned whether a corporate taxpayer (the applicant) with two employees, Mr and Mrs Dixon, satisfied the business premises test and as a result was entitled to a personal services business determination from the Commissioner.

In the first instance, the AAT heard the case as *Re Dixon Consulting Pty Ltd and FCT* [2006] AATA 186. The AAT initially decided that the taxpayer had exclusively used the premises (comprising of a garage, and office, storeroom and workshop areas) for a business purpose. Further, the AAT decided that the premises were physically separated from the taxpayer’s residence. Thus, the AAT held that the premises satisfied the business premises test in section 87–30(1) of ITAA 1997. The Commissioner appealed to the Federal Court against the AAT decision.

In *FCT v. Dixon Consulting Pty Ltd* [2006] FCA 1748, the Federal Court held that the AAT had misinterpreted section 87–30 and remitted the matter back to the AAT for further consideration.

Upon remittance, the AAT stated that in deciding whether the taxpayer had used the premises exclusively for a business purpose, any private use could only be ignored when it was slight. While the storage of some items by the Dixon’s children in the garage would entail a de minimis use, after considering the private usage of the garage by Mr and Mrs Dixon, the AAT was satisfied that the private use was not de minimis and was not so slight that it should be ignored. Consequently, the AAT was satisfied that the taxpayer did not use the premises exclusively for a business purpose, thus the requirements of the business premises test were not fulfilled.

In light of the AAT’s finding that the garage was not used exclusively for the applicant’s business, it was not necessary to consider whether the premises were physically separated from the taxpayer’s residential premises. However, the AAT commented that based on the configuration of the taxpayer’s property, a physical separation did not exist between the residential and business premises. It can be inferred from the AAT’s comment that in determining whether the business premises test is met, a physical separation between the private and business premises is necessary.

The Tax Office stated in the DIS that this was the first case to consider the application of the business premises test. Further, the findings of the Federal Court and the AAT confirmed the Tax Office’s view regarding the operation of the business premises test, which is provided for in Taxation Ruling TR 2001/8.

### **Business premises test — section 87–30**

Section 87–30 of ITAA 1997 states that an individual or personal services entity meets the requirements of the business premises test in an income year if, at all times during the income year, the individual or entity maintains and uses business premises:

- a) at which the individual or entity mainly conducts activities from which personal services income is gained or produced; and
- b) of which the individual or entity has exclusive use; and
- c) that are physically separate from any premises that the individual or entity or any associate of the individual or entity, uses for private purposes; and
- d) that are physically separate from the premises of the entity to which the individual or entity provides services and from the premises of any associate of the entity to which the individual or entity provides services.

The term ‘exclusive’ is not defined in either ITAA 1936 or ITAA 1997. In TR 2001/8, the Tax Office referred to the Macquarie Dictionary for the definition of ‘exclusive’ as:

*‘not admitting of something else; incompatible, limited to the object or objects designated, shutting out all other activities, single or sole ...’*

A literal interpretation of the definition conjures up the impression that premises must be used solely for business purposes. The AAT’s decision in *Re Dixon Consulting Pty Ltd and FCT* [2007] AATA 1786 reaffirms the Tax Office’s viewpoint.

## **PSI and the Results Test**

*IRG Technical Services Pty Ltd v. FCT* [2007] FCA 1867 was a test case where the Federal Court dismissed the appeals of two taxpayer entities (the taxpayers) against the Commissioner’s refusal to grant them personal services business (PSB) determinations for engineering work carried out in relation to the construction of a major gas plant.

The Court held that the taxpayers did not pass the results test because the nature of the relationship between the taxpayers and the company engaging their services was that of an employer–employee.

### **Background**

The taxpayers were a family trust and a private company each controlled by two different individuals, who were professional engineers specialising in the field of international construction, in particular the design and construction of oil and gas plants.

In the relevant income years, the individuals were recruited by labour procurement agencies (the agencies) through the taxpayers to work on the design of a LNG plant for Woodside Petroleum. The terms of the contract between the taxpayers and the agencies required the individuals to submit weekly timesheets and invoices for payment of services rendered, which were based on an hourly rate. Further, the individuals were required to provide their own equipment with the exception of stationery, computer equipment and office space.

The taxpayers sought PSB determinations on the basis that they satisfied the results test in section 87–18(3) of ITAA 1997. The taxpayers placed most weight on the terms and effect of the two contracts between themselves and the labour procurement agencies.

The Commissioner asserted that in applying the results test, it was the economic substance rather than the legal substance that determined the true nature of the relationship and denied granting the determinations to the taxpayers.

### **Judgment**

The Federal Court agreed with the Commissioner that the taxpayers were not eligible for PSB determinations.

In reaching its decision, the Court compared the facts of the case to the criterion in the results test which are discussed below. The Court found that the taxpayers were not liable for the cost of rectifying any defect in the work performed by the individuals. Notwithstanding the fact that the individuals were skilled experienced professionals which implied that minimal supervision was required, the existence of a careful interdisciplinary communication and meticulous quality assurance and control at the LNG plant meant that the requirement for the taxpayers to personally ratify and be liable for any work was rare. Further, the taxpayers did not maintain any professional indemnity insurance.

Payment of the work performed by the individuals was not pegged to the completion of any specific target – rather, the individuals were paid by the hour for 45 hours per week, paid each fortnight. Irregular submissions of invoices by the taxpayers did not affect the payment because payment was based on the timesheets submitted by the individuals.

The Court was of the opinion that the individuals’ authority to delegate any tasks was undermined because Woodside’s permission had to be sought. The ability to efficiently perform the tasks required access to Woodside’s computer system that was accessible to all the engineers. Therefore, the individuals did not need to provide any further equipment.

Examining the various aspects of the taxpayers relationship with Woodside, the Court found that the results test was not satisfied. Therefore, the taxpayers were not eligible for PSB determinations.

**Results test — section 87–18(3) of ITAA 1997**

If an individual generates PSI through a personal services entity (company, trust or partnership), section 87–18(3) states:

*‘A personal services entity meets the results test in an income year if, in relation to at least 75% of the personal services income of one or more individuals that is included in the personal services entity’s ordinary income or statutory income during the income year:*

- a) the income is for producing a result; and*
- b) the personal services entity is required to supply the plant and equipment, or tools or trade, needed to perform the work from which the personal services entity produces the result; and*
- c) the personal services entity is, or would be, liable for the cost of rectifying any defect in the work performed.’*

Taxation Ruling TR 2001/8 provides the Tax Office’s interpretation of the results test. The ruling states that the results test is based on the traditional criteria for distinguishing independent contractors from employees. The table below, which is extracted from TR 2001/8, states the factors that are relevant to making the distinction:

<b>Factor</b>	<b>Explanation</b>
The contractual obligations	An independent contractor enters into a contract for a specific task or specific tasks.
How the work is performed	The independent contractor maintains a high level of discretion and flexibility as to how the work is performed. However, the contract may contain precise terms as to materials used and methods of performance and still be one for a result.
Risk	An independent contractor stands to make a profit or loss on the task. They bear the commercial risk. The independent contractor bears the responsibility and liability for any poor workmanship or injury sustained in performance of the task. Often an independent contractor would carry their own insurance and indemnity policies.
Tools and equipment	An independent contractor provides the asset, equipment and tools, if any, necessary for the work.
Hours of work and place of work	An independent contractor may set their own hours of work, or place of work, depending on the contract or the nature of the work.

Leave and other entitlements	A contract for a result usually does not contain leave provisions, or allowances.
Payment	Payment to an independent contractor is often based upon performance of the contract rather than being paid a hourly rate, piece rates or award rates.
Expenses	An independent contractor usually incurs their own expenses.
Appointment	An independent contractor is likely to advertise their services to the public at large, and the contract for a result is often the direct result of this activity.
Termination	An independent contractor is contracted to complete a set task. The payer may only terminate the contract without penalty where the worker has not fulfilled the conditions of the contract. The contract usually contains terms dealing with defaults made by either party.
Delegation	An independent contractor may delegate all or some of the tasks to another person, and may employ other persons.

Source: Taxation Ruling TR 2001/8.

For more information about TR 2001/8, visit the ATO website at:

<<http://law.ato.gov.au/atolaw/view.htm?docid=TXR/TR20018/NAT/ATO/00006>>.

## Trust Cloning

An exception to a CGT event arises when an asset is transferred between two trusts that have the same beneficiaries and terms. This practice is commonly referred to as trust cloning. Taxation Ruling TR 2006/4 provides the Tax Office's view of when the CGT exception will apply.

Following the release of TR 2006/4, the Tax Office has become aware of further examples where trusts, particularly discretionary trusts, may not be 'the same' and therefore assets transferred between the trusts will trigger a CGT event.

The Commissioner has raised concerns that some practitioners may not appreciate the requirements for the exception test to be satisfied. An asset that does not satisfy the exception test will trigger a CGT event and depending on the particular circumstances, tax may be payable.

The Commissioner is currently considering representations made by practitioners and their implications.

Taxpayers or their advisers who have relied on the exception but who are now concerned that the exception test was not satisfied are encouraged to contact the Tax Office on 13 28 66 or lodge a private ruling in respect of their circumstances.

The transferring of an asset between two trusts will, generally, result in CGT events E1 and E2 occurring. However, exceptions can apply. Sections 104–55(6) and 104–60(6) of ITAA 1997 indicate that if the new trust was created by transferring assets from the transferee trust and both trusts have the same beneficiaries and terms, any capital gain or loss arising from the transfer is to be disregarded.

TR 2006/4 provides that the wordings of both trust deeds need not be similar. However, the wordings must give rise to the same meaning and effect. The meaning and effect of a trust deed is a reference to its strict legal meaning which must be determined using the rules generally applied by the courts in interpreting trust deeds.

The following factors, which are extracted from TR 2006/4, are relevant to in identifying whether the two trusts are identical:

<b>Terms</b>	<b>Requirements</b>
Beneficiaries	The direct beneficiaries of both trusts must be the same and in the same capacity.
Terms	The terms of both trusts must be the same. The new trust must contain all the terms contained in the original trust and no others.
Trustees	Both trusts do not need to have the same trustee.
Appointor	If the original trust has an appointor, the new trust must have an appointor. Further, the identity of the appointor and their successors must be similar for both trusts.
Beneficiaries' rights and entitlements	Each beneficiary must have the same rights, entitlements and interests in the new trust, which they had in the original trust.
Vesting and termination dates	The vesting and termination dates must be the same for both trusts.
State laws	The same state laws must govern each trust.
Family trust and interposed entity elections	If the original trust has made a FTE or an IEE, the new trust must have also made the same type of election.
Name	Both trusts need not have the same trust name.
Commencement or establishment date	Both trusts need not have the same commencement or establishment date.
Settlor	Both trusts need not have the same settlor.
Trust property	Both trusts need not have the same trust property with the exception of the transferred asset, which must be an asset of both trusts.

Source: Taxation Ruling TR 2006/4.

For more information about trust cloning, see TR 2006/4 which can be found online at:  
<http://law.ato.gov.au/atolaw/view.htm?locid='TXR/TR20064/NAT/ATO'&PiT=99991231235958>.

The media release by the Tax Office can be found online at:  
[www.ato.gov.au/print.asp?doc=/content/00109677.htm](http://www.ato.gov.au/print.asp?doc=/content/00109677.htm).

## **Acquisition of Coles by Wesfarmers**

In Class Ruling CR 2007/114, the Tax Office provides its view of the tax implications for a Coles shareholder following the acquisition of Coles by Wesfarmers.

Under the terms of acquisition, a Coles shareholder will receive a combination of cash consideration, Wesfarmers shares and Wesfarmers Partially Protected (WPP) shares. The amount of cash consideration, and the number of Wesfarmers and WPP shares a shareholder receives depends on the payment option selected.

The Tax Office has ruled that a shareholder will be eligible to elect a script-for-script rollover under section 124–780 of ITAA 1997. If a shareholder elects the rollover relief, any capital gains arising from the disposal of the Coles shares will be disregarded. However, the capital gains are not disregarded to the extent that the capital proceeds includes the cash consideration.

## **Cost base of Wesfarmers shares and WPP shares — if rollover chosen**

The first element of the cost base for the Wesfarmers shares and WPP shares will be a reasonable portion of the cost base of the Coles shares exchanged for those shares under the scheme. A shareholder must first reduce the cost base of the Coles shares by that part of the cost base that is attributable to the cash consideration received.

The acquisition date for the Wesfarmers shares and WPP shares was 23 November 2007.

## **Cost base of Wesfarmers shares and WPP shares — if rollover not chosen**

The first element of the cost base of the Wesfarmers shares and WPP shares will be a reasonable portion of the market value of the Coles shares exchanged for those shares under the scheme. A shareholder must first reduce the cost base of the Coles shares by that part of the market value which is attributable to the cash consideration received.

The market value of the Coles shares is determined at the time of acquisition of the Wesfarmers shares and WPP shares.

The acquisition date for the Wesfarmers shares and WPP shares was 23 November 2007.

## **Capital gains implications for non-resident Coles shareholders**

The Tax Office ruled that the disposal of Coles shares would not result in any CGT consequences for a non-resident shareholder unless the shares were used in connection with the carrying on of a business through a permanent establishment in Australia.

The ruling applies from 7 November 2007 to 30 June 2008. Further, it will continue to apply after 30 June 2008 to all entities that entered into the scheme during the period of the ruling.

## **Tax Office Releases GIC and SIC Rates**

The Tax Office has released the general interest charge and shortfall interest charge rates for the third quarter of the 2007/08 financial year (1 January 2008 to 31 March 2008). The rates are as follows:

<b>Rate</b>	<b>Annual (%)</b>	<b>Daily (%)</b>
GIC	14.15	0.03866120
SIC	10.15	0.02773224

The Tax Office has also released the interest rate for overpayments, early payments and delays in refund for the third quarter of the 2007/08 financial year (1 January 2008 to 31 March 2008). The applicable interest rate is 7.15%

For more information about the GIC, visit the ATO website at:  
<[www.ato.gov.au/print.asp?doc=/content/2832.htm](http://www.ato.gov.au/print.asp?doc=/content/2832.htm)>.

For more information about the SIC, visit the ATO website at:  
<[www.ato.gov.au/print.asp?doc=/content/65367.htm](http://www.ato.gov.au/print.asp?doc=/content/65367.htm)>.

## **Other Tax Issues — Goods Taken for Private use — TD 2007/30**

In Taxation Determination TD 2007/30, the Tax Office provided the amounts that it accepts as estimates of the value of goods taken from trading stock for private use for the 2007/08 income year by taxpayers in certain categories.

TD 2007/30 should be read in conjunction with IT 2659. In IT 2659, the Tax Office recognised that a greater or lesser value may be appropriate depending on the taxpayer's circumstances. If a taxpayer uses a lesser

value, they must be able to substantiate it. Where the value of goods is greater than the Tax Office's values, the actual amount should be used.

Section 70–110 of ITAA 1997 provides that where a taxpayer stops holding an item as trading stock but still owns it, the taxpayer is treated as having sold it for its cost. The taxpayer is required to include the deemed proceeds from the disposal in their assessable income.

<b>Type of business</b>	<b>Amount (excluding GST) for adult/child over 16 years)</b>	<b>Amount (excluding GST) for child 4–16 years</b>
	<b>\$</b>	<b>\$</b>
Bakery	1,040	520
Butcher	700	350
Restaurant/café (licensed)	3,570	1,425
Restaurant/café (unlicensed)	2,850	1,425
Caterer	3,100	1,550
Delicatessen	2,850	1,425
Fruiterer/greengrocer	750	375
Takeaway food shop	2,700	1,350
Mixed business (includes milk bar, general store and convenience store)	3,400	1,700

TD 2007/30 can be accessed at: <<http://law.ato.gov.au/pdf/td2007-030.pdf>>.

IT 2659 can be accessed at: <<http://law.ato.gov.au/pdf/it2659.pdf>>.

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