client alert | explanatory memorandum

June 2008

Tax Laws Amendments

The Government has introduced *Tax Laws Amendment (2008 Measures No 2) Bill 2008* into the House of Representatives, which seeks to amend:

- ITAA 1997 to allow taxpayers to claim a deduction in relation to an amount misappropriated by an employee or agent;
- *Superannuation Guarantee (Administration) Act 1992* (SGAA) to extend the period within which an employer can make a contribution — after the due date — and still be eligible to use the late payment offset to reduce its superannuation guarantee charge liability;
- ITAA 1997 to ensure that the market substitution rule does not apply when CGT event C2 occurs in relation to interests in certain companies and trusts;
- ITAA 1997 to ensure that the Endeavour Executive Award and research fellowship grants received under the Endeavour Awards scholarship program are exempt from income tax;
- ITAA 1997 to extend an income tax exemption to early completion bonuses paid to apprentices by State and Territory governments; and
- ITAA 1997 to update the list of deductible gift recipients (DGRs) to include nine new DGRs and extend the time period of four existing DGRs.

A brief discussion of the proposed amendments follows.

Misappropriated amount

The Bill amends the ITAA 1997 to allow taxpayers to:

- claim a deduction in relation to an amount misappropriated by an employee or agent following the disposal of an asset that has been dealt with under the uniform capital allowance provisions (amends Division 25 of ITAA 1997);
- recognise the amount misappropriated by an employee or agent if a CGT event occurs and the amount would have otherwise been taken into account in working out the amount of capital gain or capital loss. Where there has been a misappropriation of the capital proceeds by an employee or agent of the taxpayer, in calculating a capital gain or loss, the taxpayers will:
  1. have to include all the capital proceeds that they were entitled to receive, regardless of whether or not they actually received all of the proceeds; and
  2. disregard any later recovery of the capital proceeds for CGT purposes; or
- both claim a deduction and recognise the misappropriation as discussed above (depending on whether the asset was used for taxable purposes or not).

These amendments take effect when the Bill receives Royal Assent and apply to amounts misappropriated in the 2007/08 and later income years.

Examples from the EM

Example 1

Henry is an architect and operates a business from home. He owns a computer, which is used 60% in the business. Henry authorises an agent to sell the computer on his behalf and collect the proceeds.

The agent sells the computer for $1,500 (its termination value). At that time, in the 2008 year, the adjustable value of the computer is $1,000. The balancing adjustment calculation will use an adjustable value of $1,000 and a termination value of $1,500. Since Henry is taken to receive the amount, $300 (60% of $500) will be included in Henry's assessable income.

In the same year, Henry becomes aware that his agent has misappropriated the sale proceeds. Under the new provisions, Henry can claim a deduction of $900 (60% of $1,500) for the 2008 income year.

Example 2

Parvin sold a rental property in the 2007 income year for $500,000. She would include $500,000 as the capital proceeds for the purposes of working out the capital gain in her 2007 tax return.

However, if the purchaser paid $500,000 to Parvin's solicitor and the solicitor misappropriated the amount, under the current law she would still have to include the full $500,000 as capital proceeds even though the solicitor did not pass on those proceeds to her.

Under the amendments, the $500,000 would not be included as capital proceeds for the purposes of working out the capital gain.

Current law

Currently, no equivalent exists in either ITAA 1936 or ITAA 1997.

Superannuation guarantee late payments

The Bill amends the SGAA to extend the period within which an employer can make a contribution — after the quarterly due date — and still be eligible to use the late payment offset to reduce its superannuation guarantee (SG) charge liability.

The change is designed to reduce the incidence of employers having to potentially pay the same amount twice: once when they make a late contribution to the employee's fund and again when they are assessed with an SG charge (payable to the Tax Office) for making the contribution late.

The amended late payment offset will be available to employers who:

- have made a contribution for an employee after the due date for the quarter;
- have an outstanding SG charge for the employee for that quarter; and
- elect in the approved form to use the offset.

However, the late contribution can only be offset against an SG charge that relates to the same quarter and to the same employee.

Importantly, the SG charge and late payment offset are not tax deductible to the employer (sections 26–95 and 290–95 of ITAA 1997). Therefore, employers still have a strong incentive to continue making their SG quarterly payments on time.

The amendment applies from the date of Royal Assent. Transitional provisions will allow employers to use the offset if they have an SG charge or liability for a year (rather than a quarter) which becomes payable after Royal Assent to the Bill.

Current law

Currently, contributions made more than one month after the due date for the quarter for an employee cannot be offset against the SG charge for that quarter for the employee.

CGT market substitution rule

The amendment will ensure that the market value substitutional rule, which is contained in subsection 116–30(2) of ITAA 1997, does not apply where CGT event C2 occurs in relation to a share in a widely held company or a unit in a widely held unit trust. This is achieved through the insertion of subsection 116–30(2B) and section 116–35 into ITAA 1997.

The amendment assumes that the parties in these circumstances are dealing with each other at arm's length. Furthermore, it is aimed at facilitating arrangements whereby widely held companies or unit trusts, as part of their ongoing capital management strategy, cancel shares or units and agree with their shareholders or unit holders on a cancellation price in advance of the cancellation taking place.

The amendment will commence from the date the Bill receives Royal Assent and apply to CGT events that occur in the 2006/07 income year and later income years.

Awards and fellowships

The amendment will exempt the entire amount received from either a research fellowship under the Endeavour Awards program or an Endeavour Executive Award from income tax, regardless of whether the amounts are made for full- or part-time educational pursuits.

The amendment applies to fellowships and awards received in the 2007/08 income year and later income years.

Current law

The tax treatment of the three components of a research fellowship (travel allowance, establishment allowance and monthly stipend) depends on whether the recipient is a full- or part-time student. If the recipient is a full-time student, all three components are exempt from income tax. If the recipient is a part-time student, the stipend is assessable income and the allowances may be assessable income, depending on the form they take.

An Endeavour Executive Award is made up of three components (travel allowance, establishment allowance and monthly stipend) and the tax treatment is identical to that of a fellowship award.

Apprenticeship bonuses

The amendment will exempt from income tax the first $1,000 of an early completion bonus paid to an apprentice by a State or Territory government.

Early completion bonuses are payments made to apprentices who complete their apprenticeship more quickly than normal. Currently, only the Queensland Government pays an early completion bonus to apprentices.

The amendment will apply to assessments for the 2007/08 income year and later income years.

Current law

Presently, the entire early completion bonus is assessable income to the apprentice.

Deductible gift recipients

The amendments will update the list of DGRs in ITAA 1997 to include nine new DGRs and extend the time period of four existing DGRs.

The nine new DGRs and their respective dates of effect are:

Name of fund	Date of effect	Special condition
AE 2 Commemorative Foundation Ltd	29 February 2008	The gift must be made after 28 February 2008 and before 1 March 2010.
Ian Thorpe's Foundation for Youth Limited	29 February 2008	The gift must be made after 28 February 2008.
Wheelchairs for Kids Incorporated	29 February 2008	The gift must be made after 28 February 2008 and before 1 March 2010.
Amy Gillett Foundation	14 September 2007	The gift must be made after 13 September 2007.
The Spirit of Australia Foundation	11 September 2007	The gift must be made after 10 September 2007.
World Youth Day 2008 Trust	5 September 2007	The gift must be made after 4 September 2007 and before 1 July 2009.
Memorials Development Committee Ltd	5 September 2007	The gift must be made after 4 September 2007 and before 1 July 2010.
The Council for Jewish Community Security	10 August 2007	The gift must be made after 9 August 2007.
Playgroup Australia Incorporated	3 August 2006	The gift must be made after 2 August 2006.

The four DGRs whose time periods have been extended are:

Name of fund	Extended to	Previous date
Dunn and Lewis Youth Development Foundation Limited	1 January 2009	1 January 2008
Finding Sydney Foundation	1 July 2009	28 August 2007
Xanana Vocational Education Trust	21 July 2009	21 July 2007
Australia for UNHCR	28 June 2012	28 June 2007

Self-education Expenses

In a recent decision, the AAT affirmed that a taxpayer was not entitled to a deduction for self-education expenses incurred in undertaking a course of study in hospitality and tourism management at the Blue Mountains Hotel School: *AAT [2008] AATA 220, Re Cheung and FCT.*

The course required the taxpayer to undertake two semesters of industry employment. At the same time, she worked on a casual basis in another hotel. At the end of her course, unable to return to her casual job because of the hotel's budget constraints, she obtained employment as a food and beverage supervisor in another hotel.

The test to determine whether an expenditure for self-education expenses was deductible required more than establishing a connection, the Tribunal said. Rather, it required the expense to be incidental and relevant to the derivation of assessable income. Therefore, the Tribunal found that the expenditure was not incidental and relevant to her income-producing activities and did not have the essential character of an income-producing expense, despite the taxpayer having to undertake industry employment as part of the course and working in the industry on a casual basis.

Instead, the Tribunal found that the course was undertaken with a view to improving the taxpayer's future employment prospects and that it did not have the necessary nexus with any on-going income-earning activities.

Deductibility of self-education expenses

Self-education expenses are generally deductible under section 8–1 of ITAA 1997 if there is sufficient connection with a taxpayer's income-producing activities (subject to the limitation in section 82A). If section 82A applies, the total allowable deduction cannot be greater than the amount by which the net amount of self-education expenses exceeds $250, i.e. the first $250 of the expenses is non-deductible. In Taxation Ruling TR 98/9, which discusses the deductibility of self-education expenses, the Tax Office states that it is always necessary to have regard to section 8–1 and apply the section to the facts surrounding the taxpayer. This requires an objective analysis of the surrounding circumstances.

The Taxation Ruling states the circumstances in which self-education expenses are allowable deductions:

- if the expenses have a relevant connection to the taxpayer's current income-earning activities;
- if the expenses are incurred in maintaining or improving a taxpayer's skills and knowledge in his or her present occupation; and
- if an objective assessment that the expenses leads to, or are likely to lead to, an increase in a taxpayer's income from his or her current income earning activities in the future.

Further, the Taxation Ruling states the Tax Office's view that self-education expenses incurred before employment commences or to obtain new employment are not deductible.

Taxpayer Alerts

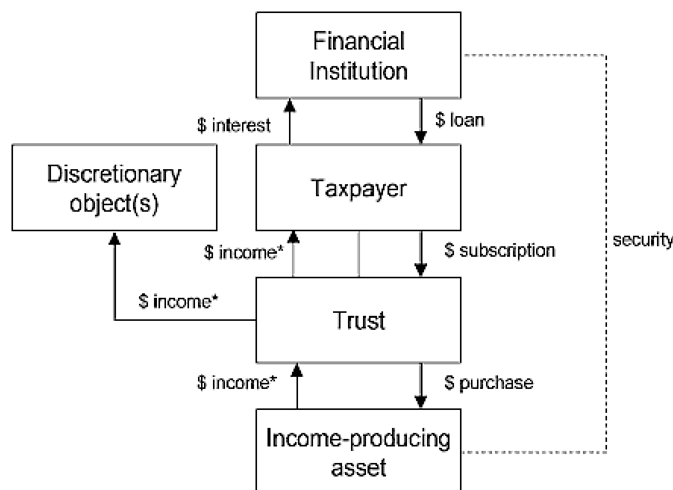
The Tax Office has released four Alerts warning taxpayers of certain arrangements that are currently being examined.

Uncommercial use of trust

Taxpayer Alert TA 2008/3 describes a non-arm's length arrangement under which taxpayers use borrowed funds to acquire an interest, such as units, in a certain type of trust, which uses the funds to purchase income-producing property. The Tax Office says the arrangement seeks to provide income tax deductions to the taxpayers for all of their interest payments and other borrowing costs.

The Tax Office view is that the arrangement does not provide a sufficient connection between the expenditure and the production of future income and/or capital gains, which may be distributed to other beneficiaries of the trust, who may have a lower tax rate.

The basic structure of the arrangement, which the Alert is concerned about, is summarised diagrammatically below:



SMSF deriving income from certain uncommercial trusts

In Taxpayer Alert TA 2008/4, the Tax Office describes a non-arm's length arrangement under which a self-managed superannuation fund (SMSF) derives income through a direct or indirect interest in a closely-held trust. The arrangement may be of the type of trust described in Taxpayer Alert TA 2008/3, where an individual or another entity borrows funds to invest in a trust and seeks a tax deduction for the interest costs. The Tax Office considers that the arrangement may give rise to certain taxation issues.

The Commissioner says the Tax Office is not concerned about all "discretionary" or "hybrid" trust arrangements. Rather, he said the Tax Office is concerned about negatively-geared trust arrangements which involve the taxpayer incurring interest expenses or borrowing costs where all or a proportion of the borrowed funds could be used for the benefit of the beneficiaries, or where the taxpayer's interest in the trust could be brought to an end before their costs of investment have been recouped.

Borrowings by self-managed superannuation funds

Taxpayer Alert TA 2008/5 is concerned with arrangements under which the trustee of a self-managed superannuation fund (SMSF) enters into certain limited-recourse borrowings, which may not meet the conditions in subsection 67(4A) and/or breach other provisions of the *Superannuation Industry (Supervision) Act 1993* (SIS Act), as well as related superannuation rules.

This Taxpayer Alert does not deal with taxation issues other than those relating to the application of the superannuation law.

The Alert applies to arrangements which have the following features:

1. The trustee of the SMSF ("the trustee") borrows money to acquire an asset.
2. The asset acquired (or any replacement asset) is held in trust so that the trustee acquires a beneficial interest in it.
3. The legal interest in the asset (or any replacement) is held by the trust as security for the borrowed money.
4. The trustee has the right to acquire legal ownership of the asset (or any replacement) by making one or more payments after acquiring the beneficial interest.
5. The borrowing is of a limited-recourse nature, noting particularly that any recourse that the lender has under the arrangement against the trustee must be limited to rights relating to the asset acquired (or any replacement). In other words, the lender is able to recover monies where there is a default on the borrowing by repossessing or disposing of the asset acquired (or any replacement), but cannot recover such monies through recourse to the SMSF's other assets.
6. The arrangement has one or more of the following features:
   (a) The interest rate for the borrowing is zero or less than a commercial rate, particularly where the lender is a related party;
   (b) The interest rate for the borrowing exceeds a commercial rate, particularly where the lender is a related party;
   (c) Interest on the borrowing can be capitalised;
   (d) A personal guarantee for the borrowing is given by a third party, particularly where the guarantee is given by a member or a related party of the SMSF;
   (e) The asset acquired (or any replacement) is one that a trustee is prohibited from acquiring under the SIS Act or any other law, or under the SMSF's governing rules (for example, acquiring residential property, which is not business real property, from a related party).

The Tax Office considers that instalment warrant arrangements with the features described in the Alert may give rise to tax and superannuation regulatory issues, including:

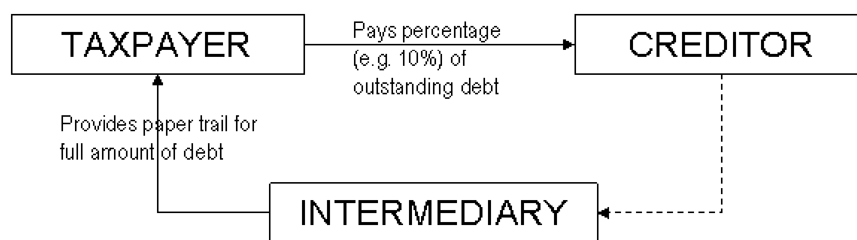
1. monies advanced by a member or related party at zero or less than a commercial rate of interest could be characterised as a contribution to the SMSF. This may result in the trustee/member having to pay excess non-concessional contributions tax under Division 292 of ITAA 1997;
2. monies advanced by a member or related party at greater than a commercial interest rate of interest may result in:
   (a) a breach of the sole purpose test outlined in section 62 of SIS Act, on the basis that the excessive interest rate may mean that the SMSF is not being maintained solely for the purpose of providing superannuation benefits, and/or
   (b) a breach of paragraph 65(1)(b) of the SIS Act by the trustee, which prohibits the trustee from giving financial assistance to a member of the SMSF or to a relative of such a member using the resources of the SMSF;
3. interest capitalised may result in the arrangement failing to meet the requirement that the money borrowed is or has been applied for the acquisition of an asset under paragraph 67(4A)(a) of the SIS Act;
4. a personal guarantee of the type outlined in paragraph 6(d) above may result in recourse being made to the assets of the SMSF other than the assets acquired (or any replacement) in the event that the guarantee is enforced against the trustee as the principal debtor, contrary to the intent of the exception in subsection 67(4A) of SIS Act; and
5. an asset of the type outlined in paragraph 6(e) above may result in breaches of the SIS Act or SIS Regulations.

The Taxpayer Alert reminds trustees that existing fund assets cannot be placed into a limited recourse borrowing without breaching the SIS regulatory requirements.

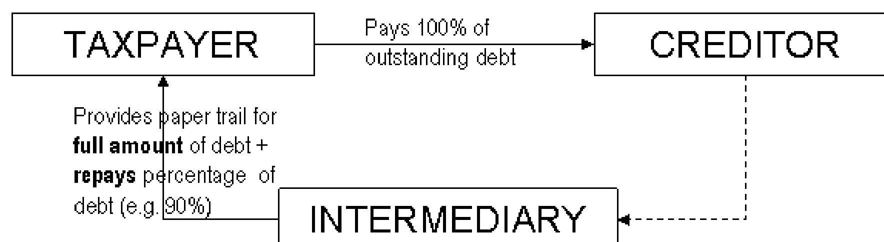
Debt deductions from a previous tax planning scheme

Taxpayer Alert TA 2008/6 is concerned with arrangements whereby taxpayers are involved in a previous tax avoidance scheme entered into an arrangement under which they purport to be able to claim a tax deduction for debts relating to that scheme that have been forgiven or where repayments of the debt are refunded.

The basic structure of the arrangement, which the Taxpayer Alert is concerned about, is summarised diagrammatically below:



Alternatively, the arrangement may constitute a round robin, such as:



The Tax Office is concerned about the following taxation issues that arise:

- whether the arrangement or certain steps within it are a sham;
- whether the outstanding debt or the net amount actually repaid under the arrangement may be deductible under section 8–1 of ITAA 1997;
- whether Part IVA applies to the arrangement, on the basis that its dominant purpose is to enable the taxpayer to obtain a tax benefit; and
- whether any entity involved in the arrangement is a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 of TAA 1953.

Legal status of Alerts

Taxpayer Alerts are only intended to be an "early warning" of tax planning arrangements that the Tax Office has under risk assessment. However, it is expected that the Tax Office will follow up on the release of any Alert with a public ruling or determination.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in an Alert can seek a formal determination of the Tax Office's position through a Private Ruling.

Super Update

In the March 2008 issue of the Super Update, the Tax Office reminded employers of two important changes that will take effect from 1 July 2008: the calculation of superannuation guarantee contributions for employees, and insurance requirements for employer-nominated super funds.

Superannuation guarantee contributions

From 1 July 2008, ordinary time earnings (OTE), which are defined in section 6 of *Superannuation Guarantee (Administration) Act 1992* (SGAA), must be used to calculate superannuation guarantee contributions for employees to avoid the superannuation guarantee charge (SGC). The Tax Office has urged employers to ensure that they have the correct systems in place to handle this change in requirements and to plan for any additional costs.

Ordinary time earnings

The term OTE is generally defined as what an employee earns for his or her ordinary hours of work, including over-award payments, shift loading and commissions. However, it excludes overtime earnings. While most employees have OTE as their earnings base, some employees have other earnings bases that may be contained in:

- an industrial award;
- an existing agreement they have with their employer;
- a fund's trust deed; or
- a Commonwealth, State or Territory law.

Currently, employers who are contributing to a superannuation fund for the benefit of their employees in accordance with an earnings base established before 21 August 1991 can continue to use that notional earnings base until 30 June 2008. This means employees may currently be paid lower superannuation contributions (as a proportion of total remuneration) when compared with another employees in similar circumstances. However, from 1 July 2008, the earnings base is standardised to OTE for all employees under the SGAA. As a result, all employers are required to use a notional earnings base that is at least equivalent to the OTE.

If the current superannuation guarantee amounts paid to employees are less than the minimum 9%, the Tax Office has stated that employers should increase these amounts to meet the minimum to avoid the SGC.

In Superannuation Guarantee Ruling SGR 94/4, the Tax Office explained what ordinary time earnings are. In it, the Tax Office stated that if the ordinary hours of work are not specified or agreed, the ordinary hours of work will be the hours actually worked and any hours of paid leave.

In addition, the Ruling stated that ordinary hours of work are not limited to hours between 9am to 5pm, Monday to Friday, and could include night and weekend shifts.

The tables below, which are from the Ruling, summarise what earnings are and are not included in OTE.

Earnings which are included in ordinary time earnings

Types of earnings	**Reasons**
Directors' fees	Any fees paid for directors are payments for directors' ordinary hours of work.
Remuneration while on annual leave, sick leave or long service leave	Paid for an entitlement accrued on the basis of ordinary hours of work.
Allowances (not reimbursement of expenses)	Allowances are payments of a definite predetermined amount to cover estimated expenses. They are paid regardless of whether the employee incurs the expected expenses.
Bonuses calculated by reference to work undertaken/sales made during ordinary hours of work	These payments are paid in respect of ordinary hours of work.
Casual loading	These are payments for ordinary hours of work to reflect the lack of formal benefits associated with employment such as sick leave, annual leave, etc.
Top-up payments or accident make-up payments when the employee works	These are payments paid by the employer to the employee for actual hours acquired to attend or perform work.
Government (wages) subsidies	The employer should not deduct the subsidies to determine ordinary time earnings. The amount the employee receives in respect of ordinary hours of work is not affected by an amount the employer receives as a subsidy.
Over award payments (even if paid for work done outside ordinary hours of work)	An over award payment is the excess by which the actual rate paid to an employee exceeds the award rate.
Shift loadings (even if paid for work done outside ordinary hours of work)	A shift loading is an additional payment for employees who work shifts other than normal day shifts, and is paid as compensation for inconvenient working hours.
Commissions (even if paid for work done outside ordinary hours of work)	Commissions are any payments made to an employee on the basis of agreed performance criteria in relation to their work.

Earnings which are not included in ordinary time earnings

Types of earnings	Reasons
Overtime payments	These are paid for work performed outside ordinary hours of work.
Christmas bonuses	These are discretionary payments made as a free gift and not subject to negotiation.
Ex gratia payments	These payments do not form part of the OTE.
Payments in lieu of notice	These are paid for hours never worked.
Redundancy payments	Paid for non-transferable credits, inconvenience and hardship. No entitlement accrues during ordinary hours.
Payments not covered in the above table which are made by employer upon termination of employment	These are connected, not with ordinary hours of work, but with the end of ordinary hours of work. They should not be confused with payments for ordinary hours of work accumulated until the termination of employment.
Payments when made on maternity or paternity leave	These are payments made in respect of employment and parenthood, not in respect of ordinary hours of work.
Lump sums paid for accrued annual leave, accrued long service leave or accrued sick leave on termination of employment	The definition of OTE, which is contained in section 6 of SGAA, excludes these payments.
Workers' compensation payments	These are payments made in respect of employment, not ordinary hours of work.
Top-up payments or accident make-up payments when the employee does not work	Payments made to employees who do not attend or perform work are payments in respect of employment, not ordinary hours of work.
Top-up payments. For example, when serving on jury duty or reserve forces, etc.	These are payments made either by obligation or gratuitously, and are not in respect of ordinary hours of work.
Benefits subject to fringe benefits tax	These benefits are excluded from the definition of "salary and wages", and therefore cannot form part of OTE.
Payments by way of restraint of trade	These are paid for not exercising rights or freedoms. They are not paid in respect of ordinary hours of work.
Reimbursement of expenses	These are paid to compensate for expenses incurred by an employee rather than for ordinary hours of work.
Annual leave loading	This is paid in respect of employment, not ordinary hours of work.

Employer checklist

The Tax Office has suggested that employers may consider the following factors in preparing for the changes:

- reviewing the earnings base for all employees to ensure that their superannuation guarantee contributions are being calculated based on OTE;
- paying of employees bonuses should be included when calculating the superannuation guarantee contributions (but some exceptions apply, eg Christmas bonuses);
- paying of employees allowances should be included when calculating the superannuation guarantee contributions (there are exceptions for reimbursements or fully expended allowances);
- paying of employees commissions should be included when calculating the superannuation guarantee contributions;

- allowing for any cost impacts if the business is required to increase superannuation guarantee contributions for employees;
- ensuring accounting systems have been updated to handle the change in calculating the superannuation guarantee contributions; and
- devising and implementing strategies to inform employees of possible changes to their superannuation guarantee contributions.

Insurance requirements for employer-nominated super fund

From 1 July 2008, an employer-nominated super fund must offer minimum levels of life insurance death cover to its members. An employer-nominated super fund is the fund that an employer chooses to pay an employee's superannuation guarantee contributions to if the employee does not choose a fund.

The minimum level of life insurance cover must be:

- at a minimum $0.50 per week for employees under 56 years,
- at a level of cover as prescribed in the table below, or
- at a level of cover equivalent to the amount prescribed in the table below if the contributions are made to a defined benefit fund on behalf of a defined benefit member.

Age range	Minimum level of life insurance cover
0 to 19	Nil
20 to 34	$50,000
35 to 39	$35,000
40 to 44	$20,000
45 to 49	$14,000
50 to 55	$7,000
56+	Nil

However, an employer is not required to meet the life insurance requirements in some instances, such as if it is making contributions under a federal award or into a retirement savings account, or has arranged insurance either with another super fund or with an insurance provider, and it meets the requirements.

Employers can still contribute to a fund for an employee if the super fund they choose will not provide life insurance because of an employee's:

- high-risk occupation,
- health, or
- working hours (for example, some casuals).

SMSF and Acquisition of Assets

The Tax Office has released a Draft Self Managed Superannuation Funds Ruling SMSFR 2008/D2, which explains how the prohibition on a self-managed superannuation fund (SMSF) to acquire assets from a related party applies to contributions of assets to an SMSF by a member or a related party.

Under subsection 66(1) of SIS Act, a trustee or investment manager of an SMSF must not intentionally acquire an asset from a "related party" of the fund unless one of the limited exceptions under subsections 66(2) or 66(2A) applies to the acquisition (i.e. market value acquisitions of business real property, listed securities or an in-house asset (under the 5% limit)).

Related party of a SMSF

A "related party" of a superannuation fund is defined very broadly in section 10 of SIS Act to include a member of the fund or Part 8 associate of either a member or standard employer-sponsor. A "Part 8 associate" is defined widely to include a relative and entities that are majority owned or controlled by a member or a standard employer sponsor, partners and relatives.

Contributions of money

In the Commissioner's view, the term "acquire an asset" encompasses accepting a contribution of an asset. While an asset is defined to include any form of property (including money), section 66(5) makes it clear that the phrase "acquire an asset" does not include accepting money. Therefore, a trustee does not contravene section 66 by accepting contributions of money.

The Tax Office says a contribution of money may also include the contribution of a cheque or a promissory note that is not a commodity in its own right. However, the Tax Office states that the contribution of a promissory note that is traded as a commodity in its own right (i.e. it is an object of exchange and not a medium of exchange) is not a contribution of money. A contribution of collectable bank notes and coins, or a trade or barter of dollars is also not a contribution of money but an acquisition of an asset other than money.

Intention to acquire

The Draft Ruling states that whether a trustee intentionally means to acquire an asset from a related party is a matter that either requires direct proof (eg an admission) or may be established by drawing an inference from the relevant circumstances (eg the trustee's awareness of the likelihood that the party from whom the asset is acquired is a related party). The Tax Office says the relevant factors for considering whether an inference may be drawn that the trustee meant to acquire the asset from a related party include:

- an SMSF is invariably a small closely held fund such that the trustee is likely to know of the relationship between a contributing person or entity and the SMSF;
- whether the trustee has had previous dealings with the contributing person or entity; and
- the nature of the asset and whether it is likely to be contributed by an unrelated party of the SMSF. For example, it may be possible to infer that the trustee must have been aware that there was no possibility of shares in a closely held family company being contributed by an unrelated entity.

Acquired at market value

For most of the exceptions under subsections 66(2) and 66(2A) to apply to an acquisition of an asset, the asset must be "acquired at market value". The Commissioner considers that an excepted asset may also be acquired from a related party of the SMSF if the asset is partly purchased by, and partly contributed to, the SMSF.

Real property held as tenants in common

The Commissioner states that a trustee does not contravene subsection 66(1) by accepting a contribution of an interest in real property from a related party, which results in the SMSF and another related party holding the property as tenants in common, if:

- the interest acquired is business real property of the contributing related party; it is acquired by the SMSF at market value and the SMSF has fewer than 5 members (i.e. the exception in subsection 66(2)(b)) applies); or
- the interest acquired in the property is an in-house asset because it is subject to a lease or lease arrangement between the trustee of the SMSF and a related party (and therefore not excluded from the meaning of in-house asset under section 71(1)(i)), the interest is acquired at market value and the acquisition of the interest does not cause the SMSF to exceed the 5% market value ratio limit for in-house assets (i.e. subsection 66(2A)(a)(i) applies).

The Tax Office noted that it may perhaps have been thought that the absence of a reference to subsection 71(1)(i) in subsection 66(2A)(a)(iv) implies that the exceptions to section 66 do not apply at all to an asset consisting of an interest held as a tenant in common. However, the Commissioner does not take that view and instead states that the exceptions still apply if the acquisition satisfies the terms of the exceptions in another way.

Furthermore, the Tax Office says that if the interest acquired in real property is not an interest in business real property of the contributing related party and is not an in-house asset under subsection 71(1), a trustee contravenes subsection 66(1) by accepting a contribution of the interest, as there are no other exceptions that are relevant.

Other SIS Act issues

The Tax Office warns that the Draft Ruling does provide the Commissioner's views on how other SIS Act and SIS Regulations provisions apply to any of the arrangement discussed. Simply, such arrangements or transactions described in the Draft Ruling may still be prevented via the operation of:

- the sole purpose test (section 62);
- the prohibition on lending money to a member or relative (section 65);
- the prohibition on placing a charge over an SMSF asset (SIS Regulations 13.14);
- the prohibition on borrowing (section 67);
- arm's length dealings (section 109); or
- in-house asset rules (section 71).

When finalised, the Ruling will apply to SMSFs and former SMSFs for all income years.

Legal status of the Determination

The Ruling represents the Commissioner's views about the way in which provisions of the SIS Act, or regulations under that Act, apply to SMSFs.

The Ruling is not legally binding on the Commissioner. However, if the Commissioner later takes the view that the law applies less favourably to you than the Determination, the fact that a taxpayer acted in accordance with the Ruling would be a relevant factor in the Commissioner exercising his discretion as to what action to take in response to the breach of that law.

Overhaul of SMSF Tax Returns

From the 2007/08 income year onwards, self-managed super funds will have only one return to complete. The fund income tax return and regulatory return have been merged with the member contributions statement to produce a single annual return for self-managed funds. The new return is called the "SMSF annual return".

A brief overview of some of the key changes to the return is set out below.

Supervisory levy

Commencing from the 2007/08 income year, separate payment of the supervisory levy is no longer required. Rather, the levy will be included in a SMSF's notice of assessment and is due to be paid by the date stated on the notice of assessment. The levy is still payable even when a SMSF is in the pension phase.

The levy has increased from $45 to $150 per year starting from the 2007/08 income year.

Approved auditors and lodgment

The Tax Office has stated that an approved auditor must complete a compliance and financial audit before the SMSF annual return can be lodged. It will no longer accept as lodged a SMSF annual return that has not had its yearly audit completed.

Member information

The "Member information" is a new section in the return, which replaces the need for separate reporting of member contribution statements. The fund is required to report for all its members as at 30 June 2008, even if no contributions were received for the member during the income year. However, a fund is not required to report for members who left during the relevant income year.

Trustees questions

The Tax Office says that, for the first time, it will be asking trustees ongoing disclosure questions. The questions will include whether:

- the SMSF had/has financial involvement with related parties;
- the SMSF has lent money to members or their families ;
- the investments have been undertaken on an arm's length basis;
- the SMSF has allowed members access to assets and money before retirement;
- the trustees have paid themselves for their services;
- the SMSF received any non-cash contributions (known as "in-specie" contributions);
- the fund's trustees have become disqualified during the year;
- the SMSF has engaged in activities of selling goods and/or services;
- the assets are appropriately secured through appropriate documentation as owned by the SMSF; and
- the approved auditor has provided services other than auditing to the SMSF.

The Tax Office has stated that failure to provide answers may result in the fund's return not being accepted.

ECRP to Farmers

The Tax Office has released a Draft Determination stating that an exceptional circumstances relief payment (ECRP) paid to a farmer is not primary production income. The ECRO is ordinary income and therefore will be assessable as such.

It is the Tax Office's view that the source of an ECRP is the government. It is not income that is derived from, or results from, the carrying on of a primary production business. Therefore, it is not assessable primary production income under Division 392 of ITAA 1997.

The exclusion of the ECRP from assessable primary production income does not affect whether a tax offset is available or extra tax is payable under the income averaging provisions contained in Division 392. This is because an ECRP is included in both the key components to be compared – basic taxable income and average taxable income. However, after these amounts have been compared and it has been determined that a taxpayer is entitled to a tax offset or is liable to pay extra tax, the fact that an ECRP is not part of assessable primary production income affects the amount of tax offset or extra tax.

The Tax Office has stated that a taxpayer whose assessable income includes an ECRP is entitled to a beneficiary rebate. In addition, if the ECRP is supplemented by additional payments under the *Social Security Act 1991* by way of rental assistance and remote area allowances, these payments are exempt income.

When finalised, the Determination will apply to all income years.

Stapled Security Sold at a Loss

In the March 2008 issue, we wrote about Tax Alert TA 2008/1, which warned taxpayers investing in certain stapled securities involving notes and preference shares that the Tax Office was considering whether a deduction is available on the disposal of the stapled securities at a loss. The Tax Office has followed up on the Alert with the release of a Draft Determination, TD 2008/D6.

The Draft Determination states that a taxpayer is not entitled to a tax deduction under subsection 70B(2) of ITAA 1936 where a stapled security of the kind described in Taxpayer Alert TA 2008/1 is sold at a loss or upon the occurrence of an Assignment Event. (see the EM accompanying the March 2008 issue.)

The Commissioner has carefully considered the arrangement, and has concluded that the stapled security is a single instrument for the purposes of subsections 26BB and 70B. Furthermore, the Draft Determination says neither the note nor the stapled security, as a whole, is a traditional security for the purposes of section 70B.

Accordingly, the Tax Office says, for taxpayers who do not acquire and sell the stapled security in the ordinary course of business, a profit from the disposal of the stapled security by way of a sale is assessable as a capital gain, rather than as statutory income under section 26BB. Likewise, a loss from the sale of the stapled security is a capital loss that can be offset against capital gains of the taxpayer, rather than a loss on revenue account under section 70B.

However, according to the Tax Office, a taxpayer who acquires and sells stapled securities in the ordinary course of business will be entitled to a deduction for a loss incurred on the sale of the stapled security under section 8–1 of ITAA 1997 if a loss is incurred. Likewise, if a profit is made from the sale of the stapled security in the ordinary course of business, it will be assessable under section 6–5 of ITAA 1997.

A taxpayer will not derive any gain or incur a loss upon the occurrence of an assignment event, as there is no disposal of the stapled security at this time, the Draft TD stated.

The Commissioner stated that because a taxpayer is not entitled to a deduction under section 70B, therefore the arrangement will not give rise to a tax benefit within the meaning of Part IVA. However, if a taxpayer is entitled to a deduction under section 70B, the Commissioner may consider whether Part IVA applies to cancel the deduction. If the Commissioner concludes, based upon the facts of the particular stapled security arrangement, that there was a scheme entered into for the sole or dominant purpose of obtaining a tax benefit (being the allowable deduction under section 70B), he may determine that Part IVA applies.

FBT Rates for 2008/09

In five related but separate Taxation Determinations, the Tax Office has released the FBT thresholds and rates for the 2008/09 FBT year (i.e. the FBT year commencing on 1 April 2008).

Taxation Determination TD 2008/3

In this Determination, the Tax Office states the amounts which it accepts as the reasonable food component of a living-away-from-home allowance for expatriate employees for the 2008/09 FBT year (for larger family groupings, add $127 for each additional adult and $62 for each additional child):

	Per week
One adult	$211
Two adults	$388
Three adults	$379
One adult and one child	$273
Two adults and one or two children	$379
Two adults and three children	$442
Three adults and one child	$442
Three adults and two children	$505
Four adults	$505

Taxation Determination TD 2008/4

In this Determination, the Tax Office states the rates to be applied on a cents-per-km basis for calculating the taxable value of a fringe benefit arising from the private use of a motor vehicle other than a car for the 2008/09 FBT year. The rates are:

Engine capacity	Rate per kilometre
0 – 2,500cc	42 cents
Over 2,500cc	51 cents
Motor cycles	13 cents

Taxation Determination TD 2008/5

In this Determination, the Tax Office states the indexation factors in the valuing of non-remote housing for the purpose of section 28 of *Fringe Benefit Assessment Act 1986* for the 2008/09 FBT year:

State/Territory	Indexation factor
New South Wales	1.045
Victoria	1.044
Queensland	1.073
South Australia	1.041
Western Australia	1.097
Tasmania	1.054
Australian Capital Territory	1.059
Northern Territory	1.072

Taxation Determination TD 2008/6

The small business record-keeping exemption threshold for the 2008/09 FBT year is $6,766 ($6,614 for the 2007/08 FBT year), the Determination stated.

Taxation Determination TD 2008/7

This Determination states that the benchmark interest rate for the FBT year that commenced on 1 April 2008 is 9% per annum (up from 8.05% previously). The rate is used to calculated the taxable value of:

- a fringe benefit provided by way of a loan; and
- a car fringe benefit where an employer chooses to value the benefit using the operating cost method.

Social Security Deeming Rates

The deeming rates for social security payments have increased by 0.05% from 20 March 2008. The new deeming rates are:

- 4% for the first $39,400 of a single pensioner's financial investments ($65,400 for pensioner couples and $32,700 for each member of an allowee couple); and
- 6% for financial investments above those amounts.

Until 20 March 2008, the below threshold rate was 3.5% and the above threshold rate was 5.5%.

Cents per Kilometre Rates

The Tax Office has released the cents per kilometre rates to be used for calculating deductions for car expenses for the 2007/08 income year. The rates for the current income year did not change from the 2006/07 rates and are as follows:

Description	Engine capacity non-rotary engine (cc)	Engine capacity rotary engine (cc)	Rate per kilometre (cents)
Small car	0 – 1,600	0 – 800	58.0
Medium car	1,601 – 2,600	801 – 1,300	69.0
Large car	2,601 +	1,301 +	70.0

GIC and SIC Rates Released

The Tax Office has released the general interest charge and shortfall interest charge rates for the fourth quarter of the 2007/08 income year. The rates are:

Rate	Annual (%)	Daily (%)
GIC	14.69	0.04013661
SIC	10.69	0.02920765

The Tax Office has also released the interest rate for overpayments, early payments and delays in refunds for the fourth quarter of the 2007/08 income year. The applicable interest rate is 7.69%.

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