client alert | explanatory memorandum

November 2008

Tax Laws Amendment (2008 Measures No. 5) Bill

On 25 September 2008, the Government introduced Tax Laws Amendment (2008 Measures No. 5) Bill 2008 into the House of Representatives. The Bill seeks to amend the:

- GST provisions relating to the sale of real property;
- thin capitalisation regime in relation to the use of accounting standards for identifying and valuing an entity's assets, liabilities and equity capital;
- interest withholding tax regime by extending the eligibility for exemption to bonds issued in Australia by state and territory central borrowing authorities;
- FBT provisions to ensure that the 'otherwise deductible rule' applies to benefits provided in relation to investments that an employee holds jointly with a third party; and
- streaming and modernising of the eligible investment business rules for managed funds as contained in Division 6C of ITAA 1936.

A brief discussion of some of the amendments contained in the Bill follows.

GST and sale of real property

The Bill will amend the *A New Tax System (Goods and Services Tax) Act 1999* (GSTA) to ensure the interaction between the margin scheme provisions and:

- the sale of business as a going concern (Subdivision 38–J of GSTA);
- the sale of farm land (Subdivision 38–O of GSTA); and
- the general anti-avoidance provisions (Division 165 of GSTA)

does not allow property sales to be structured in a way that results in GST not applying to the value added to real property on or after 1 July 2000 by an entity.

Broadly, these amendments will seek to ensure:

- the GST liability on the sale of a real property calculated under the margin scheme will include the value added by the entity which made the original supply;
- the eligibility to use the margin scheme cannot be reinstated by interposing a GST-free or non-taxable supply; and
- the GST general anti-avoidance provisions can apply to contrived arrangements with the sole or dominant purpose of obtaining a GST benefit.

Calculation of GST liability

The Bill will insert provisions into the GSTA to ensure that if an entity sells real property under the margin scheme, the entity's GST liability is calculated on the value added (i.e. the difference between the acquisition price and the selling price) and the value added to the property by the entity from which it acquired the property (i.e. the difference in the entity's purchase price and the previous entity's selling price). However,

the entity is only required to calculate its GST liability under these provisions if the property was acquired as a going concern, as a GST-free farmland or as a non-taxable supply.

The Explanatory Memorandum provides the following example:

> A is registered for GST, and held land before 1 July 2000 valued at $110,000. A sells the land to B for $165,000. The margin scheme is applied to this sale. A's GST liability is based on A's value added.
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> B begins operating an enterprise of construction and sale of a unit complex, and later sells the construction site as part of a going concern to C. Because B and C agree to treat the supply as a GST-free going concern, B pays no GST on the sale price of $440,000 for the site.
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> By interposing a GST-free sale, the tax on B's value added becomes payable on C's sale. This potential tax liability was contemplated by the parties when they negotiated the GST-free sale price. At the time of the GST-free sale, C could ensure that the necessary documentation evidencing B's acquisition price of the real property was obtained.
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> C completes the construction and sells it to D for $495,000, applying the margin scheme. In calculating the margin for the sale, C subtracts B's acquisition price of $165,000 from C's final sale price of $495,000. This results in a margin of $330,000 for this supply. C pays $30,000 in GST to the Tax Office.
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> This is equivalent to the outcome that would have been obtained had B sold the property to C under the margin scheme. In this case B would have paid GST of $25,000, based on B's margin of $275,000 ($440,000 – $165,000). C would have paid $5,000 GST, based on C's margin of $55,000 ($495,000 – $440,000). The total GST collection from B and C would still have been $30,000.

Ineligibility for margin scheme

The Bill will amend the GSTA to ensure a supply of real property by an entity will be ineligible for the margin scheme if:

- the interest, unit or lease in the property was acquired GST-free either under Subdivision 38–J of GSTA (sale of business as a going concern) or under Subdivision 38–O of GSTA (sale of farm land);
- the previous supplier was registered or required to be registered at the time of the acquisition by the entity; and
- the previous supplier had acquired the entire interest, unit or lease through a taxable supply on which the GST was worked out without applying the margin scheme.

The ineligibility to use the margin scheme will also be extended if:

- the interest, unit or lease in the property was acquired from an associate without consideration;
- the associate was registered or required to be registered at the time of the acquisition by the entity;
- the supply by the associate was not a taxable supply;
- the associate made the supply in the course or furtherance of an enterprise that is carried on; and
- the associate had acquired the entire interest, unit or lease through a taxable supply on which the GST was worked out without applying the margin scheme.

If the acquisition from the associate was not by means of a supply by the associate, the ineligibility will still apply. However, the requirements that the supply was not a taxable supply and made in the course of furtherance of the associate's enterprise do not apply.

The amendments will require an entity to 'look back' through one transaction to determine its eligibility to use the margin scheme (look back test). That is, the entity must look back at the preceding acquisition of the real property.

General anti-avoidance

The Bill will amend Division 165 of GSTA to ensure that a GST benefit is not attributable to the making of a choice, election, application or agreement if a scheme was entered into for the sole or dominant purpose of creating a circumstance or state of affairs necessary to enable the choice, election, application or agreement to be made by inserting a new section.

The new section requires a conclusion to be drawn on whether the sole or dominant purpose of the arrangement was to obtain a GST benefit. However, the section will be limited in its potential application to arrangements that are artificial or contrived in nature.

Date of effect

The amendments will apply from the date that the Bill receives Royal Assent.

(Note that the measure was previously announced in the 2008/09 Federal Budget.)

The margin scheme

Broadly, the margin scheme allows the calculation of the GST liability attached to certain taxable supplies of real property to be based not on the amount of consideration for the supply (as is the general liability rule), but on the difference between the consideration for the supply and the cost of its acquisition (i.e. the so-called margin on the sale). See Division 75 of GSTA.

FBT and jointly held assets

The No. 5 Bill will amend the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) to ensure that if an employer provides an employee and an associate of the employee with a fringe benefit in relation to a jointly held investment asset (e.g. a low interest or low reimbursement of expenses related to a rental property), the employee's FBT liability on the taxable value of the fringe benefit will be limited to the employee's share of the fringe benefit used for income producing purposes.

The Bill will insert a new provision into the otherwise deductible rule for loan fringe benefits, expense payment fringe benefits, property fringe benefits and residual fringe benefits (in subsections 19(1), 24(1), 44(1) and 52(1) of FBTAA). This new provision will ensure that if a fringe benefit provided jointly to an employee and his or her associate is deemed by subsection 138(3) of FBTAA to be provided solely to the employee, the taxable value of the benefit is only reduced by the employee's share of the benefit (measured by reference to the employee's percentage of interest in the income producing asset or thing, whether tangible or intangible, to which the benefit relates).

Background to proposed amendments

In *National Australia Bank Ltd v. FCT* (1993) 26 ATR 503, the Federal Court held that, if an employer provides a low interest loan jointly to an employee and their associate (the employee's spouse in that case), the 'otherwise deductible' rule in section 19 of FBTAA operates to reduce the taxable value of the loan fringe benefit to nil so that the employer has no FBT liability arising from the loan fringe benefit provided to both the employee and their associate. This is because subsection 138(3) deems a benefit provided jointly to an employee and one or more associates of the employee to be provided solely to the employee.

The NAB decision led to arrangements involving expense payment fringe benefits where a spouse on a higher marginal tax rate salary sacrifices his or her income by an amount equivalent to the joint rental expenses. This allows the spouse on the higher marginal tax rate, through a salary reduction, to effectively claim a deduction for all the rental expenses despite owning only a share in the property.

Date of effect

The amendments will apply from 7.30 pm (AEST) on 13 May 2008.

(Note that the measure was previously announced in the 2008/09 Federal Budget.)

Transitional provisions

For loans entered into before 7.30 pm (AEST) on 13 May 2008, the existing law will continue to apply to loan benefits provided before 1 April 2009.

For expense payment benefits, property benefits and residual benefits provided under a salary sacrifice arrangement, the changes will apply to agreements entered into after 7.30 pm (AEST) on 13 May 2008. For agreements entered into before this time, employees will be able to utilise the current law until 1 April 2009.

Definition of associates for FBT

The meaning of an 'associate' for FBT purposes is given by section 318 of ITAA 1936. The term is broadly defined in section 318 of ITAA 1936 and includes a spouse (whether legally married or a de facto), a relative, and the spouse or a child of a relative. The term 'relative' includes parents, grandparents, brothers, sisters, uncles, aunties, nephews, nieces, linear descendents or adopted children of the individual or the individual's spouse. The definition also covers a partnership in which the employee is a partner and the other partners, a trustee of a trust where the employee or associate of the employee is a beneficiary or potential beneficiary, and a company controlled by the employee or an associate of the employee.

Besides the 'standard' definition of associate found in section 318, section 159 of FBTAA 'extends' the definition of associate for FBT purposes. Subsection 159(2)(a) states that a company that is related to another company is deemed to be an associate of that other company. Further, section 159(4) states that where the composition of a partnership changes, the new partnership is also an associate of the old partnership.

It is paramount to realise that for FBT purposes, a third party can be deemed as an associate of an employee. This is achieved through the deeming provision in subsection 148(2) of FBTAA:

> ' … Where, in respect of the employment of an employee, a benefit is provided by a person (in this subsection referred to as the 'provider') to a person other than:
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> (a) the employee; or
>
> (b) a person who, but for this subsection, is an associate of the employee,
>
> under an arrangement between –
>
> (c) the provider, the employer or an associate of the employer; and
>
> (c) the employee or a person who, but for this subsection, is an associate of the employee,
>
> the recipient of the benefit shall be deemed to be an associate of the employee …'

Put simply, a third party is deemed an 'associate' for FBT purposes if he or she receives a benefit under an arrangement between the employer and the employee. In ATO ID 2003/7, the Tax Office stated that the same-sex partner of an employee is deemed to be an associate for the purposes of section 148(2). The operation of subsection 148(2), arguably, requires that an arrangement exist between the employer (who can also be the provider of the benefit) and the employee or an associate of the employee.

The term 'arrangement' is defined in subsection 136(1) of FBTAA and includes any agreement, understanding, promise or undertaking, whether express or implied, and whether legally enforceable or not. Further, an arrangement includes a scheme, plan, proposal or course of action even if unilateral. However, whether an arrangement exists pursuant to subsection 148(2) will depend upon the circumstances of each case.

Education Tax Refund

On 25 September 2008, the Government introduced Tax Laws Amendment (Education Refund) Bill 200*8* into the House of Representatives. The Bill will amend the ITAA 1997 by introducing a 50% refundable tax offset for eligible education expenses (the Education Tax Refund) up to a maximum of $750 for children undertaking primary studies and $1,500 for children undertaking secondary studies.

The proposed Education Tax Refund is structurally similar to the initial measure announced by the Government, as discussed in the February 2008 and June 2008 issues of this report.

Families receiving Family Tax Benefit (FTB) Part A payments will be eligible for the refund. In addition, those who would be eligible for FTB Part A in respect of a child but, for the fact that they or the child are in

receipt of other payments such as Youth Allowance, Disability Support Pension or ABSTUDY Living Allowance, are also eligible for the Education Tax Refund. Students who are living independently from their parents may also be eligible for the Education Tax Refund for their own expenses. Eligible families will be able to claim the 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);
- 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' is 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 (establishing and maintaining costs);
- printers;
- education software; and
- school text books.

However, school fees have been excluded as an eligible item.

If a taxpayer has an 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. For those not required to lodge an income tax return, they will be able to access their entitlement to the offset through the Tax Office by lodging a separate form at the end of the 2008/09 financial year.

Date of effect

The tax offset will apply to eligible expenses incurred from 1 July 2008.

Medicare Levy Surcharge Threshold

The Tax Laws Amendment (Medicare Levy Surcharge Thresholds) Bill 2008 has been rejected by the Senate on 24 September 2008. However, the Government has introduced Tax Laws Amendment (Medicare Levy Surcharge Thresholds) Bill (No. 2) 2008 into the House of Representatives on 25 September 2008.

The Bill (No. 2) will seek to increase the Medicare levy surcharge threshold:

- for individuals from $50,000 to $75,000 which will be indexed annually to Average Weekly Ordinary Time Earnings (AWOTE) in $1,000 increments; and
- for families, from $100,000 to $150,000, and going forward will be double the single threshold. (Note that the family threshold remains unchanged from the original Bill.)

Transitional provisions

The Bill (No. 2) contains transitional arrangements so that individuals who have insurance policies that provide private patient hospital cover before 1 January 2009 will avoid the levy surcharge for the period 1 July 2008 to 31 December 2008.

Date of effect

The increased thresholds are still proposed to apply from the 2008/09 income year.

Luxury Car Tax

The package of four Bills (A New Tax System (Luxury Car Tax Imposition — Excise) Amendment Bill 2008, A New Tax System (Luxury Car Tax Imposition — Customs) Amendment Bill 2008, A New Tax System (Luxury Car Tax Imposition — General) Amendment Bill 2008 and Tax Laws Amendment (Luxury Car Tax) Bill 2008) that proposed to increase the luxury car tax (LCT) rate from 25% to 33% from 1 July 2008 received Royal Assent on 3 October 2008.

Broadly, the Tax Laws Amendment (Luxury Car Tax) Bill 2008 as passed contained the following amendments:

1) ***exempting fuel-efficient vehicles that do not exceed the fuel-efficient car limit from the LCT*** – A fuel-efficient vehicle is defined as a vehicle with a fuel consumption not exceeding seven litres per 100 kilometres. The fuel-efficient car limit will be indexed annually. For the 2008/09 income year, the limit is $75,000. According to the Revised Supplementary Explanatory Memorandum accompanying the Bill, the depreciation limit and GST input tax credits for fuel-efficient vehicles are based on the car limit ($57,180 for 2008/09).

2) ***refunding the increase in the LCT to eligible primary producers and tourism operators*** – That is, farm vehicles and vehicles used by tourism operators in carrying tourists for 'tourist activities' may be eligible for a refund of the LCT. Vehicles eligible for the refund are 4-wheel drives or all-wheel drives specified in regulations to be made. The amount of the refund is the lesser of:

   (i) 8/33rds of the LCT borne by the primary producer or tourism operator; and

   (ii) $3,000.

   Primary producers are eligible for a refund in respect of one vehicle in a financial year. Refunds must be claimed within four years of becoming so entitled.

   The refund amendments apply to taxable supplies of luxury cars and taxable importations of luxury cars on or after 1 July 2008. (Note that the term 'tourist activities' is to be defined in the regulations.)

3) ***indexing of the LCT threshold*** – From 1 July 2012, the LCT threshold will be indexed to the CPI method provided for by Subdivision 960–M of ITAA 1997, unless Parliament decides on another indexation factor. Currently, the LCT threshold is indexed using the motor vehicle purchase component of the CPI.

4) ***removing back-dating of the amendments*** – vehicles ordered before 7.30 pm by legal time in the ACT on 13 May 2008 but not delivered until after 1 July 2008 are not subjected to the increased tax.

Tax Laws Amendment Update

Tax Laws Amendment (2008 Measures No. 3) Bill 2008 received Royal Assent on 20 September 2008 as Act No. 91 of 2008. The Bill, which was discussed in the July 2008 issue, contained amendments concerning:

- amendments to shareholder and unitholder rights to restore the original tax treatment of rights issued by companies to shareholders to acquire additional shares to overcome the impact of the High Court decision in *FCT v. McNeil* (2007) 64 ATR 431; and

- restriction on GST refunds and time limits for recovery and refund of indirect tax. The amendments arise as a result of the Federal Court decision in *KAP Motors Pty Ltd v. FCT* (2008) 68 ATR 927. The Bill also amended the *Taxation Administration Act 1953* to correct a deficiency in the GST refund restriction provisions and addressed deficiencies in the four-year time limit on indirect tax liabilities.

Borrowings of Money and SMSFs

The Tax Office has released Draft Self Managed Superannuation Funds Ruling SMSFR 2008/D4, which states the Commissioner's preliminary view on the meaning of the phrases 'borrow money' or 'maintaining an existing borrowing of money' for the purposes of section 67 of the *Superannuation Industry (Supervision) Act 1993* (SISA). The Draft also states how the application of the meaning of these phrases to a borrowing

arrangement will determine whether a trustee of a self-managed superannuation fund (SMSF) has contravened the general prohibition on borrowing in subsection 67(1).

Borrowing money

The Draft states that the phrase 'borrow money' takes on its ordinary meaning as read in the context of the SISA. The Draft also states that the prohibition and exceptions in section 67 only applies to borrowings of money. It further states that a borrowing is an arrangement that exhibits two necessary characteristics:

- a temporary transfer of money from one entity (the lender) to another (the borrower); and
- an obligation or an intention by the borrower to repay the money to the lender, which may be satisfied by the provision of an asset.

It is the Commissioner's view that whether an arrangement contravenes section 67 requires an objective analysis of all the circumstances surrounding the arrangement and does not depend on the label ascribed to it. Therefore, the Commissioner says that it is necessary to discover the true substance of an arrangement, having regard to its purpose and by reference to its legal nature rather than its economic effect.

The Draft states that where it is determined that an SMSF trustee has borrowed money or has maintained an existing borrowing of money, it is necessary to determine whether any of the exceptions in section 67 apply.

The Draft provides nine examples of common arrangements and whether these arrangements will contravene section 67:

- monies advanced by members for an SMSF to acquire assets;
- overdrafts maintained by an SMSF;
- contributions by members for an SMSF to acquire assets;
- margin lending account maintained by an SMSF;
- investing in contracts for difference by an SMSF;
- payments made on behalf of an SMSF;
- reimbursement of payments made on behalf of an SMSF;
- deferred repayment of amount paid on behalf of an SMSF; and
- instalment purchase agreement entered into by an SMSF.

Maintaining an existing borrowing of money

The Draft states that the phrase 'maintaining an existing borrowing of money' takes on its ordinary contextual meaning and must be construed as a whole within the statutory context in which it appears. Therefore, the Draft states that an existing borrowing is maintained if a borrowing arrangement previously entered into remains in place where an SMSF trustee is obliged or intends to repay the money lent. The Draft also states that the prohibition to maintain an existing borrowing extends to arrangements where an SMSF trustee undertakes obligations with respect to amounts borrowed by other parties, regardless of whether an amount has been received in consideration for undertaking the borrower's obligations.

In the Commissioner's view, if an original loan is refinanced, a new separate borrowing has been entered into. The Commissioner also considers that each drawdown of funds from a loan facility or similar arrangement constitutes a separate borrowing, even if the facility or arrangement makes provisions for redraws arising from earlier repayments.

Definition of money

The Draft states that the term 'money' is any generally accepted medium of exchange of goods, services, or the payment of debts that confers complete liquidity on its holder. It also states that 'money' includes cheques and other equivalent negotiable instruments (e.g. bills of exchange and promissory notes). It further states that the term includes both Australian and foreign currency.

Other issues

The Draft does not provide the Commissioner's views on how other provisions of the SISA or the Superannuation Industry (Supervision) Regulations 1994 (SISR) apply to an arrangement. Therefore, the Draft emphasises that a trustee of an SMSF must also consider any other relevant provisions including:

- the sole purpose test under section 62 of SISA;
- the trustee's duties under section 52 of SISA; and
- prohibition on placing a charge over fund assets under regulation 13.14 of SISR.

Legal status of the Ruling

An SMSF Ruling, whether draft or final, represents the Commissioner's views about the way in which provisions of the SISA, or regulations under that Act, apply to SMSFs.

An SMSF Ruling is not legally binding on the Commissioner. However, if the Commissioner later takes the view that the law applies less favourably to a taxpayer than the Ruling, the fact that the 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.

Restriction on borrowings

Section 67 of SISA prohibits a trustee of a regulated fund (including an SMSF) from borrowing money or maintaining an existing borrowing. However, subsection 67(2) provides exceptions for temporary purposes. A borrowing is not prohibited by section 67 if:

- the purpose of the borrowing is to enable the trustee to make a payment to a beneficiary in accordance with a requirement of law or the fund's governing rules, and which payment the trustee could not make without effecting the borrowing;
- the period of the borrowing does not exceed 90 days; and
- if the borrowing were to take place, the total amount borrowed by the trustee would not exceed 10% of the value of the assets of the fund.

Subsection 67(3) provides a further limited exception to subsection 67(1) to cover situations where the trustee borrows in order to settle on the acquisition of certain financial instruments such as bonds, shares, units, futures contracts and other types of instruments detailed in subsection 67(3)(a). The borrowing for this purpose must not have been foreseen when the relevant investment decision was made, and the period of the borrowing must not exceed seven days. Again the borrowings must, in total, not exceed 10% of the value of the fund's assets.

APRA Superannuation Circular No II.D.4 'Borrowing by Superannuation Entities' contrasts what is a borrowing with other debts that may be incurred by a superannuation fund. Examples given in the Circular of what would not constitute borrowings include:

- amounts payable by a fund for expenses incurred by the fund;
- financial leasing arrangements and hire purchase transactions in general;
- the liability of a fund to pay benefits as they fall due; and
- pre-paid contributions, provided such were properly characterised at the time of payment as being contributions.

The Circular also points out that investments by a fund in units in a unit trust which itself borrows would not breach the borrowing rules of the SISA.

Borrowings and instalment warrants

Since 24 September 2007, superannuation funds are permitted to borrow money to invest in instalment warrants arrangements of a limited recourse nature over any asset a fund would be permitted to invest in

directly: subsection 67(4A) of SISA. However, the Tax Office and APRA formed the view that traditional instalment warrants entail a prohibited borrowing under section 67 of SISA and amount to an in-house asset.

Under subsection 67(4A) of SISA, an exception to the prohibition on borrowing allows a superannuation fund trustee to borrow money in accordance with an arrangement that has the following features:

- the borrowing is used to acquire an asset that is held on trust so that the superannuation fund trustee receives a beneficial interest and a right (but not an obligation) to acquire the legal ownership of the asset (or any replacement) through the payment of instalments;
- the lender's recourse against the superannuation fund trustee in the event of default on the borrowing and related fees, or the exercise of rights (typically a put option) by the fund trustee, is limited to rights relating to the asset. These rights may include taking possession of, or disposing of, the asset (A put option is a type of financial instrument commonly referred to as a derivative. Broadly, it is an agreement between parties to exchange ownership of a share at an agreed upon price within a certain time period.); and
- the asset (or any replacement) must be one which the superannuation fund trustee is permitted to acquire and hold directly. While the asset may be any asset (e.g. real property, listed securities or artwork in certain circumstances), the existing investment restrictions (e.g. in-house assets and acquiring certain assets from a related party) continue to apply.

While the amendments mean that certain instalment warrants will not breach the prohibition on borrowings, an instalment warrant investment must still comply with other superannuation rules, e.g. it must not result in fund assets being subject to a charge.

In Taxpayer Alert TA 2008/5, which was discussed in the June 2008 issue, the Tax Office stated its concern with arrangements under which the trustee of an SMSF enters into certain limited-recourse borrowings, which may not meet the conditions in subsection 67(4A) and/or breach other provisions of the SISA, as well as related superannuation rules.

Death Binding Nominations and SMSFs

The Tax Office has released Draft Self Managed Superannuation Funds Determination SMSFD 2008/D1, which states the Commissioner's preliminary view on whether there are any restrictions in the *Superannuation Industry (Supervision) Act 1993* (SISA) or Superannuation Industry (Supervision) Regulations 1994 (SISR) on a trustee of a self-managed superannuation fund (SMSF) from accepting a death binding nomination from a member nominating the recipients of any benefits payable in the event of the member's death.

The Draft states that section 59 of SISA and regulation 6.17A of SISR do not apply to SMSFs. Therefore, the governing rules of an SMSF may permit members to make death benefit nominations that are binding on the trustees, whether or not in circumstances that accord with the rules in regulation 6.17A. However, the Draft states that a nomination is not binding on the trustee if it nominates a person who cannot receive a benefit in accordance with the operating standards in SISR. The Draft further states that a member's death benefits must be cashed in, in favour of the member's legal personal representative and/or the member's dependants as defined in subsection 10(1) of SISA, subject to certain exceptions.

The Draft states that while subsection 59(1) provides a prohibition against the governing rules of a superannuation fund permitting a discretion to be exercised by a person other than the trustee, subsection 59(1A) provides an exception. The Draft further states that for the exception to apply, a fund must satisfy any regulations made for the purpose of subsection 59(1A). In particular, regulation 6.17A requires a trustee to give a member seeking to make a death benefit nomination certain information to assist the member understand his or her rights in relation to the nomination. However, the Draft acknowledges that this regulation has little relevance to the administration of SMSFs whose management and membership is essentially the same people. Therefore, the Draft states that subsection 59(1A) has no application to SMSFs and consequently regulation 6.17A does not apply to SMSFs. Accordingly, as section 59 does not apply to SMSFs, a member of an SMSF is able to make a binding death benefit nomination in a different manner and form to that in regulation 6.17A, provided the governing rules of the SMSF permits such a nomination.

Death binding nominations

A death binding nomination is a legal instrument that 'binds' a trustee of a superannuation fund to distribute the superannuation benefits of a deceased member to the beneficiary (or beneficiaries) stated in the nomination. It is of paramount importance that if a member of an SMSF is considering making a death binding nomination, the member should be familiar with the definition of 'dependant' and to whom superannuation benefits can be cashed.

In absence of a nomination, a trustee of an SMSF has the discretionary power in determining how a member's superannuation benefits should be distributed in accordance with the trust deed, trust law and the superannuation legislation: see sections 55A and 31 of SISA. However, if the rules in the trust deed are inconsistent with the superannuation legislation, the latter will prevail: subsection 55A(2).

A nomination must be signed and dated in the presence of two witnesses, who are over the age of 18 years and are not nominated beneficiaries. Further, the nomination is only valid for a maximum of three years.

Legal status of the Determination

An SMSF Determination, whether draft or final, represents the Commissioner's views about the way in which provisions of the SISA, or regulations under that Act, apply to SMSFs.

An SMSF Determination is not legally binding on the Commissioner. However, if the Commissioner later takes the view that the law applies less favourably to a taxpayer than the Determination, the fact that the taxpayer acted in accordance with the Determination 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.

Death benefits dependant

The term 'dependant' is defined differently in the SISA and the ITAA 1997. A dependant is defined in section 10 of SISA as 'the spouse of the person, any child of the person and any person with whom the person has an interdependency relationship'. Whereas, a death benefits dependent of a deceased member is defined in section 302-195 of ITAA 1997 as:

- the deceased member's spouse or former spouse, including a current de facto;
- the deceased member's child aged less than 18 years old;
- any person with whom the deceased member had an 'interdependency relationship' (as defined in section 302–200 of ITAA 1997) just before he or she died; or
- any other person who was a dependant (according to its ordinary meaning) of the deceased just before he or she died.

The ordinary meaning of the term 'dependant' includes someone who is financially dependant on the person.

From 2008/09, same–sex couples and their children will be treated the same as opposite-sex couples and their children in relation to death benefits.

Tax treatment of superannuation death benefits

The tax treatment of a superannuation death benefit will depend on:

- whether the recipient of the benefit is a 'death benefits dependant';
- whether the death benefit is a superannuation lump sum or superannuation income stream;
- the components of the superannuation benefit, i.e. the tax-free component or taxable component;
- whether the superannuation benefit contains an element untaxed in the fund; and
- in the case of income streams, the age of the deceased when they died (or in some cases the age of the recipient of the death benefit income stream).

Broadly, the tax treatments for superannuation lump sum death benefits and superannuation income stream death benefits are set out below:

Superannuation lump sum death benefits

Component	Payment to dependant	Payment to non-dependant[1]	
		Element taxed in the fund	Element untaxed in the fund
Tax-free component	Tax-free	Tax-free	Tax-free
Taxable component	Tax-free	15%	30%

1. The tax rates specified are the maximum rates of tax. The entire taxable component of the lump sum death benefit is included in the non-dependent recipient's assessable income and a tax offset applies to effectively cap the maximum tax rate. Medicare levy of 1.5% is also payable.

Superannuation income stream death benefits

Age of deceased	Age of dependant recipient[1]	Tax-free component	Taxable component[2]	
			Element taxed in the fund	Element untaxed in the fund
60+	Any age	Tax-free	Tax-free	Marginal rate (10% tax offset)
0 – 59	60+	Tax-free	Tax-free	Marginal rate (10% tax offset)
0 – 59	0 – 59[3]	Tax-free	Marginal rate (15% tax offset)	Marginal rate (no tax offset)

1. Since 1 July 2007, a superannuation income stream death benefit can only be paid as a lump sum to a non-dependent. Death benefit income streams payable to non-dependants that commenced prior to 1 July 2007 continue to be taxed as if received by a dependant.
2. The entire taxable component of the income stream death benefit is included in the non-dependant recipient's assessable income and a tax offset applies where indicated. Medicare levy of 1.5% is also payable.
3. A death benefit income stream paid to a dependant child must be commuted to a lump sum (tax-free) when the child turns 25, unless the child is permanently disabled.

Exempt Fringe Benefits

The Tax Office has issued two separate but related ATO IDs that states its view on the application of the exempt fringe benefits provisions contained in section 58X of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA).

GPS navigation device

In ATO ID 2008/133, the Tax Office states that a GPS navigation receiver is a portable electronic device for the purposes of subsection 58X(2)(a) of FBTAA.

As the term 'portable electronic device' is not defined in the FBTAA, the Tax Office states that the term takes on its ordinary meaning. The Tax Office also states that the meaning of a 'portable electronic device' is limited to a device that is easily carried by hand and is based on electronics. The Tax Office further states that for a device to qualify as a 'portable electronic device' under subsection 58X(2)(a), it must possess four primary characteristics:

- easily portable and designed for use away from an office environment;
- small and light;
- operate without an external power supply; and
- designed as a complete unit.

The ATO ID notes that before a conclusion can be drawn as to whether or not the benefit relating to the provision of the GPS navigation receiver is an exempt benefit under section 58X, a taxpayer must consider the other requirements contained in that section.

Eligible work related items

It is of paramount importance to realise that the Tax Office's view contained in the ATO ID is based on the current section 58X, as amended by *Tax Laws Amendment (Budget Measures) Act 2008*. The amendments in that Act took effect from 7.30 pm (AEST) on 13 May 2008 other than items acquired under a contract entered into at or before that time. In particular, the eligible work related item that qualified under section 58X was rewritten with the introduction of the amendments:

Current section 58X	Former section 58X
• a portable electronic device • an item of computer software • an item of protective clothing • a briefcase • a tool of trade	• a mobile phone or car phone • an item of protective clothing • a briefcase • a calculator • a tool of trade • an item of computer software • an electronic diary, a laptop computer or a similar portable computer • a portable printer designed for use with a notebook computer, a laptop computer or a similar portable computer

Primarily for use in employee's employment

In ATO ID 2008/127, the Tax Office states that a laptop computer provided to an employee, who regularly visits clients, is provided primarily for use in the employee's employment. The employer anticipated there might be incidental personal use of the laptop computer by the employee. However, there was no written policy restricting any personal use.

The term 'primarily' is not defined in the FBTAA. Therefore, the Tax Office states that the term takes on its ordinary meaning. Whether a laptop computer was used primarily in the employee's employment 'is based on intended use at the time the benefit is provided to the employee that is, why the laptop computer was provided to an employee 'in the first place''. The ATO ID states that this conclusion is determined by reference to the available evidence at the time the benefit is provided such as an employee's job description, duty statement or employment contract.

If there are competing uses (i.e. business use and private use), the ATO ID states that the following factors may assist an employer in reaching a conclusion as to whether a laptop computer is primarily for use in an employee's employment:

- the reason or reasons the laptop computer was provided to the employee;
- the type of work to be performed by the employee;
- the co-relation between the employee's employment duties and the use of the laptop computer; and
- the employer's policy and any conditions relating to the use of a laptop computer.

The ATO ID notes that before a conclusion can be drawn as to whether the provision of a laptop computer is an exempt fringe benefit under section 58X, an employer must consider the other requirements contained in that section.

When is an Invoice Issued?

In a recent case, the AAT varied a penalty imposed by the Commissioner in relation to a GST shortfall payable by a taxpayer. In doing so, the Tribunal rejected the Commissioner's contention that the invoice was issued based on the date of the invoice: *AAT Case [2008] AATA 843, Re Tavco Group Pty Ltd and FCT* (AAT, Ref No: 2007/6119, Walker DP, 22 September 2008).

Background

In June 2006, the Commissioner commenced an audit into the GST affairs of the taxpayer for the period 1 July 2002 to 30 June 2006. Following the audit, he concluded that the taxpayer had a GST shortfall of $80,271 for the quarter ended 30 June 2005. In the following month, the taxpayer amended its September 2005 BAS to include an omitted invoice, which increased its GST liability by $80,271. However, the taxpayer did not inform the auditor of the amendment until December 2006.

In March 2007, the Commissioner notified the taxpayer that the June 2005 and September 2005 BASs were revised to record an additional figure of $882,982 for sales and $80,271 for GST. The Commissioner also imposed a penalty of $40,135 on the basis of the taxpayer's recklessness. The taxpayer objected to the imposition of the penalty, which was disallowed by the Commissioner.

Decision

In reaching its decision, the Tribunal stated that if the invoice was not issued until the September 2005 quarter, 'there could be no issue of penalty because there would be no shortfall'. The Tribunal noted that neither the Commissioner nor the taxpayer cited any authority on when the liability under an invoice accrued.

The Tribunal rejected the Commissioner's contentions that the invoice was issued for the purpose of subsection 29–5(1)(b) of the *A New Tax System (Goods and Services Tax) Act 1999* (GSTA) based on the date the invoice bore and that it was irrelevant whether the invoice was sent. The Tribunal considered various cases previously heard by the courts regarding the word 'issue'. It formed the viewpoint that 'an invoice is issued within the meaning of subsection 29–5(1)(b) when some act has been done to convey it to the intended recipient'. However, the Tribunal stated that the date on an invoice could be taken to be the date on which it was issued unless there was evidence to the contrary.

The Tribunal found that there was evidence which supported the taxpayer's claim that the invoice was issued in July 2005. Although the taxpayer contended that the omission of the invoice was not reckless when viewed in the context of its overall tax compliance record, the Tribunal stated 'that the focus of the analysis must be on the particular act or omission in question', which was consistent with legal principles. The Tribunal also stated that the taxpayer's overall record was only relevant when the Tax Office was considering the question of remission of a penalty.

However, the Tribunal found that a 10% reduction of the penalty was warranted. This was because the criteria set out in Practice Statement PS LA 2006/2, which deals with the remission of a penalty, had been met by the taxpayer.

The Tribunal concluded that the invoice should be reported in the September 2005 BAS and not the June 2005 BAS as contended by the Commissioner. Further, it noted that while neither the amount of the penalty nor remission could be altered, any GIC should be calculated from the September 2005 quarter.

Timing of an invoice

In the absence of prior payment, attribution of liability is timed to the tax period during which an invoice is 'issued'. Identifying the actions that constitute 'issuing' an invoice is therefore critical in order to correctly attribute and meet GST liabilities.

The Commissioner's contention in *Tavco* regarding the timing of when an invoice is issued contradicts the accepted view, as stated in GSTR 2000/34 at paragraph 33:

An invoice is issued when the supplier sends a document which notifies the recipient of the obligation to pay. The actual date when the invoice issues may not be the preparation date. The actual date is the date when the invoice is electronically transmitted, posted, couriered, hand delivered or similar. This date determines the tax period to which the GST payable and input tax credits are attributable.

The Tribunal in *Tavco* cited and followed Chief Justice Latham of the High Court in *Koon Wing Lau v. Calwell* (1949) 80 CLR 533 and concluded that the taxpayer had reported the invoice in the correct quarter. In doing so, the Tribunal clearly enunciated that the date appearing on the invoice should only be taken to be the date the invoice was issued in the absence of any evidence to the contrary.

ITC and Termination of an Enterprise

In a recent case, the District Court of Queensland reduced the indemnity costs payable by the plaintiff to the applicants: *Amos v. Monsour Pty Ltd & Ors* [2008] QDC 194, District Court of Queensland, Brabazon J, 12 August 2008.

The indemnity costs which included GST of $3,056 related to legal expenses incurred by the applicants. In reaching its decision, the Court had to consider whether the applicant company was entitled to claim an input tax credit (ITC) for the legal expenses. This was because notwithstanding the company had terminated its operations, it still maintained its GST registration.

The Court considered an accountant's opinion that 'at the present time the company is not carrying on an enterprise for GST purposes and is not entitled to claim any [ITC] for these legal expenses'. The accountant had referred to paragraphs 140–147 of Miscellaneous Taxation Ruling MT 2006/1, which stated the Tax Office's view on whether the termination of an enterprise constituted the carrying on of an enterprise for GST purposes. However, the Court did not agree with the accountant's opinion.

The Court based on its own analysis of the Ruling concluded that 'in resisting [the plaintiff's] claims, the company has been carrying on an incidental aspect of [its] business, while terminating the enterprise'. Therefore, the Court was of the view that the company was entitled to claim the ITC. Accordingly, the Court found the indemnity costs should be reduced by the ITC amount.

Carrying on of an enterprise

The term 'carrying on of an enterprise' is defined in section 195–1 of the *A New Tax System (Goods and Services Tax) Act 1999* (GSTA) to include 'doing anything in the course of the commencement or termination of the enterprise'.

The Tax Office's view regarding activities that are undertaken in the course of terminating an enterprise are set out from paragraphs 140–147 of Miscellaneous Taxation Ruling MT 2006/1.

The Ruling states that generally an enterprise terminates when all assets are disposed of, or converted to another purpose or use, and all obligations are satisfied. The Ruling also states that an enterprise is considered to terminate if outstanding obligations cannot be satisfied and other activities have ceased. The Ruling acknowledges that there may still be some other activities undertaken to terminate the enterprise such as the cancellation of the entity's ABN and GST registration, and lodging of any outstanding income tax returns and BASs.

According to the Ruling, whether an activity is done in terminating of an enterprise is 'one of fact and degree depending on the circumstances of each particular case'. Therefore, it is important to consider all the circumstances surrounding the termination of the enterprise.

GIC and SIC Rates

The Tax Office has released the general interest charge (GIC) and shortfall interest charge (SIC) rates for the second quarter of the 2008/09 income year. The rates are:

Rate	Annual (%)	Daily (%)
GIC	14.31	0.03909836
SIC	10.31	0.02816939

The Tax Office has also released the interest rate for overpayments, early payments and delays in refunds for the second quarter of the 2008/09 income year. The applicable interest rate is 7.31%.

Tax Update

Overseas charity funds

The Assistant Treasurer has published five notices in the *Gazette* declaring that the following funds are developing country relief funds under subsection 30–85(2) of ITAA 1997:

- Share (Australia) Inc. Overseas Aid Fund;
- International Help Fund Australia Public Fund;
- Yooralla Overseas Development Fund;
- Hope Projects Fund; and
- Wheelchairs For Kids Relief Fund.

The notices took effect from 24 August 2008.

Legislative background

Subsection 30–85 states that a deduction for donations made by a taxpayer to a developing country relief fund if the fund is declared to be such a fund by the Government by notice in the *Gazette*.

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