



Explanatory Memorandum

April 2010

Currency:

This issue of Client Alert takes into account all developments up to and including 15 March 2010.

Non-commercial Losses and Commissioner's Discretion: Tax Office Update

Taxpayers who make a net loss in a business activity may, under certain circumstances, claim that loss by offsetting it against their income from other sources. As a result of legislation passed in 2009, changes to the operation of the non-commercial loss rules apply for the 2009/10 and later income years. The changes became law on 14 December 2009, and are contained in *Tax Laws Amendment (2009 Budget Measures No 2) Act 2009*.

Commissioner's discretion

In limited circumstances, the Commissioner may exercise a discretion allowing taxpayers to offset their business losses. The new discretion concerns individuals who do not meet the income requirement but whose business activity is commercially viable. For the Commissioner to exercise the discretion, taxpayers must demonstrate there is an objective expectation that their business activity will produce a tax profit within a time commercially viable for the industry concerned. The commercially viable period must be determined using evidence from independent sources.

To facilitate applications for the discretion, the Tax Office has released application forms and an evidentiary checklist. The checklist asks questions about satisfying the \$250,000 threshold for non-commercial losses, when the business activity commenced, is there a business plan, did the loss arise solely because of the deductions for the small business and general business tax break, etc.

The Tax Office says taxpayers are to complete and answer all questions in the evidentiary checklist and attach it to their application. All relevant evidence from independent sources that supports an explanation to the evidentiary checklist should also be attached. The Tax Office said the Commissioner will notify taxpayers of his decision in writing.

Web links for the Tax Office materials (accessed on 17 March 2010):

- Application forms <www.ato.gov.au/businesses/content.asp?doc=/content/81600.htm>
- Evidentiary checklist <www.ato.gov.au/businesses/content.asp?doc=/content/00230961.htm>
- Further information <www.ato.gov.au/businesses/content.asp?doc=/content/00230941.htm>

Government Looking to Move on Phoenix Activities

The Assistant Treasurer has flagged coming Government action against phoenix activities. He says the Tax Office estimates that the annual cost to revenue of phoenix activities is around \$600 million. He said the activity has been prevalent in the building construction industry, hospitality, cleaning services, but is spreading into other sectors.

The Government released a discussion paper on this in November 2009 and Senator Sherry outlined some of the possible action the Government might take, such as:

- change the law so that directors engaged in fraudulent phoenix activity cannot avoid personal liability for paying tax that is owed and superannuation guarantee;

- extend Pt IVA to give the Commissioner specific powers over phoenix-type activities — there could be a description of phoenix-type activity in the law.

The aim is to ensure there are anti-avoidance provisions in the taxation law (either through an expansion of Pt IVA or through the creation of a specific provision) to effectively negate any taxation benefit derived from fraudulent phoenix activity;

- stopping a company reusing the same name that it's just used when it collapsed;
- if someone's got a previous record of phoenix-like activity, they would have to pay effectively some tax up front (ie effectively, a bond) before they can activate the business through the company structure. (That is, provide the Commissioner with the discretion to require a company to provide an appropriate bond (supported by sufficient penalties) where it is reasonable to expect that the company would be unable to meet its tax obligations and/or engage in fraudulent phoenix activity.)

The Assistant Treasurer said the problem is a serious one, and he was 'utterly determined, I'm prepared to wear some flak on this issue, frankly, in order to protect workers' entitlements and also legitimate businesses who'll lose out when not paid for their supplies'. He said he would receive the detailed analysis from Treasury on the submissions in the next month and then he would be keen to get 'some specific amendments, proposals to the law, out for this year'.

Source: Transcript of Assistant Treasurer's interview with Peter Mares, The National Interest, ABC Radio National, 19 February 2010 <www.treasurer.gov.au/DisplayDocs.aspx?doc=transcripts/2010/005.htm&pageID=004&min=njsa&Year=&DocType=>, accessed on 17 March 2010.

GST: Arrangements to Claim Unintended RITCs — Tax Office Taxpayer Alert

On 18 February 2010, the Tax Office released Taxpayer Alert TA 2010/1 (GST: interposing an associated 'financial supply facilitator' to enhance claims for reduced input tax credits for expenses incurred in the course of a company takeover). The Alert warns taxpayers about uncommercial arrangements designed to create or increase an entitlement to a reduced input tax credit (RITC) in relation to a company's float, merger or acquisition.

The Tax Office says under these arrangements, a company involved in a takeover uses a related associate to procure all the services required for the takeover. The associate then invoices the company for the services. The company would claim RITCs that it would not normally be entitled to if those services were directly acquired from a service provider. In the Tax Office's view, there is insufficient commercial rationale for the associate's involvement in the supply of the services.

According to the Taxpayer Alert, tax issues of concern to the Tax Office include:

- the entitlement of an associate to input tax credits under Div 11;
- the associate may be a financial supply facilitator under item 9 in GST reg 70-5.02(2);
- the possible application of the anti-avoidance provisions of Div 165 of the GST Act; and
- whether any entity involved in an arrangement may be a promoter of a tax exploitation scheme under Div 290 in Sch 1 to the *Taxation Administration Act 1953*.

The Commissioner said the Tax Office is seeing more of these arrangements and is currently reviewing several of them. The Commissioner warned taxpayers who are considering these arrangements that the Tax Office will examine the tax affairs of any taxpayer participating in the arrangements.

Those who are unsure about their situation should seek independent advice or contact the Tax Office for a private ruling on their individual circumstances, said the Commissioner. He said taxpayers who contact the Tax Office before they are contacted for an audit will be entitled to a reduction in any penalties that may apply.

Source: Taxpayer Alert TA 2010/1 <<http://law.ato.gov.au/atolaw/view.htm?docid=%22tpa%2Fta20101%2Fnat%2Fato%2F00001%22>>, accessed on 17 March 2010.

Tax Amendment (No 1) Bill 2010 Introduced

The *Tax Laws Amendment (2010 Measures No 1) Bill 2010* was introduced into the House of Representatives on 10 February 2010. The Bill contains various amendments including the following:

- **Entrepreneurs' tax offset:** Introduces an income test into the eligibility criteria for the entrepreneurs' tax offset (ETO). Will restrict eligibility of individuals whose income is over \$70,000 (where singles) or \$120,000 (where they have a family). See below for further information.
- **Forestry MIS:** Amends the four-year holding period rule for forestry managed investment schemes (MIS) to ensure the test cannot be failed for reasons genuinely outside an investor's control. Also amends promoter penalty provisions to ensure they continue to apply to promoters of forestry schemes where investors' deductions are allowed to stand because of the above amendments. See below for further information.
- **Establishes a superannuation clearing house** for employer superannuation contributions. The clearing house (to be Medicare Australia) will be available to eligible small businesses (ie those with fewer than 20 employees) from July 2010. Businesses will be able to register with Medicare Australia from May 2010. See below for further information.
- **Makes other miscellaneous amendments and technical corrections**, including amendments relating to the CGT small business retirement exemption and the CGT main residence exemption. See below for further information.

Eligibility restrictions imposed on entrepreneurs' tax offset — income test

The Bill amends Subdiv 61-J of ITAA 1997 by introducing an income test into the eligibility criteria for the ETO. The income test will restrict the eligibility of individuals whose income is over a threshold amount of adjusted taxable income for ETO purposes (\$70,000 if they are single and \$120,000 if they have a family).

The ETO provides eligible taxpayers with a maximum tax offset of 25% of their income tax liability that is attributable to their net small business income for the income year. The ETO begins to phase out at aggregated small business turnovers of \$50,000 and eligibility ceases when aggregated turnover reaches \$75,000.

Under the proposed amendments, the ETO calculated after applying the aggregated turnover test will phase out at 20 cents for every \$1 of income for ETO purposes over the threshold amount. For singles, the threshold amount of income for ETO purposes is \$70,000, and for families, the threshold amount is \$120,000. This reduction will operate in addition to the current eligibility requirements applicable to the ETO (in particular, the aggregated turnover test phase-out where aggregated turnover of the small business exceeds \$50,000).

The income for ETO purposes will include both the claimant's and their spouse's (if they had a spouse at the end of the income year) taxable income, reportable fringe benefits total, reportable superannuation contributions and total net investment loss for the year. However, the claimant's net small business income (or share of that income) that has already been considered in determining eligibility for the ETO under the existing law will not be taken into consideration for the purposes of the income test.

Date of effect

The amendment is proposed to apply in relation to assessments for income years that commence on or after 1 July 2009. Note that the amendment was previously announced to commence on 1 July 2008, but this was deferred by 12 months.

Forestry MIS: four-year holding rule amended

The Bill amends ITAA 1997 and ITAA 1936 with the stated aim of protecting the deductions of investors in forestry MIS where the four-year holding period rules are failed for reasons genuinely outside the investor's control. The *Taxation Administration Act 1953* will also be amended to maintain the capacity of the Commissioner to apply for civil penalties against the promoters of affected schemes, notwithstanding the amendments to the four-year rules.

At the time of announcing the change last year, the Assistant Treasurer said the collapse of Timbercorp and Great Southern was expected to lead to a number of forestry MIS being wound-up or restructured, which could cause investors to fail the requirement of having held their interest in the MIS for four years as a condition of an up-front tax deduction. The Government therefore decided to amend this four-year holding period rule for forestry MIS to ensure that it cannot be failed for reasons genuinely outside an investor's control. These events include insolvency of the MIS manager, the death of the investor or where an MIS interest is cancelled, for example because of trees being destroyed by fire, flood or drought.

Currently, under Div 394 of ITAA 1997, investors in forestry MIS can claim an immediate tax deduction for expenditure incurred in the scheme, subject to certain conditions. In order for an initial investor in a forestry MIS to claim and retain a deduction under Div 394, the law requires that a CGT event does not happen in relation to the investor's forestry interest within four years after the end of the income year in which an amount is first paid by the investor.

The Government said the Tax Office's interpretation of the current law is that the Commissioner has no discretion to allow a deduction claimed under Div 394 in these circumstances, even where the reason for the CGT event happening is outside the taxpayer's control.

Under the proposed amendments, failing the four-year holding rule will not lead to the denial of a deduction where this failure is for reasons outside the investor's control. Furthermore, such reasons must not have been able to be reasonably anticipated by the investor at the time they acquired their interest. This means that it could not have been anticipated by a reasonable person standing in the shoes of the investor.

Situations that could be 'genuinely outside the initial investor's control' include:

- the accidental death of the initial investor;
- the interest in the scheme being compulsorily transferred, because of marriage breakdown or compulsory acquisition by a government;
- the initial investor becoming insolvent;
- the interest in the scheme being cancelled, because of trees being destroyed by fire, flood or drought; and
- the insolvency of the manager of the scheme, leading to the winding up of the scheme.

Date of effect

The amendments are proposed to apply to CGT events happening on or after 1 July 2007.

Approved superannuation clearing house established

The Bill amends various parts of the superannuation legislation (as well as ITAA 1936 and the *Taxation Administration Act 1953*) to implement the Government's 2008/09 Budget announcement to provide a free superannuation clearing house service for small businesses.

The amendments will allow employers to meet their obligations to make compulsory superannuation contributions for the benefit of their employees, and to promptly remit superannuation amounts deducted from an employee's salary or wages, by paying to an approved clearing house.

The clearing house will be Medicare Australia and will be available to eligible small businesses (ie those with fewer than 20 employees) from July 2010. Businesses will be able to register with Medicare Australia from May 2010.

Under the proposed amendments, a contribution to a fund by an employer for the benefit of an employee will also be made in compliance with the choice of fund requirements if:

- the contribution is made through an approved clearing house;
- the employee has given the employer written notice choosing a fund; and
- the employer passed the information contained on the written notice to the approved clearing house within 21 days of receiving it from the employee.

These amendments also allow taxpayer information to be disclosed to an approved clearing house for the purpose of performing its functions.

Date of effect

The amendments are proposed to apply from 1 July 2010.

Miscellaneous and technical (but not minor) amendments

The Bill makes a number of technical corrections and other miscellaneous amendments to various taxation laws. Some of the more significant amendments concern:

- **CGT small business retirement exemption:** the Bill corrects an unintended effect on the operation of the small business CGT retirement exemption made by the *Superannuation Legislation Amendment (Simplification) Act 2007* which inadvertently exposed payments a trust makes to a CGT concession stakeholder under the retirement exemption to CGT event E4. Prior to the superannuation amendments in 2007, any payment made under the retirement exemption to a CGT concession stakeholder was an eligible termination payment (ETP). Under the ETP rules, CGT exempt amounts were ignored in determining whether the CGT concession stakeholder made a capital gain. The amendment made by the Bill effectively restores that position by treating a payment representing an amount that was subject to the small business retirement exemption made by a company or trust to a CGT concession stakeholder as not assessable and not exempt income of the stakeholder. This means that the payments are disregarded for the purposes of CGT event E4 through the operation of s 104-71(1)(a) of ITAA 1997. The amendments affect s 152-310(2)(a) of ITAA 1997. *Date of effect:* The amendment is proposed to apply to payments made after 30 June 2007 to give it the same date of effect as the superannuation amendments mentioned above.
- **CGT main residence:** the Bill seeks to ensure that a replacement dwelling that is eligible for the compulsory acquisition roll-over is also treated as a continuation of the original dwelling for CGT main residence exemption purposes. The amendments affect various provisions within Subdiv 118-B of ITAA 1997. *Date of effect:* The amendment is proposed to apply to CGT events happening in relation to replacement dwellings on or after the day the Bill receives Royal Assent.

Tax Effective Investment Scheme Entity Assessable on 'Accrued' Farm Management Fees

AAT Case: *Re Reynolds Wines Ltd and FCT [2010] AATA 121*

A company which operated a tax effective investment scheme has been unsuccessful in arguing that it should only be assessable on those fees received from investors for which the Commissioner had allowed a deduction for actual cash outlays. Instead, the AAT found the company, as an accruals taxpayer, had derived all the fees that it was contractually entitled to receive under the scheme, which included those non-cash payments arising from the round-robin loan arrangements entered into with investors: *Re Reynolds Wines Ltd and FCT [2010] AATA 121* (Receiver and Manager Appointed) (In Liquidation) (AAT, Ref Nos NT 2004/215 and 370, NT 2005/281 and 314, Frost SM, 16 February 2010).

Background

Together with related unit trusts, the taxpayer operated a tax effective investment scheme. As part of the scheme, 'farm fees' were paid directly to the taxpayer as owner of the farms, and 'farm management fees' were paid to it indirectly through the related unit trusts which managed the farms. (In this regard, the Tribunal noted that, in the 1999 income year, some \$20 million in net income had been distributed between the unit trusts.) Under the scheme various round-robin non-recourse loan arrangements were entered into with investors to provide them with funds to invest in the scheme.

The Commissioner struck down the deductions claimed by the investors for the fees under Pt IVA of ITAA 1936. But in accordance with his settlement policy for tax effective investment schemes, investors were allowed a deduction for actual cash outlays for the fees paid.

In these circumstances, the taxpayer argued that it should not be assessable on all the fees originally returned as income, but only on those fees for which cash outlays had been made by investors. In

particular, it argued that only those cash amounts had 'come home' to it for the purposes of the derivation of its income and that, in this regard, the round-robin loan agreements were of no legal effect.

In effect, the taxpayer argued for 'symmetrical treatment' between the deductions for fees allowed to the taxpayer and the derivation of its income. Alternatively, it argued that a compensating adjustment should be made under s 177F(3) of ITAA 1936 to exclude from its income those amounts of fees which were not cash outlays.

Decision

On the basis that the company was an accruals basis taxpayer, the Tribunal found that all the fees (which included those generated under the round-robin loan arrangement with investors) had been in fact derived by the company. This was because the income had 'come home' to it when the debt became due to it under the relevant farming agreements entered into with the investors. This was the case even though such amounts may have not been paid. In this regard, the Tribunal found that the time at which, or the mode by which, the payments were made were irrelevant to the question of derivation.

In short, the Tribunal determined that in these circumstances where the taxpayer was an accruals basis taxpayer, the proper approach was to recognise as 'income derived' the amount specified in the farming agreement (subject to the farm management fees having been 'earned' in accordance with the *Arthur Murray* principle). The Tribunal also dismissed the taxpayer's arguments that the round-robin loan arrangements were of no legal effect on the grounds that they only had a bearing on the means by which the fees were to be received, and not whether they had been derived.

In arriving at its conclusion, the Tribunal applied the decision and reasoning of the Federal Court in *Business and Research Management Ltd (in liq) v FCT* [2008] FCA 1652 — namely, that as an accruals basis taxpayer, the income represented by the management fees was derived when those fees fell due. The AAT also noted that many of the individuals involved in that case were also involved in structuring the tax effective investment scheme in the current matter.

At the same time, the Tribunal found that the company had not met the conditions under s 177F(3) of ITAA 1936 for the Commissioner (or the Tribunal standing in his shoes) to exercise the discretion to make a compensating adjustment to exclude the 'accrued' farm management fees from the company's assessable income.

In particular, it found that the condition in s 177F(3)(c) had not been satisfied as the taxpayer had not been able to pinpoint 'an amount' that was included in its assessable income that would not have been included but for the scheme. This was because no scheme had been identified (by either party) to make such a finding and because the taxpayer had failed to establish an appropriate 'alternative postulate' (other than 'doing nothing', which the Tribunal rejected). The Tribunal also indicated that the taxpayer would have failed to establish that it was 'fair and reasonable' for the Commissioner to exercise the discretion as required by the section.

Seller of Duty-free Goods Liable for Income Tax, GST and Excise Duty

AAT Case: Re Sogo Duty Free Pty Ltd and FCT [2010] AATA 111

In a matter relating to whether the taxpayer had sold cigarettes duty-free in circumstances where it knew or should have known the goods were intended for domestic consumption, the AAT has concluded that the taxpayer had failed to discharge the relevant onus of proof. It therefore found that the taxpayer was liable for attendant income tax, GST and excise duty liabilities: *Re Sogo Duty Free Pty Ltd and FCT* [2010] AATA 111 (AAT, Ref Nos VT200300211-213, VT200400047, 2009/1459, Hughes M, 12 February 2010).

In relation to the **income tax liability**, the Tribunal found the Commissioner's methodology in determining the taxpayer's taxable income was appropriate and possibly conservative in the circumstances. It also said it was not necessary for the Tribunal to go further and establish the precise accuracy of the assessment. Furthermore, the Tribunal found that nothing turned on the argument that the relevant sales were shams as any such characterisation, as opposed to the substance of the transactions, was not of any relevance.

In relation to **GST**, the Tribunal emphasised it was relevant that the taxpayer had failed to prove that the goods were sold to relevant travellers. Accordingly, it found that the actual sales by the taxpayer were not

GST-free. The Tribunal then said it therefore followed that the taxpayer understated its GST liability as recorded in its GST returns for each quarter in the relevant income year.

In relation to **excise duty**, the Tribunal found the goods were not sold for export but were delivered into home consumption, thus rendering the taxpayer liable to pay excise duty on each cigarette stick. In particular, it said the taxpayer failed to keep the goods safely in terms of s 60 of the *Excise Act 1901* (whose object was to ensure that excisable goods do not find their way into home consumption without the payment of duty). Furthermore, it said the taxpayer clearly contravened the 'Delivery Condition' and failed to satisfy the 'Proof Condition' which formed the basis upon which he had been entrusted the possession of the goods.

On the question of **penalties**, the Tribunal confirmed that the appropriate rate was imposed by the Commissioner in each instance — namely, 75% in the case of the income tax application and 50% in the case of the GST claim.

GST: Assessment for Net Amounts Upheld

AAT Case: Re Douglass and FCT [2010] AATA 138

The Administrative Appeals Tribunal has held that a taxpayer was unable to substantiate his claims for input tax credits (ITCs) and accordingly affirmed a notice of assessment for net amounts issued by the Commissioner: *Re Douglass and FCT [2010] AATA 138* (AAT, Ref No: 2008/4872, Block DP, 25 February 2010).

Background

The taxpayer conducted a lawn mowing business. Following an audit, the Tax Office formed an opinion that the taxpayer had over-claimed ITCs. The acquisitions related to goods and services from a mower centre and the purchase of fuel.

The non-fuel invoices

The taxpayer claimed that some of the invoices which he intended to send to the Tax Office to substantiate his claims were stolen from his car during a break-in. However, the Tribunal noted that a police report made in relation to the break-in did not mention the theft of any invoices. It also noted the taxpayer was unable to explain why the report made no reference to the invoices allegedly stolen. The Tribunal agreed with the Commissioner's submission that assuming there was an 'actual break-in', there was no theft of the invoices.

The Tribunal observed that the invoices from the mower centre contained irregularities including that the handwriting on the invoices was that of the taxpayer and the use of liquid-paper on the invoices. The Tribunal also observed that some of the invoices did not satisfy the requirements to be considered 'tax invoices'. While the Tribunal acknowledged it had the discretion to treat a document as constituting a tax invoice, it was of the view that the taxpayer's circumstances did not warrant the exercise of the discretion.

The purchase of fuel

In relation to the acquisition of fuel, the Tribunal said the taxpayer's claims 'were on the balance of probabilities fictitious'. The taxpayer claimed to have purchased fuel daily. However, the Tribunal said there was no plausible reason why the taxpayer needed to purchase the fuel daily especially when he was working a second job on some days. It noted that the fuel expenditure for one of the tax periods in dispute was significantly higher than other periods despite the earnings for that quarter being 'so much less'. Therefore, in the Tribunal's view, the taxpayer was unable to substantiate his claims for ITCs relating to the purchase of the fuel.

In conclusion, the Tribunal found that the taxpayer had not discharged the onus of proving that the Commissioner's assessment was incorrect. Accordingly, the Tribunal upheld the assessment issued.

Superannuation Contributions — Timing and Deductions

Taxation Ruling TR 2010/1

This Ruling, released on 25 February 2010, explains the Commissioner's views on the ordinary meaning of 'contribution', how a contribution can be made to a superannuation fund and the timing of when a contribution is made. The Ruling also explains key aspects of the rules in Div 290 of ITAA 1997 for deducting employer superannuation contributions and personal contributions.

The ruling was previously released as Draft Ruling TR 2009/D3 and has been revised in several important respects.

Meaning of 'contribution'

The Commissioner considers that a 'contribution' is anything of value that increases the capital of a superannuation fund provided by a person whose purpose is to benefit one or more particular members of the fund or all of the members in general. In this respect, the Commissioner has revised his view from the previously released Draft Ruling TR 2009/D3 to ensure that consideration is given to the circumstances of the fund and the objective purpose of the contributor.

By examining both the circumstances of the fund and the purpose of the contributor, the Commissioner says it should not be necessary to rely on a detailed exception to the definition of contribution for the income, profit or gain of a fund. Generally, the Tax Office says a person will be said to intend the natural and probable consequences of their acts and likewise their purpose may be inferred from their acts. As such, not every increase in the capital of a fund is a superannuation contribution as a person who increases a fund's capital must have the purpose of benefiting a member of the fund. For example, the Tax Office notes that an arm's length tenant's improvements to a commercial property owned by a fund are made to further the tenant's business, not to obtain superannuation benefits for the fund's members.

Forms of contribution

The Ruling says a contribution (ie an increase in capital) can be made, directly or indirectly, by:

- transferring funds (money) to the superannuation fund;
- rolling over a superannuation benefit;
- transferring an asset to the superannuation fund (an in specie contribution);
- creating rights in the fund;
- paying an amount to a third party (eg a guarantee payment) for the benefit of the fund;
- forgiving a debt owed by the fund; or
- shifting value to an asset owned by the superannuation fund.

A superannuation contribution is most commonly made by transferring funds to the superannuation fund. A transfer of funds can occur in a number of ways but the Tax Office says no contribution will be made if payment of a cheque or promissory note is not honoured. The Tax Office notes that an actual payment, albeit to reimburse the superannuation fund for an expense incurred in operating the fund, may also constitute a contribution.

The Tax Office says the ordinary meaning of a 'contribution' includes a rollover superannuation benefit (other than an internal rollover) and a transfer of a person's benefits from an overseas superannuation fund to an Australian superannuation fund. However, the Tax Office notes that the definition of contribution in reg 1.03(1) of the SIS Regulations specifically excludes benefits that have been rolled over or transferred. Furthermore, rollovers and transfers from foreign superannuation funds are specifically excluded from deductions allowed for contributions: s 290-5 of ITAA 1997.

In specie contributions

Subject to the restrictions in the SIS Act on a superannuation fund acquiring assets from a related party (see SMSFR 2010/1), the Tax Office says a fund's capital will be increased when a person transfers an asset to the superannuation fund which pays no consideration or pays consideration less than the market value of the asset.

Debt forgiveness and payments by guarantors

The Tax Office considers that a contribution can arise when a liability incurred by the superannuation fund is forgiven by the person to whom the liability is owed. According to the Tax Office, a contribution by way of debt forgiveness will be taken to occur when a deed of release that relieves a superannuation fund from the obligation to pay the liability is executed or the creditor is barred under the law from enforcing the liability.

Instalment warrant arrangements

Although the SIS Act generally prohibits a trustee of a superannuation fund from borrowing money, there are a few limited exceptions. The Tax Office notes that some instalment warrant borrowing arrangements entered into by superannuation funds under s 67(4A) of the SIS Act have required a person other than the fund trustees, or a fund trustee in their personal capacity, to provide a guarantee for the repayment of the borrowed amount. The Commissioner considers that the capital of a fund is increased where a liability incurred by the superannuation fund is forgiven by the person to whom the liability is owed.

Timing of a contribution

The timing of when a superannuation contribution is made has long been relevant for superannuation guarantee purposes and in terms of determining the relevant income year for deducting a contribution and including it in the assessable income of the receiving superannuation fund. Increasingly, what constitutes a contribution and its timing is relevant for determining if a taxpayer has exceeded his or her concessional contributions cap for a particular financial year.

The Ruling says a contribution is 'made' when it is 'received' by the superannuation fund or retirement savings account (RSA). The Ruling summarises the timing of when a contribution is made as follows:

- **cash** — when received by the superannuation fund;
- **electronic funds transfer (EFT)** — when funds are credited to the superannuation fund's account;
- **bank cheque or money order** — when received by superannuation fund (unless dishonoured);
- **personal cheque** — when received by superannuation fund (provided cheque is promptly presented and is honoured);
- **personal cheque (post-dated)** — date on the cheque (provided cheque is promptly presented and is honoured);
- **promissory note from related party** — when received (so long as payment demanded promptly and is honoured).

Contribution of property

The Ruling says a contribution by way of a transfer of an asset will be made when the superannuation fund obtains ownership of the asset from the contributor. The Commissioner accepts that a contribution of property is made when beneficial ownership of the property is obtained by the superannuation fund (which may be some time before the formal registration of the change of legal ownership occurs for shares in a publicly listed company or Torrens title land).

Off-market share transfers

As with a contribution of real property, the Commissioner accepts that a superannuation fund may acquire beneficial ownership of shares or units in an Australian Stock Exchange listed company or unit trust effected through an off-market share transfer, when the trustee obtains a properly completed off-market share transfer in registrable form.

However, the Commissioner warns that a contributor or superannuation fund who seeks to argue a contribution of property occurs when beneficial, not legal, ownership of property passes must retain sufficient evidence of the relevant transactions and events to precisely identify when the change of beneficial ownership occurs.

Electronic funds transfer

The Commissioner does not accept that a contribution made by electronic funds transfer (EFT) or via internet banking may occur as soon as the contributor has done everything necessary to effect a payment. According to the Commissioner, it is not until an amount is credited to a bank account of the superannuation fund that a contribution will be taken to be made.

Deducting contributions

The Ruling also sets out the Commissioner's views on aspects of the rules in Div 290 of ITAA 1997 for deducting contributions for an employee and personal contributions.

Company directors

The Tax Office says a company director is an employee for the purposes of the superannuation guarantee law (and employment activity condition) if the director is entitled to payment for the performance of duties as a member of the company's executive body. However, the Ruling says a company cannot deduct a superannuation contribution for a member of the executive body who is not entitled to payment.

Deducting personal contributions

To deduct a personal superannuation contribution, it is necessary to satisfy the conditions set out in Subdiv 290-B of ITAA 1997. The Ruling sets out the Commissioner's views on the key provisions affecting:

- the maximum earnings as an employee condition (10% test) under s 290-160; and
- the notice of intent to deduct contributions under s 290-170.

Maximum earnings as an employee: 10% test

Where the person engages in any 'employment' activities (for superannuation guarantee purposes) in the income year, a deduction can only be claimed where the sum of assessable income, reportable fringe benefits and, from 1 July 2009, 'reportable employer superannuation contributions' attributable to the employment activities is less than 10% of the person's total assessable income, reportable fringe benefits and reportable employer superannuation contributions in the income year that the contribution is made: s 290-160.

However, the Tax Office says those persons who have not engaged in an 'employment' activity in the income year in which they make a contribution are not subject to this earnings test. For example, a person who, although no longer employed, is receiving workers' compensation payments, is not subject to the maximum earnings test.

In the application of the maximum earnings test, the Tax Office says the relevant employment activity need not be an activity in Australia.

Notice of intention to claim deduction

A person who intends to deduct their personal superannuation contributions must give to their superannuation fund a valid notice in the approved form before lodging their income tax return for the year (or within 12 months of the end of the income year if they have not lodged their return by that time). The trustee must also acknowledge receipt of the notice.

The Tax Office notes that a person may choose how much of their contributions to deduct and this notice is used to give effect to that choice. For example, a person may choose not to deduct a portion of their personal contributions to ensure they are entitled to the superannuation co-contribution.

Examples

The Ruling includes 11 Examples to illustrate the treatment of contributions in the following scenarios:

1. Contribution made by paying a fund's expense (accounting and audit fees).
2. No contribution where chartered accountant prepares the accounts and income tax and regulatory return for his or her SMSF each year without remuneration.
3. Contribution made by forgiving liability.
4. Contribution made by employer's reimbursement.
5. No contribution made by employer sponsor paying wages of employees to provide assistance to the trustees and administrators of the fund.
6. In specie contribution of real property.
7. In specie contribution of shares.
8. Maximum earnings test — no need to meet test where not engaged in an 'employment' activity in the income year.
9. Maximum earnings test — worker's compensation.
10. Valid notice of intention to deduct on reduce amount following partial rollover.
11. Invalid notice of intention to deduct — commencement of pension.

Date of effect

The Ruling applies both before and after its date of issue. However, the Commissioner's views on the rules for deducting contributions only applies to the 2007/08 and later income years. Taxation Ruling TR 2005/24, which was partially withdrawn from 17 June 2009, continues to apply for income years up to and including 2006/07.

SMSF Prohibition on Acquiring Assets from Related Party

Self Managed Superannuation Funds Ruling SMSFR 2010/1

This SMSF Ruling, released on 25 February 2010, explains the prohibition on a self-managed superannuation fund (SMSF) from acquiring an asset from a related party. The Ruling has been revised in several respects since it was previously issued as Draft Self Managed Superannuation Funds Ruling SMSFR 2008/D2.

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

Related party of an SMSF

A 'related party' of a superannuation fund is defined very broadly in s 10 of the SIS Act to include a member of the fund or Part 8 associate of either a member or a 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.

Acquire an asset

The Commissioner says an 'asset' means any 'form of property' and includes every type of right and intangible personal property that can be enforced by legal or equitable action such as a debt or an interest in a trust fund. Other examples of assets include a freehold interest in land (including an easement); rights arising under a contract; an option to acquire something; a boat; machinery; shares in a company; units in a unit trust; a promissory note; a mining exploration license; a mining lease; patents; trademarks; copyright.

The phrase 'acquire an asset' encompasses not only the purchase of an asset but also the acquisition of an asset where the SMSF does not provide any consideration. For example, accepting a contribution of an asset, assets gained through improvements made to SMSF property, receiving an in specie trust distribution or receiving an in specie payment of income, profit or gain: see also TR 2010/1.

The Commissioner considers that the acquisition of the performance of a service by a related party does not contravene s 66. Likewise, a payment made by a related party of an SMSF to a third party to extinguish a liability the SMSF has with a third party does not contravene s 66.

Examples

The Ruling includes 13 Examples on topics including:

- promissory notes;
- collectible banknotes and coins;
- trade dollars;
- performance of a service;
- improvements to an SMSF property;
- acquisitions of listed shares or units in a unit trust;
- business real property and fixtures.

Other SIS Act issues

The Tax Office warns that the Ruling does not provide the Commissioner's views on whether an asset acquired is a contribution to the SMSF and how to work out the market value of the asset acquired. Likewise, the Ruling does not provide the Commissioner's views on how other SIS Act and SIS Regs provisions apply to any of the arrangements discussed.