



Explanatory Memorandum

February 2010

Currency:

This issue of Client Alert takes into account all developments up to and including 4 January 2010.

Proposed Amendments to the Tax Laws

The Government introduced Tax Laws Amendment (2009 Measures No 6) Bill 2009 into the House of Representatives on 25 November 2009. The Bill proposes to:

- remove the CGT trust cloning exception and provide a limited fixed trust rollover;
- permit the rollover of capital losses and transfer of revenue losses between complying superannuation funds upon a merger;
- clarify the circumstances in which income derived by life insurance companies in respect of immediate annuity business qualifies as non-assessable non-exempt income;
- update the list of deductible gift recipients to include two new organisations and change the name of one organisation;
- exempt the Income Recovery Subsidy payments to North Western Queensland flood victims from income tax; and
- ensure imported high strength spirits blended with domestically produced high strength spirits are duty-free under the concessional spirits scheme.

Proposed CGT-related amendments

The Bill will repeal the trust cloning exceptions to CGT events E1 and E2. However, the other exception to the CGT events will be retained. That is, CGT events E1 and E2 do not happen when an asset is transferred to a trust (other than a unit trust) by a taxpayer who is the sole beneficiary of the trust and is absolutely entitled to the asset as against the trustee: see ss 104-55(5)(a) and 104-60(5)(a) of ITAA 1997.

Change of trustee

The Bill will add a note to s 960-100(2) of ITAA 1997 and s 184-1(2) of the GST Act to confirm that a change of trustee does not trigger a CGT event (eg CGT events A1, E1 and E2). That is, the trustee will be the same entity even if there is a change in the person who holds the office of trustee.

Fixed trust roll-over

The Bill will insert proposed Subdiv 126-G into ITAA 1997 to provide an optional CGT roll-over for the transfer of assets between 'fixed' trusts. The trustees of the transferring trust and receiving trust must choose to apply the rollover. The effect of the rollover will be to defer the making of any capital gain or loss in respect of the asset transfer. It will also result in adjustments to the cost base of interests held by beneficiaries.

'Fixed' trust requirement

Under the proposed amendments, both the transferring trust and the receiving trust must be 'fixed trusts', ie the beneficiaries' interests in the trusts must be 'fixed'. For the purposes of the proposed rollover, the existing definition of 'fixed trust' in the tax law will not be used. Rather, the Bill proposes that CGT event E4 must be capable of happening to all the units or interests in each of the trusts.

The Bill also proposes a range of measures which could apply to deny the rollover if the trustee (or another entity) has the power to alter a beneficiary's interest in the trust. For example, the manner or extent to which each beneficiary of each trust can benefit from the trust must not be capable of being significantly affected by the exercise, or non-exercise, of a power. However, the power to merely facilitate the administration of the trust or a trustee's right of indemnity will be excluded under the proposed measures.

The proposed measures provide that the terms of the two trusts are not required to be precisely the same (although any differences that result in a significant difference in the nature or extent of beneficiaries' interests will prevent the rollover applying).

'Empty trust' requirement

Under the proposed measures, the receiving trust must have no CGT assets, other than a small amount of cash or debt, just before the transfer time. If the transfer is part of a series of rollovers, this condition will only apply to the first transfer time.

Same beneficiaries must have the same interests

Both trusts must have the same 'direct' beneficiaries. It will not be sufficient that the 'indirect' or ultimate beneficiaries of both trusts are the same. Further, both trusts will be required to have the same classes of membership interests with the same, or substantially the same, rights. In addition, the total market value of each beneficiary's interests in the transferring trust of a particular class and their interests of the matching class in the receiving trust will be required to be substantially the same just before and just after the transfer time.

Exclusions from rollover

The Bill states that the rollover will not be available if a receiving trust is a foreign trust for CGT purposes and the transferred asset is not taxable Australian property. In addition, the rollover will not be available if either trust is a corporate unit trust or a public trading trust at any time in the income year that the transfer occurs.

Multiple asset transfers

The rollover will apply on an asset-by-asset basis. However, the rollover will apply to multiple assets transferred as part of an arrangement in order to satisfy the 'empty trust' requirement. As a result, the 'empty trust' requirement will not apply to the second and later transfers where relevant conditions are met (eg the asset must be transferred in the same income year as when the first transfer occurred).

Trusts must make same tax choices

The rollover will not be available unless both trusts have the same tax choices in force just after the transfer (eg the family trust election). In addition, any conditions that apply to the original choice (or first choice) will be required to apply in a corresponding way to the mirror choice. The Bill seeks to provide that a mirror choice must be in force just after the transfer time (subject to allowing trustees six months from the date of Royal Assent to make the mirror tax choices or such further time as the Commissioner allows).

Consequences for trustees

Under the proposed amendments, any capital gain or capital loss made by the trustee of the transferring trust in respect of the transferred asset will be disregarded. Further, the first element of the cost base and reduced cost base of the asset in the hands of the trustee of the receiving trust will be equal to the cost base and reduced cost base of the asset in the hands of the trustee of the transferring trust just before the transfer time.

If the trustee of the transferring trust acquired the asset pre-CGT, then the proposed amendments provide that the trustee of the receiving trust will be taken to have acquired it pre-CGT also. Otherwise, the receiving trust will acquire the asset when the trust is created or the asset is transferred. For the purposes of the CGT discount, the ownership period of the transferred asset in the receiving trust will include the period of ownership by the trustee of the transferring trust.

In addition, if the receiving trust has carried forward any net capital losses or tax losses, the proposed measures state that they cannot be used to reduce the trust's capital gains or its assessable income after the transfer (ie they are effectively extinguished). The trustee of the receiving trust will be required to make a notional calculation to determine whether it would have had a net capital loss or a tax loss.

Consequences for beneficiaries

Under the proposed amendments, the first element of the cost base and reduced cost base of each membership interest in the transferring trust after the transfer time will be a proportion of the cost base of that interest, just before the transfer time. The proportion is what is reasonable having regard to the market value of that interest (or a reasonable approximation of its market value), just before and just after the transfer time. The effect of the adjustment will be to reduce the other elements of the cost base and reduced cost base to zero.

The first element of the cost base and reduced cost base of each membership interest in the receiving trust will be an amount such that the total cost base of that interest and the cost base of the corresponding interest(s) or proportion of interest in the transferring trust, just after the transfer time, will reasonably approximate the total cost base of those interests just before the transfer time. That is, the increase in cost bases of interests in the receiving trust will match the decrease in cost bases of corresponding interests in the transferring trust.

The proposed measures provide that the beneficiaries are deemed to have acquired their interests in the receiving trust at the transfer time. However, interests in the receiving trust will be taken to have been acquired pre-CGT if corresponding interests in the transferring trust were acquired pre-CGT. For the purposes of the CGT discount, the proposed amendments provide for the ownership period to include the period of ownership of membership interests in the transferring trust.

Finally, the proposed measures require the trustee of the transferring trust to send a written notice containing certain information to each of its beneficiaries within three months of the end of the income year in which the transfer occurs to enable the calculations to be carried out.

Date of effect

The amendments will apply to CGT events happening on or after 1 November 2008.

Rollover relief for merging superannuation funds

The Bill will insert proposed Div 310 into ITAA 1997 to allow a complying superannuation fund to choose to roll over capital losses and revenue losses arising from an arrangement to merge the fund with an APRA-regulated superannuation fund with five or more members before 1 July 2011. This will be achieved through the provision of a loss transfer and an asset rollover. The transferring fund may also transfer previously realised capital losses and revenue losses, including its prior year losses.

Where the eligibility rules are satisfied, a trustee will be able to choose the optional loss transfer and asset rollover when there is an 'arrangement' to merge complying superannuation funds. The broad term 'arrangement' is not intended to limit the manner in which superannuation entities may merge.

An eligible entity with an arrangement to merge superannuation funds may choose:

- a loss (capital losses and revenue losses) transfer only;
- an asset rollover only; or
- a combination of the loss transfer and the asset rollover.

Eligibility for the asset rollover is conditional on an entity being eligible for the loss transfer, but will not be dependent on the entity actually choosing the loss transfer. This will permit an arrangement to merge superannuation funds to occur in the following ways:

- a transfer of cash only following the disposal of all the transferring entity's assets;
- a transfer of assets only; or
- a combination of cash and asset transfers.

Potential application to SMSFs

The loss relief is potentially available where a self-managed superannuation fund (SMSF) merges with a non-small APRA-regulated superannuation fund. However, it will not be available where the two funds are SMSFs before the merger or where an SMSF merges with a small APRA-regulated fund. The continuing superannuation fund must also be a complying large APRA-regulated fund immediately before the transfer of assets.

Consequential amendments

The Bill will make consequential amendments to s 115-30(1) of ITAA 1997 to ensure that, for CGT assets transferred from the transferring entity to the continuing entity for a rollover under Div 310, the 12-month ownership period requirement for the CGT discount commences from the date when the transferring entity acquired the asset.

The general provisions which specify the capital proceeds for CGT events A1, C2 and E2 are also modified in respect of transactions arising from the transfer of assets covered by the CGT loss rollover, as the rollover rules specify the capital proceeds in those cases.

The provisions which specify the notice requirements to enable a member in a fund to obtain a deduction for a personal contribution in s 290-170 are amended so that a member of a fund that has merged with a continuing fund may provide the necessary notice. The rules which provide for the variation of the notice in s 290-180 are also amended.

Date of effect

The loss relief measures will be available for superannuation fund mergers that occur on or after 24 December 2008 and before 1 July 2011.

Income from immediate annuity business

The Bill proposes to amend ITAA 1997 to clarify the circumstances in which income derived by life insurance companies in respect of immediate annuity business qualifies as non-assessable non-exempt income.

Superannuation income streams (July 2007)

The Bill will amend s 320-246 of ITAA 1997, effective from the 2007/08 income year, to ensure that the annuity conditions do not apply to immediate annuity policies that provide for superannuation income streams.

It is proposed that from 1 July 2007 an exempt life insurance policy will only include a life insurance policy that provides for an immediate annuity that:

- was purchased on or before 9 December 1987;
- is a superannuation income stream; or
- satisfies the relevant annuity conditions.

Annuity conditions (from July 2000)

The Bill will also amend the annuity conditions in s 320-246, effective from 1 July 2000, to ensure they are consistent with the former annuity conditions. That is, the annuity conditions from 1 July 2000 are:

- the annuity contract does not permit the residual capital value of the annuity to exceed, broadly, its purchase price;
- if the annuity contract provides that the annuity is payable until the end of a term of 'years certain', then the contract does not permit the total commutation payments to exceed, broadly, the remaining amount of the annuity's purchase price;
- if the annuity contract:
 - provides that the annuity is payable until the death of a person (or of the death of the last of two or more persons to die) or until the end of a term of years certain; and
 - permits one or more commutation payments to become payable before the end of a term of years certain,

then the contract does not permit the total of those commutation payments to exceed, broadly, the remaining amount of the annuity's purchase price; and

- no unreasonable deferral of payments of annuity income to policyholders.

Date of effect

The amendments to rewrite the annuity conditions will apply from 1 July 2000. The amendments to ensure that the annuity conditions do not apply to immediate annuity policies that provide for superannuation income streams apply from the 2007/08 income year.

Deductible gift recipients

The Bill proposes to amend ITAA 1997 to update the list of deductible gift recipients (DGRs) to include two new entities and change the name of one entity.

The two new DGRs and their commencement dates for donations are:

- The Green Institute Ltd, for donations made on or after 24 June 2009; and
- United States Studies Centre Limited, for donations made on or after 27 July 2009.

The Bill will also amend the name of 'Dymocks Literacy Foundation Limited' to 'Dymocks Children's Charities Limited', effective from 4 June 2009.

Date of effect

Various as noted above.

Income Recovery Subsidy payments

The Bill proposes to amend s 51-30 of ITAA 1997 to ensure Income Recovery Subsidy payments for the North Western Queensland flood victims are retrospectively exempt from income tax for the 2008/09 income year. The Bill also proposes to exclude the subsidy from the definition of 'separate net income' in calculating a taxpayer's entitlement to a tax offset for maintenance contributions in relation to their dependants.

Date of effect

The amendments will apply retrospectively to the 2008/09 income year.

Excise

The Bill proposes to amend the *Excise Act 1901* to ensure that the blending of certain high strength neutral (HSN) spirits (ie with greater than 10% volume by alcohol) is treated as 'excise manufacture'. The Bill also proposes to give the Commissioner the power to exclude certain activities from being excise manufacture by legislative instrument.

Date of effect

The amendments are proposed to apply from the date of Royal Assent of the Bill.

Amendments to the Administration of GST

The Government has also introduced Tax Laws Amendment (2009 GST Administration Measures) Bill 2009 into the House of Representatives. The Bill seeks to:

- provide a four-year period for claiming input tax credits and fuel tax credits;
- allow residents of Australia's external territories to claim refunds of GST and/or wine equalisation tax under the tourist refund scheme;
- allow entities who facilitate supplies or acquisitions for another entity to utilise the simplified accounting procedures;

- exclude amounts that a gambling operator is liable to pay on GST-free wagers from total monetary prizes;
- treat an overpaid refund to a taxpayer under the GST Act, Luxury Car Tax Act or the Fuel Tax Act as a tax liability; and
- ensure the GST treatment of a supply to an associate without consideration will be an input taxed supply, a GST-free supply or a financial supply, where appropriate.

Four-year period for claiming ITCs and FTCs

The Bill proposes that input tax credits (ITCs) and fuel tax credits (FTCs) must be claimed within a four-year period. This will be achieved by amending the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act), the *Fuel Tax Act 2006* (Fuel Tax Act), the *Taxation Administration Act 1953* (TAA) and ITAA 1997 to provide that a taxpayer will cease to be entitled to an ITC (including a reduced ITC) or FTC if the credit has not been claimed within four years.

The four-year period commences from the day on which a taxpayer is required to give the Commissioner a business activity statement for the tax period to which a credit would be attributable under the basic attribution rules in s 29-10 of the GST Act or s 65-5 of the Fuel Tax Act.

The proposed amendments will not affect the entitlement of taxpayers to ITCs or FTCs where the credits have been taken into account in a taxpayer's earlier return or assessment but the relevant liability or entitlement has not been paid (either by the Commissioner or the taxpayer). In addition, the proposed amendments will only apply to ITCs for fully and partially creditable acquisitions and FTCs. This is because other entitlements and liabilities (eg ITCs for creditable importations and adjustments) are subject to separate attribution rules that do not allow deferral.

Exceptions to the four-year period

The Bill proposes three exceptions to the four-year limitation period. The three exceptions are:

- **notices removing the time limit for liabilities** — the first exception is the four-year period will not apply to a liability if the Commissioner provides notice within the period to a taxpayer requiring payment of an amount.
- **fraud and evasion** — the second exception will apply to credits linked to liabilities avoided as a result of fraud or evasion.
- **notices removing the time limits for refunds and credits** — the third exception will apply where a taxpayer notifies the Commissioner of their entitlement to a credit in accordance with s 105-55(1) of the TAA. However, a notice only preserves a pre-existing entitlement to a credit. Where the taxpayer has already ceased to be entitled to an ITC or FTC, the issue of the notice will not restore this entitlement. The taxpayer will also not be able to preserve their entitlement where s 105-55 does not apply.

For an exception to apply the ITC or FTC must have arisen from the same circumstances that gave rise to a liability or entitlement.

The Explanatory Memorandum accompanying the Bill states that for a credit to arise from the same circumstances, the credit must stem from both the same event and the same reason that gave rise to an amount in a notice or an amount avoided by fraud or evasion. The Explanatory Memorandum also states that in some circumstances the 'arise from the same event' requirement will achieve the same result as the present test for the limitation period provisions. In particular, if a notice is issued in relation to a period because there has been no return or payment provided for that period, then all of the credits attributable to the period may arise from the same circumstances as the notice.

An entitlement to an ITC will not be preserved beyond the four-year limitation period, even though the exceptions may apply, if:

- the Commissioner is no longer able to obtain payment of the GST from the supplier of the taxable supply related to ITCs an entity seeks to claim; and
- a tax invoice was not issued for the supply within four years.

Adjustments for payments and gross-up clauses

The Bill also seeks to amend the GST Act to create an extra adjustment rule. The proposed rule will require taxpayers to adjust their net amount where they are contractually required to provide payment as a result of a supplier being liable to pay GST after a taxpayer has ceased to be entitled to the relevant ITC.

The proposed adjustment rule will address the situation whereby a gross-up clause in a commercial contract results in a recipient of a supply bearing the burden of the GST. This will be achieved by providing that where the recipient must pay more as a result of the gross-up clause and they have ceased to be entitled to the input tax credit for the acquisition, the taxpayer will have a decreasing adjustment, reducing their GST liability.

Date of effect

The amendments relating to ITCs will apply to GST returns and assessments lodged or issued from 7.30 pm AEST on 12 May 2009 and revisions to such returns and revised assessments issued or made after this time.

It is intended the amendments apply to returns and assessments for the purpose of fuel tax law lodged or issued from 1 July 2010 and revisions to such returns and revised assessments issued or made after this time.

The amendments will affect taxpayers based on when they lodge a return and not the tax period to which the return relates. Taxpayers will also be subject to the four-year limitation period:

- when claiming ITCs in tax periods that ended before 12 May 2009 but for which they had not previously lodged returns or been assessed; or
- when seeking to amend earlier returns or assessments after 12 May 2009.

Consequential amendments

The Bill will make consequential amendments to ensure that adjustments resulting from the amendments to address gross-up clauses interact appropriately with the rules for adjustments currently operating in the GST Act.

The proposed amendments will not repeal s 105-55(1)(c) of Sch 1 to the TAA. However, they have significant implications for the operation of this section. This section will cease to have any effect for GST and fuel tax credits following the commencement of the amendments. As taxpayers' entitlement will cease after the four-year period has passed, it will not be possible for them to be taken into account in working out any net amount. Where appropriate, the amendments seek to preserve the entitlement to ITCs and FTCs to the extent they arise from the circumstances of the fraud or evasion.

Australian external territory refund collection system

The Bill seeks to amend the *A New Tax System (Wine Equalisation Tax) Act 1999 (WET Act)* and the GST Act to allow unregistered residents of Australia's external territories (eg Norfolk Island, Christmas Island and the Cocos Islands) to claim refunds of GST, or GST and WET under the tourist refund scheme (TRS) on goods not exported as accompanied baggage. The residents must satisfy the conditions outlined in the GST Regulations before an entitlement arises. Where the goods are wine, the conditions in the WET Regulations must also be satisfied.

The Bill will also clarify that goods can only be sold as a GST-free export (under s 38-185(3) of the GST Act) to an Australian external territory resident if the resident declares to a supplier that the goods were not subject to a refund claim for GST and/or WET under the TRS. The declaration must be presented to the supplier at the time 'sufficient documentary evidence of exportation' is provided.

Date of effect

The amendments will commence on 1 July 2010 and apply to goods purchased on or after that date.

Agency provisions

The Bill will allow entities that facilitate supplies or acquisitions for another entity through acting as an intermediary to utilise the simplified accounting procedures (SAP) in Subdiv 153-B of the GST Act, irrespective of whether the intermediary can legally bind the principal by their acts. Simply put, the Bill seeks

to permit 'transaction facilitators' (eg billing and paying agents) that fall short of the requirements to be regarded as common law agents to use the SAP.

The principal and the intermediary will need to enter into a written agreement stating that the intermediary will, on the principal's behalf:

- make supplies to third parties;
- make acquisitions from third parties; or
- make both supplies to and acquisitions from third parties.

The agreement will also need to specify the other matters required in s 153-50, such as the kinds of supplies and acquisitions to which the agreement will apply and the requirement for the intermediary to issue tax invoices to third parties instead of the principal.

Date of effect

The amendments will apply to supplies and acquisitions made by intermediaries on or after 1 July 2010 and apply to goods purchased on or after that date. In addition, a pre-existing written agreement may be used as long as it meets the conditions in s 153-50.

Consequential amendments

This Bill seeks to allow an intermediary to treat the value of any taxable supply that they are taken to make under Subdiv 153-B as being an amount equal to the 'value' of the commission or similar payment that the principal is liable to pay to them for their services relating to that supply. If an intermediary chooses to work out their GST turnover in this manner, their GST turnover would be equal to the amount that would have been their GST turnover, had they not entered into an agreement under Subdiv 153-B.

Gambling supplies by entities outside Australia

The Bill proposes to exclude prize monies that a gambling operator is liable to pay out on GST-free wagers from total monetary prizes for the purposes of s 126-10 of the GST Act (because supplies made to entities outside Australia are GST-free).

The Explanatory Memorandum states that for prize monies to be excluded from total monetary prizes the monies must relate to supplies that reflect the issue of a ticket, however described, or acceptance of a bet in a gambling event. The Explanatory Memorandum also states that the amendments do not alter the nexus required between supplies and the liability to pay prize money under the current law.

The supplies or gambling events to which the monetary prizes relate do not have to arise in the tax period during which the liability for the prize money arises. This means that the gambling operator will not have to match up its monetary prizes with the particular supplies on which the liability to pay arises in order to determine the start date of the measure (or for general GST accounting).

Date of effect

It is intended the amendments will apply to monetary prizes for which liabilities arise during or after the first quarterly tax period that commences on or after the Bill receives Royal Assent. A gambling operator does not need to have a tax period commencing at this time or be paying GST quarterly.

Recovering overpaid refunds

The Bill seeks to ensure an overpaid refund to a taxpayer under the GST Act, Luxury Car Tax Act and Fuel Tax Act will be treated as an amount due and payable from the date of the overpayment.

Overpaid refunds under the GST Act

The amendments will ensure that if an amount refunded under s 35-5 of the GST Act for a tax period is subsequently reduced to a lesser amount by the Commissioner making an assessment or amending an assessment, or by a taxpayer revising their business activity statement, the amount by which the overpaid refund has been reduced is treated as if it was GST that became due and payable from the time it was paid to the taxpayer or applied against a tax debt.

Overpaid refund under the Luxury Car Tax Act

The amendments will ensure that an overpayment of a LCT credit to a non-registered entity will be treated as if it was LCT that became due and payable from the date it was paid or applied to the entity.

Overpaid refund under the Fuel Tax Act

The amendments seek to ensure that if an amount was refunded under s 61-5 of the Fuel Tax Act for a tax period or a fuel tax return period is subsequently reduced to a lesser amount by the Commissioner making an assessment or amending an assessment, or by a taxpayer revising their fuel tax return, the amount by which the overpaid refund has been reduced is treated as if it was a net fuel amount that became due and payable from the time it was paid to the taxpayer or applied against a tax debt.

Liability for GIC

The Bill proposes that taxpayers who are overpaid refunds will be liable for GIC from the date that they receive the benefit of the overpayment. However, the Commissioner has the discretion to remit the GIC in part or in full in the appropriate circumstances. This will include circumstances where it is fair and reasonable to do so, based on the particular facts of each individual case.

Date of effect

The amendment will apply to overpayments made by the Commissioner from the start of the first quarterly tax period after the Bill receives Royal Assent.

Consequential amendments

The *Taxation Administration Act 1953* will be amended to include new provisions that overpaid refunds (under the GST Act, Luxury Car Tax Act or Fuel Tax Act) are tax-related liabilities.

GST and associates provisions

The Bill will ensure that Div 72 of the GST Act applies such that a supply to (or from an associate) may constitute an input-taxed supply, a GST-free supply or a financial supply despite being without consideration.

The Bill will also ensure that a supply to an associate, that would otherwise be a sale or some other kind of supply if it was for consideration, is taken to be a sale or that other kind of supply despite the lack of consideration. Similarly, if, apart from a lack of consideration, an acquisition from an associate would be by sale or some other means, the acquisition is taken to be an acquisition by that means.

Further, the Bill seeks to provide that supply of goods without consideration to an associate is GST-free if the supplier exports the goods from Australia.

Date of effect

The amendments will commence on the date of Royal Assent of the Bill.

GST and Sale of Vacant Land

The Federal Court has affirmed that the sale of two blocks of vacant land by a taxpayer did not satisfy the definition of residential premises and, therefore, constituted taxable supplies: *Vidler v FCT* [2009] FCA 1426.

The taxpayer sold the vacant lands in December 2004 and May 2005 respectively. The first block was zoned as residential low density and the second block was zoned as character mixed residential. Both blocks were capable of being connected to utility supplies and sewerage infrastructure. The taxpayer did not remit GST on the sales because he contended that they were input taxed supplies, that is, the lands were residential premises to be used predominantly for residential accommodation pursuant to s 40-65(1) of the GST Act.

In reaching its judgment, the Court considered the decision of the Federal Court in *South Steyne Hotel Pty Ltd v FCT* (2009) 71 ATR 228. In the *South Steyne* case, Stone J said the definition of residential premises requires the term of the occupation or intended occupation to be disregarded. Therefore, in Her Honour's view, for premises to be considered residential it was necessary that the 'element of shelter and basic living facilities such as provided by a bedroom and bathroom' were presented. The Court noted this interpretation

of residential premises was affirmed by the Full Federal Court in *South Steyne Hotel Pty Ltd v FCT* [2009] FCAFC 155.

The Court noted the two blocks of land were not occupied at the time of sale. Therefore, the Court said for the lands to satisfy the definition of residential premises they must, at the time of sale, have been capable of providing some shelter and basic living facilities. The Court acknowledged that zoning permitting residential occupation might be necessary for land or a building to be capable of providing shelter and basic living facilities. However, the Court said it was not sufficient to satisfy the definition. Accordingly, in the Court's view, the lands did not provide any element of shelter and basic living facilities.

The Court rejected the taxpayer's submission that the lands were intended to be occupied and were capable of being occupied as residences. The Court said the second limb of the definition of residential premises in s 195-1 of the GST Act is focused on the 'capacity of the land to be used at the relevant time for the nominated purpose; it is not concerned with the potential for the land to be developed to have that capacity'. The Court also said the taxpayer's distinction between 'bare vacant land' and 'serviced vacant land' treats the proposition that the latter is included in the definition of residential premises as 'both the premise and the conclusion of the argument'. The logical fallacy was immediately apparent in the taxpayer's analysis, said the Court.

In conclusion, the Court found that the lands did not satisfy the definition of residential premises because there was no element of shelter and basic living facilities.

Definition of residential premises

The term 'residential premises' is defined in s 195-1 to mean land or a building that:

- is occupied as a residence or for residential accommodation; or
- is intended to be occupied, and is capable of being occupied, as a residence or for residential accommodation;

(regardless of the term of the occupation or intended occupation) and includes a floating home.

The Commissioner's established view on the definition of residential premises is contained in GST Ruling GSTR 2000/20. In the ruling, the Commissioner states that 'to be residential premises as defined, a place need only provide sleeping accommodation and the basic facilities for daily living, even if for a short term'. This view was confirmed by the Federal Court in *South Steyne Hotel Pty Ltd v FCT* (2009) 71 ATR 228. In addition, the Commissioner states that vacant land can never have sufficient physical characteristics to be able or intended as a residence or for residential accommodation. The Commissioner also states that the physical characteristics common to residential premises that provide accommodation are:

- the premises provide the occupants with sleeping accommodation and at least some basic facilities for day to day living; and
- the premises may be in any form, including detached buildings, semi-detached buildings, strata-title apartments, single rooms or suites of rooms within larger premises.

Continuity of Trust

In a matter involving trusts and the calculation of net capital gains, husband and wife taxpayers have been successful before the Federal Court in arguing that the net capital gain arising out of a disposal of properties by the trust could be reduced by previously unapplied net capital losses: *Clark v FCT* [2009] FCA 1401.

Background

In the 2001 income year, the trust sold two properties and realised a net capital gain of \$1,932,006. The taxpayers contended that previously unapplied net capital losses from earlier income years applied to reduce the net capital gain to nil.

Conversely, the Commissioner contended the capital gains from the disposal of the properties could not be reduced by the carried forward net capital losses. In the Commissioner's view, a series of events in June 1993 resulted in a discontinuity in the trust estate that made the capital gain in the 2001 income

year and the trust estate that incurred the unapplied net capital losses. The Commissioner submitted that the events brought about a break in the continuity of:

- the trust fund;
- the trustee's interest in the trust estate; and
- the interests of the beneficiaries in the trust fund.

The Commissioner also submitted that the limiting criterion to be applied is that a net capital loss from an earlier income year must be attributed to the same taxpayer who seeks to apply it to a capital gain in a future income year. The Commissioner said the 'scheme of the ITAA 1936 and the ITAA 1997 imports a requirement of continuity although the statutory scheme does not lend any precision to the criterion of continuity'.

Decision

The Court said neither ITAA 1936 nor ITAA 1997 requires a 'statutory integer of a right to apply any previously unapplied net capital losses incurred by the trustee of the trust estate from earlier income years (so as to reduce the amount remaining after calculating the net capital gain in the relevant income year), a continuity in the trust estate or continuity in the structure of the trust or continuity in the rights, duties and obligations arising under the trust instrument, in the year of the net capital gain and the income year of the net capital loss'. It noted that there are no similar provisions as to the continuity of ownership and business comparable with those governing companies.

After considering the decision of the Full Federal Court in *FCT v Commercial Nominees of Australia Ltd* (1999) 43 ATR 42, the Court said that if:

some degree of continuity of trust property is made out and continuity in the regime of trust obligations is established, there will be sufficient identity of taxpayer in the sense that the hypothetical representative trustee taxpayer on behalf of the trust estate that incurred the loss is the hypothetical taxpayer of the trust estate that made the net capital gain.

The Court also considered the three indicia of continuity framed by the High Court in *FCT v Commercial Nominees of Australia Ltd* (2001) 47 ATR 220, albeit the case concerned a superannuation fund. The Court believed the three indicia could equally apply to trust estates for the purposes of Div 5 of Pt III of ITAA 1936 and ITAA 1997. The three indicia are the constitution of the trust, the trust property and the membership of the trust.

While the Court acknowledged the events in 1993 saw the extinguishment of the right of indemnity in respect of the former trustee, it said the trust property and the trustee's interest in the trust estate were not fundamentally altered. In the Court's view, the conditions leading to the extinguishment were matters influencing the exercise of the power to replace the trustee. The Court also said the extinguishment was an element of enabling further contributions to be made to the trust fund to enable it to embark upon property development projects.

After examining the clauses in the trust deed, the Court was satisfied that a change in trustee was not inconsistent with the continuity of the trust or trust estate. In doing so, the Court rejected the Commissioner's submission that the appointment of the current trustee effected a change in the individuals who controlled the discretionary power of application of the net income of the trust fund. The Court said a change in control in the exercise of the powers conferred on the trustee by the deed logically flows from a change of trustee.

The Court also rejected that a discontinuity had occurred because of the change in the interests of the unit holders in the trust despite a suspension arrangement entered into in 1993 in which the trustee would not be required to take into account a former unit holder's interests when allocating the net income of the trust. It said when comparing the trust estate in the income year of the capital loss with the trust estate in the income year of the capital gain, the interests of the holders of the issued units were the same, albeit the ownership of the units had changed.

In conclusion, the Court ordered the parties to make submissions as to the formal orders that reflect its reasons.

Deductibility of Disability Superannuation Benefit Premiums

The Government has announced that it will amend ITAA 1997 to provide transitional relief to complying superannuation funds for the deduction of insurance premiums for total and permanent disability superannuation benefits (TPD benefits). The amendment will defer the application of Subdiv 295-G of ITAA 1997, which governs the deductibility of insurance premiums for superannuation disability benefits, to 1 July 2011. In addition, the amendment will ensure that the current industry practice for deducting TPD premiums will apply from 1 July 2004 until 30 June 2011. That is, from 1 July 2011, the law will revert to insurance premiums only being deductible to the extent the policies have the necessary connection to a liability of the fund to provide disability superannuation benefits to their members and not other types of insurance for which premiums are collected from their members. It is proposed the amendment will apply from 1 July 2004 until 30 June 2011.

Tax Office administrative treatment

The Tax Office said that it will accept tax returns lodged by superannuation funds during the period up until the proposed law is passed by the Government. It also said past year assessments will not be reviewed until the outcome of the proposed amendment is known.

The Tax Office advised taxpayers that they will need to review their tax positions back to the 2004/05 income year after the proposed amendment is enacted:

- taxpayers who claimed deductions for disability superannuation premiums that accord with the proposed changes do not need to do anything more;
- taxpayers who underclaimed deductions for disability superannuation premiums can seek amendments. Where an amendment results in a reduction in tax payable, interest on the overpayment of tax will be paid; and
- taxpayers who overclaimed deductions for disability superannuation premiums will need to amend their tax returns.

According to the Tax Office, no tax shortfall penalties will be applied where deductions were claimed in accordance with the Government's announcement and any interest accrued will be remitted to the base interest rate up to the date of enactment of the proposed amendment. Further, the Tax Office said that any interest in excess of the base rate accruing after the date of enactment will be remitted where taxpayers actively seek to amend their assessments within a reasonable timeframe.

Thomson Reuters note

A complying superannuation fund may claim a deduction for a portion of any premiums for an insurance policy related to covering superannuation death benefits or superannuation disability benefits: ss 295-460 and 295-465 of ITAA 1997. The portion varies depending on the nature and type of policy involved.

A 'disability superannuation benefit' is defined in s 995-1 of ITAA 1997 to mean a superannuation benefit if:

- (a) the benefit is paid to a person because he or she suffers from ill-health (whether physical or mental); and
- (b) two legally qualified medical practitioners have certified that, because of the ill-health, it is unlikely that the person can ever be 'gainfully employed' in a capacity for which he or she is reasonably qualified because of education, experience or training.

Trauma Insurance Policies and SMSFs

The Tax Office has released Draft Self Managed Superannuation Funds Determination SMSFD 2009/D1 in which it states the Commissioner's preliminary views on the circumstances where a trustee of a self-managed superannuation fund (SMSF) can purchase a trauma insurance policy for a member and still satisfy the sole purpose test in s 62 of the SIS Act.

The Commissioner says any benefits payable under a trauma insurance policy must be payable to a trustee of the SMSF and become part of the assets of the SMSF, at least until the relevant member can satisfy a condition of release. In addition, a policy must not be acquired to secure some other benefit under the policy for another person (eg a member or member's relative).

If an SMSF trustee purchases a trauma insurance policy that provides for benefits payable under the policy to be paid directly to someone other than a trustee of the SMSF (eg the insured member or member's relative is the beneficiary of the policy), the Tax Office says this would contravene s 62 of the SIS Act (the sole purpose test).

Nevertheless, it is the Commissioner's view that the acquisition of a trauma insurance policy by a trustee of an SMSF will not automatically lead to the trustee contravening the sole purpose test.

Considerations for trustees

In determining whether an SMSF should offer trauma insurance, the Tax Office says trustees should consider their obligations to members generally and factors such as the proportion of contributions applied to purchase insurance cover. According to the Commissioner, matters relevant to an SMSF's compliance with the sole purpose test include how fund assets are acquired and invested, how fund assets are employed and what benefits are provided by the SMSF.

The Tax Office considers that benefits should only be provided to or for an SMSF member on or after the member's retirement, employment termination or death. The Commissioner states that any current day benefits provided to a member or a related party (eg a relative of the member or a related business) are more likely to raise questions about compliance with the sole purpose test.

The Tax Office believes an unreasonable diversion of contributions to purchase premiums for contingent trauma cover would be difficult to reconcile with the sole purpose test and the fundamental retirement objective of superannuation. The sole purpose test also implies that an SMSF should not take on an obligation (eg the payment of insurance premiums) for which it receives no benefit at all. In addition, the Tax Office says a trustee should consider other SIS regulatory provisions that complement the sole purpose test and whether the policy was acquired in order to secure some other benefit (eg cheaper premiums on other policies) for a person such as a member or member's relative.

GIC and SIC rates Released

The Tax Office has released the GIC and SIC rates for the third quarter of the 2009/10 income year (ie 1 January 2010 to 31 March 2010). The rates are:

Rate	Annual (%)	Daily (%)
GIC	10.95	0.03
SIC	6.95	0.01904110

The Tax Office has also released the interest rate for overpayments, early payments and delays in refunds for the third quarter of the 2009/10 income year. The applicable interest rate is 3.95%.

Tax Practice Update

Tax (Budget Measures No 2) Bill 2009

The Tax Laws Amendment (2009 Budget Measures No 2) Bill 2009 received Royal Assent on 14 December 2009. The Bills passed through all stages of Parliament without amendments.

Below is a short reminder of the amendments in the Bill:

- **taxation of employee share schemes** — the Bill repeals Div 13A of Pt III of ITAA 1936 and inserts new Div 83A into ITAA 1997 dealing with employee share schemes;

- ***non commercial losses rules*** — the Bill prevents high income individuals (ie individuals with an adjusted taxable income of \$250,000 or more) from offsetting losses from non-commercial activities against their salary, wage or other income; and
- ***payment of lost members' superannuation accounts*** — the Bill requires superannuation providers to transfer the balance of a lost member's account to the Commissioner of Taxation.

The associated Income Tax (TFN Withholding Tax (ESS)) Bill 2009 also received Royal Assent on 14 December 2009.

Addendum to the main Bill

An addendum to the Explanatory Memorandum accompanying the Tax Laws Amendment (2009 Budget Measures No 2) Bill 2009 was released by the Government. In particular, the addendum explains the review rights of taxpayers in relation to the Commissioner's discretion under the proposed changes to the non-commercial losses rules.

The addendum states that the Commissioner's exercise of a discretion under the non-commercial losses rules (including a decision not to exercise the discretion) is a matter leading up to or forming part of the making of an income tax assessment. The addendum also states that all decisions leading up to or forming part of the making of the assessment are subject to a formal review process. The review process includes internal review and external reviews by either the AAT or the Federal Court.