



# Explanatory Memorandum

February 2011

**CURRENCY:**

This issue of Client Alert takes into account all developments up to and including 14 January 2011.

## Whether a Property Constitutes Residential Premises for GST Purposes

The Full Federal Court has unanimously dismissed the taxpayer's appeal and held that whether a property was residential premises to be used predominately for residential accommodation within the meaning of s 40-65(1) of the GST Act was to be determined objectively by reference to the physical characteristics of the property as at the date of acquisition.

### Background

In August 2006, the taxpayer acquired a property which was occupied by a tenant pursuant to a residential tenancy agreement which had approximately 4 months to run. In addition, the property was purchased with a development application that related to the construction of 10 units. In its BAS for the quarter ending 30 September 2006, the taxpayer claimed input tax credit in respect of the property, which the Commissioner disallowed under s 40-65 of the GST Act and issued an assessment to that effect.

At first instance, the AAT agreed with the Commissioner that the property was an input taxed supply because it was "residential premises to be used predominately for residential accommodation": *AAT Case [2008] AATA 838, Re Sunchen Pty Ltd ATF The Sunchen Family Trust and FCT* (2008) 71 ATR 398. The Tribunal's decision was affirmed by the Federal Court in *Sunchen Pty Ltd v FCT* (2010) 75 ATR 13.

The taxpayer contended that the operation of s 40-65(1) was to be determined by the purchaser's subjective intentions. It submitted that this was based upon the decision of the NSW Supreme Court in *Toyama Pty Ltd v Landmark Building Developments* (2006) 62 ATR 73.

Conversely, the Commissioner contended that the operation of the section should be determined objectively by reference to the physical characteristics of the property as at the date of acquisition, which was consistent with the Full Federal Court's decision in *Marana Holdings Pty Ltd v FCT* (2004) 57 ATR 521.

### Decision

In arriving at its decision, the Full Court examined the construction of s 40-65(1). In the Court's view, the statutory construction of the words "to be used predominately for residential accommodation" could be discussed in the context of the former investment allowance deduction provisions in Subdiv B of Div 3 of Pt III of the ITAA 1936. After discussing various cases heard by the courts (eg *Smith (W D W) v FCT* (1982) 12 ATR 755 and *Kearney v FCT* (1984) 15 ATR 564) concerning the operation of the former provisions, the Full Court said the words in s 40-65(1) are only concerned with the physical attributes of the property, and not with a person's intended use of the property. Nonetheless, the Court said the actual use of the property would not necessarily be irrelevant, based on the Full Federal Court's decision in *Hamilton Island Enterprises Pty Ltd v FCT* (1982) 12 ATR 790.

In the Full Court's opinion, the phrases "intended to be occupied" and "to be used", as they appear in s 40-65(1), are synonymous. It said the word "predominately", which appears after the second phrase, qualifies the first phrase in a quantitative way. The Full Court also said the 2 phrases do not impose an objective test and subjective test.

The Court noted the concluding words (ie "to be used") of the section were concerned with the use to which the property was to be applied. However, it said this did not mean that the question posed by the words "should be answered exclusively, or even (necessarily) principally, by reference to the intention of the future of the owner" and should not be elevated to a "level of importance higher than other objective circumstances".

*Sunchen Pty Ltd v FCT* [2010] FCAFC 138, Full Federal Court, Edmonds, Jessup and Gilmour JJ, 8 December 2010 <[www.austlii.edu.au/au/cases/cth/FCAFC/2010/138.html](http://www.austlii.edu.au/au/cases/cth/FCAFC/2010/138.html)>

## Tribunal Can't Review Private Ruling Decision as Ruling Given for Wrong Years

The AAT has ruled that it lacked jurisdiction to review a taxpayer's request for review of the Commissioner's decision to disallow its objection against a private ruling because the ruling was made in respect of the wrong years of income and therefore was invalid.

### Background

The ruling had been originally sought in respect of the 2004 to 2008 income years (inclusive) in relation to whether the taxpayer was entitled to a deduction under either s 8-1 or s 40-880 of the ITAA 1997 for "capital appreciation" payments made to outgoing tenants of its retirement village. The Commissioner ruled that the taxpayer was not entitled to any deduction but, in doing so, also gave an adverse ruling for the 2003 and 2009 income years in relation to deductibility under s 8-1.

In disallowing the taxpayer's subsequent objection of 4 March 2010 to the ruling, the Commissioner relied on s 14ZW(1)(aa) of the *Taxation Administration Act 1953* (TAA) that an objection must be made against the assessment within 2 or 4 years after the Commissioner gives notice of the assessment to the taxpayer (as the case may be) and that as the notices of assessment had issued for the taxpayer for the years ended 30 June 2003 to 30 June 2008 inclusive, the objection to the private ruling for these years was invalid.

However, in papers lodged for the AAT proceedings, both parties initially agreed that the deductibility of the outgoings under s 8-1 for the 2009 income year was still in issue. The taxpayer had also conceded that there was no right to object to the ruling for the 2005 to 2008 income years because they were "nil" assessments and therefore could not be subject to review in view of the decision in *FCT v Ryan* (2000) 43 ATR 694 (albeit the law was later amended). However, Commissioner now argued before the AAT that as the taxpayer did not ask for a ruling for the 2003 and 2009 income years there had been no valid ruling which could be subject to review before the AAT.

### Decision

The AAT agreed with the Commissioner that insofar as the ruling purported to relate to the 2003 income year and the 2009 income year, this was a "manifest error" that invalidated the ruling. Specifically, the AAT found that s 359-5(1) of Sch 1 to the TAA empowers the Commissioner to make a written ruling "on application" and that as there had been no application by the taxpayer for a written ruling on the way in which the relevant provisions would apply in relation to the 2003 and 2009 income years, there was nothing on which the Commissioner could give a valid ruling.

The AAT also found that where, as here, a ruling has been made in error, then s 357-90 of the TAA (the equivalent of s 175 of the ITAA 1936 relating to the "prima-facie" validity of assessments) cannot make valid something which is "manifestly wrong". As a result, the AAT concluded that there was no decision capable of being reviewed by the AAT with respect to the 2003 and 2009 income years and, therefore, dismissed the taxpayer's application in relation to those years.

In relation to the 2004 income year (which remained in issue), the AAT found that despite being a "nil" assessment, s 359-60 of Sch 1 to the TAA did not operate to prevent the taxpayer from objecting to the ruling so far as it related to that year. However, the AAT found that even if there was a valid objection decision in respect of that year, the taxpayer had not sought a review of that decision in terms of the application lodged in the AAT which identified the 2009 year as the only one that was in issue in the proceedings. In addition, the AAT also noted the Commissioner's failure to properly give consideration to the taxpayer's request to lodge its objection out of time was also relevant.

Finally, the AAT's comments on the manner in which the Tax Office handled the matter are worth repeating (para 25):

"...the level of competence displayed in the Commissioner's office in dealing with this application falls well below the standard which the Commissioner sets and which, in my experience, is usually met. It is unfortunate that the errors were made and not detected. It is even more unfortunate that the proceedings have got to the stage that they have in the Tribunal without the matter having been raised. As a consequence of that, the applicant has expended money on legal fees and the like quite unnecessarily."

Accordingly, the AAT suggested that the Commissioner should give serious consideration to compensating the taxpayer for the costs thrown away by the late raising of the jurisdictional argument.

*AAT Case [2010] AATA 1069, AAT, Ref No 2010/3311-3317, Hack DP, 24 December 2010*  
<[www.austlii.edu.au/au/cases/cth/AATA/2010/1069.html](http://www.austlii.edu.au/au/cases/cth/AATA/2010/1069.html)>

## Retirement Village Scheme Deductions Wrong, but Taxpayers Took “Reasonable Care”

In 2 interesting cases involving husband and wife taxpayers, the AAT has held that they had taken reasonable care in lodging tax returns that claimed deductions for an investment in a retirement village scheme with the consequence that the penalties imposed were overruled and remitted.

### Background

The taxpayers are a husband and wife who are retired and in 1999, each invested \$100,000 in a retirement village scheme promoted by Prime Life Corporation Limited (or one of its subsidiaries) as a member of a syndicate or partnership. They claimed deductions for amounts actually outlaid on entering the scheme and for amounts contracted to be paid in years after entering the scheme upon a range of contractual requirements being satisfied.

The investments led to deductions of \$400,000 being claimed in the 1999 year by each taxpayer which produced carried forward loss deductions in the 2000 and 2001 years. The Commissioner disallowed the deductions beyond the amounts actually paid, contending that the amounts contracted to be paid were not incurred, and issued amended assessments. Penalties were also imposed.

The Tribunal noted that the taxpayers spoke limited English. It said Mr Shin had the dealings with the advisors to both of them and Mrs Shin relied on her husband. In the words of the Tribunal, “Mr Shin displayed minimal understanding of the retirement village investment and of the current proceedings. In 1999 he was looking to make an investment that would provide for his retirement and consulted his tax agent. Mr Shin was advised that the retirement village investment was a sound investment and that tax deductions would be available as claimed. He inspected the proposed village and thought it would be a place for him to live in his retirement”.

The Tribunal said there was evidence the taxpayers’ solicitor had also invested in the retirement village scheme. Mr Shin trusted his professional advisers and signed documents that they prepared for him to sign, the AAT noted. Those documents included his tax returns and a voluntary disclosure he had made. The Tribunal said the extent of independent analysis of any entitlements to deductions by the taxpayers’ advisers was “unknown”, and there was no evidence of what enquiries, if any, were made by the taxpayers’ tax agent.

The Tribunal noted that the substantive tax liability was not contested and it was not disputed that there were tax shortfalls.

The AAT said the issues in dispute were:

- in lodging the relevant tax returns that claimed deductions, whether the taxpayers took reasonable care within the meaning of s 226G of the ITAA 1936 for the 1999 and 2000 years and ss 284-85 and 284-90 (item 3) of Sch 1 to the *Taxation Administration Act 1953* for the 2001 year. For penalty purposes, the AAT said the Commissioner did not contend that the taxpayers did not adopt reasonably arguable positions. Accordingly, the Tribunal said if there was not sufficient evidence of what advices were obtained in preparing tax returns, “the issue can be distilled to whether the [taxpayers] can be said to have taken reasonable care if [they had] adopted a reasonably arguable position”;
- if there was a potential for penalty to be imposed, whether any penalty should be remitted pursuant to s 227(3) of the ITAA 1936 for the 1999 and 2000 years and s 298-20 of Sch 1 to the TAA for the 2001 year.

### Decision

The Tribunal said that, while the Commissioner had not imposed penalty for failure to take a reasonably arguable position, he contended, in effect, that the 2 bases on which penalty can be imposed were alternatives. The AAT considered it was the context of the whole of the wider scheme of penalties that penalties imposed pursuant to s 226G and ss 284-85 and 284-90(1) for failing to take reasonable care needed to be considered.

The Tribunal considered that of particular relevance in the present case were the penalties that could be imposed for failing to take what might be described as reasonably arguable positions - s 226K of the ITAA 1936 and ss 284-75(2) and 284-90(1) item 4 of the TAA and the role that those penalty provisions play in considering what constitutes taking reasonable care.

The Tribunal was of the view that the Commissioner’s contention did “not appear to be consistent with the policy underlying the penalty for failing to take reasonably arguable positions”. That policy was noted by Hill J in *Walster v FCT* (2003) 54 ATR 423. Hill J then quoted from the EM to the Bill that introduced the penalty regime - he said:

*"An argument could not be as likely as not correct if there is a failure on the part of the taxpayer to take reasonable care. Hence the argument must clearly be one where, in making it, the taxpayer has exercised reasonable care. However, mere reasonable case [sic] will not be enough for the argument of the taxpayer must be such as, objectively, to be 'about as likely as not correct' when regard is to be had to the material constituting 'the authorities'."*

The Tribunal considered it was necessary to reconcile Hill J's remarks with the terms of the EM. The AAT said the Minister did not suggest that failing to adopt a reasonably arguable position attracted an additional penalty. In the AAT's view, the EM explained that "the reasonably arguable position was simply a higher standard that needs to be met where large amounts are involved; the position adopted must be reasonably arguable, failing which the same level of penalty of 25% of the shortfall tax applies as would apply in cases of smaller shortfalls accompanied by a failure to take reasonable care".

The Tribunal considered it was possible to reconcile the comments made by Justices Hill and Finn (in *R&D Holdings Pty Ltd v DCT* (2006) 64 ATR 71) with the EM "if they are to be taken as saying that satisfying the reasonably arguable position test means that reasonable care has been taken". The AAT said it followed, therefore, "with some reservations given the remarks of Justices Hill and Finn", that:

- "the reasonably arguable position test is a higher standard to meet than the reasonable care standard; and
- if a taxpayer has adopted such a reasonably arguable position the reasonable care standard should be accepted as having been met."

The Tribunal said that outcome was consistent with the remarks in the EM referred to above that if a taxpayer comes to a conclusion that is reasonable, there should not be any penalty. "Coming to the same conclusion as a judge of the Federal Court, albeit one reversed on appeal, cannot be said to be an unreasonable conclusion", the Tribunal said.

In the alternative, the Tribunal said if this approach was wrong, then there were 3 matters that needed to be dealt with:

- the circumstances show that the taxpayers had acted on advice from a tax agent ie someone "who it might be expected would be in a position to know what the proper tax treatment of the outgoings and commitments to the retirement village scheme would be". If the test were limited to the taxpayer (which is not the case), then the Tribunal considered there was evidence of care being taken which in the circumstances of the taxpayers was sufficient for the standard to be met;
- the Tribunal said there was no evidence of the care that was taken by the taxpayers' tax agent. As taxpayers are vicariously responsible for their agents failures to take reasonable care, in the present matter, the Tribunal said the taxpayers could not be said to have discharged their burden and, subject to the question of remission, would fail; and
- the question of remission arises. For there to be a remission, the Tribunal said it was necessary to show that the penalty was harsh in the particular circumstances of the taxpayer. There need to be mitigating circumstances that could be regarded as mitigating the taxpayer's behaviour while at the same time recognising the purpose and role that penalties play in the self-assessment system. The Tribunal said that, "in circumstances where a taxpayer adopts a position in a tax return that conforms to the outcome reached by a considered decision of a judge of the Federal Court in materially the same circumstances, any level of penalty would be harsh". The Tribunal considered it was appropriate to remit any penalty that would otherwise be applicable.

*AAT Case [2010] AATA 1012, Re Shin and FCT <[www.austlii.edu.au/au/cases/cth/AATA/2010/1012.html](http://www.austlii.edu.au/au/cases/cth/AATA/2010/1012.html)> and AAT Case [2010] AATA 1013, Re Shin and FCT <[www.austlii.edu.au/au/cases/cth/AATA/2010/1013.html](http://www.austlii.edu.au/au/cases/cth/AATA/2010/1013.html)>, AAT, O'Loughlin SM, AAT Ref Nos: 2007/2795-2798 and 2007/2802-2805, respectively, 13 December 2010*

## Refunds for Overpayments of GST

Miscellaneous Taxation Ruling MT 2010/1, released on 15 December 2010, states the Commissioner's views on the application of s 105-65 of Sch 1 to the TAA. In brief, this section sets out when the Commissioner need not refund a taxpayer an overpayment of GST.

### Scope of s 105-65

The Ruling states the section only applies to a miscalculation of a net amount that arises as a result of the amount of GST payable being overstated and does not apply to situations where the overpayment relates to luxury car tax, wine equalisation tax or taxable importations. It also states the section applies if an entity has remitted an amount of GST for supplies that are subsequently determined to have been made by another entity. The Ruling also states the effect of the section must be taken into consideration in determining an entity's net amount.

In the Commissioner's view, the section is not limited to situations where an actual refund is payable. The Commissioner says the section can also apply if a supplier revises a relevant activity statement and, after netting off all underpayments and overpayments, has a nil net amount or still has a liability to pay for the particular tax period. The Commissioner says s 105-65 can apply to any component of the revision that represents an overpayment arising from the incorrect treatment of a supply as taxable to any extent.

### Meaning of "overpaid"

The Commissioner notes that "overpaid" is not a defined term and therefore its normal meaning will apply. According to the Ruling, in the context of s 105-65, the term means the amount that has been remitted in excess of what was legally payable on the particular supply in the relevant tax period prior to taking into account or applying the section.

### Meaning of "treated as a taxable supply"

The Ruling states a supply would be treated as a taxable supply if the supplier has mischaracterised the supply as taxable because:

- they believed it was a taxable supply;
- they dealt with the recipient of the supply as if the supply was a taxable supply; and
- they have remitted an amount as GST to the Tax Office on the supply in the calculation of their net amount.

The Ruling also states that a supply would also be treated as a taxable supply if the supplier correctly characterises a supply as:

- GST-free or input taxed but mistakenly includes GST for that supply in the calculation of their net amount; or
- taxable but miscalculates the GST for that supply in the calculation of their net amount.

The Commissioner notes that s 105-65 does not limit its application to circumstances where it was the supplier who treated the supply as taxable. The Commissioner says in most cases it will be the supplier who incorrectly treats the supply as taxable. However, the Commissioner also says in some situations it may be the Commissioner or another entity (eg a member of the same GST group) who incorrectly treats the supply as taxable. In these situations, the Ruling says the section is not precluded from applying.

### Meaning of "to any extent"

In the Commissioner's view, ss 105-65(1)(a) and 105-65(1)(b) cover all overpaid amounts arising from the supplier treating a supply as a taxable supply to any extent, regardless if the overpayment results from a miscalculation or mischaracterisation. Therefore, the Commissioner says the term "to any extent" must be interpreted in the context in which it appears and with the mischief of denying a windfall gain to the supplier in mind.

The Commissioner notes the term "to any extent" has a broad meaning. Therefore, it is the Commissioner's view that s 105-65 will apply to the following transactions:

- sale of real property using the margin scheme under Div 75;
- sale of a supply that is partly taxable and partly GST-free or input taxed (ie a mixed supply);
- sale of a gambling supply under Div 126.

### Commissioner's discretion

The Ruling sets out the guiding principles the Commissioner will have regard to when exercising his discretion. These guiding principles are:

- the Commissioner must consider each case based on all the relevant facts and circumstances;
- the Commissioner needs to follow administrative law principles (eg not restricting the discretion or taking into account irrelevant considerations);
- the Commissioner must have regard to the subject matter, scope and purpose of s 105-65, that is, to prevent windfall gains to suppliers; and
- the Commissioner should exercise his discretion where it is fair and reasonable to do so, and not arbitrarily.

The circumstances in which the Commissioner considers it may be fair and reasonable to exercise the discretion include:

- the overpayment of GST occurs as a result of an arithmetic error made by a supplier;
- the overpayment of GST arises as a direct result of the actions of the Commissioner and the taxpayer has not had the opportunity to factor in the cost of the GST or otherwise pass on the GST;

- the supplier is able to satisfy the Commissioner that an amount corresponding to the refund will be, or has been, passed on to the party that ultimately bore the cost of the overpaid GST.

The Commissioner says he will not generally exercise the discretion if the supplier has not reimbursed the unregistered recipients a corresponding amount of the overpaid GST, unless there are other countervailing reasons for doing so.

The Ruling contains 8 examples explaining the Commissioner's discretion.

### Quantum of refund

In the Commissioner's view, the words "so much of any" in s 105-65(2) mean that s 105-65(1) can apply to an amount that is less than the whole amount that has been overpaid (or not refunded). Therefore, the Commissioner states that if the supplier reimburses (in a later tax period) a lesser amount to an entity that is not registered, or required to be registered, for GST, then s 105-65 does not apply to that reimbursed amount because the conditions in s 105-65(1)(c) are not satisfied. However, the Commissioner states the section will still apply to the amount not reimbursed.

### Interaction with s 8AAZN

The Tax Office acknowledges there may be cases where its automated system inadvertently processes a refund without regard to s 105-65. In such situations, the Ruling states that s 8AAZN of the TAA may be used to recover the refund. In the Commissioner's view, the payment of the refund constitutes a mistake and, therefore, an "administrative overpayment" for the purposes of s 8AAZN.

### Date of effect

The Ruling applies to all income years, both before and after its date of issue.

The Ruling finalises Draft MT 2009/D1 and essentially remains unchanged.

Source: *Miscellaneous Taxation Ruling MT 2010/1*

<http://law.ato.gov.au/atolaw/view.htm?docid=%22MXR%2FMT20101%2FNAT%2FATO%2F00001%22>

## Automated Tax Deduction for Youth Allowance Recipients

On 17 December 2010, the ATO released a Decision Impact Statement on the High Court's decision in *FCT v Anstis* [2010] HCA 40. The Court held that a taxpayer was entitled to a deduction under s 8-1 of the ITAA 1997 for expenses incurred in deriving income from receiving Youth Allowance (YA).

The ATO says the High Court recognised that YA payments are ordinary income in the hands of recipients. In so deciding, the ATO considers the Court "appears to have approved the alternative argument presented by the Commissioner in *FCT v Stone* (2005) 222 CLR 289, at 388, which was left open in that case". In the ATO's view, it is also consistent with the assumption underlying Divs 51 and 52 of the ITAA 1997 that other regular payments made under the *Social Security Act 1991* are ordinary income in the hands of recipients, unless specifically made exempt from income tax under those Divisions.

The ATO said it recognises that the High Court decided that the non-depreciation expenses were incurred in this case in "gaining or producing" the YA income received, and were not of a private nature. The ATO says it accepts that similar expenses would also be allowable under s 8-1 to other full-time students receiving YA income. The ATO also accepts that, in working out whether a full-time student receiving YA income is entitled to deductions for the decline in value of a computer under s 40-25 of the ITAA 97, a taxable purpose in s 40-25(8) includes the purpose of producing such income.

The ATO also notes that the Court's decision does not extend to meals expenses incurred by recipients of YA income, and for travelling expenses between a full-time student's home and place of study, "whose essential character would still be of a private nature".

### Other social security payments

The ATO says it is giving further consideration to whether the High Court's decision extends to students receiving other taxable education payments and to recipients of other payments made under the Social Security Act. Of particular importance will be what a recipient was required to expend in establishing and retaining an entitlement to the receipts, the ATO said.

The ATO invites comment on whether the Court's finding, that the occasion of the taxpayer's study expenses was to be found in what she did to establish and retain her statutory entitlement to the YA receipts, has wider implications under the taxation laws. The ATO will consider whether any further public advice or guidance is necessary, having regard to any comments received.

## Ruling TR 98/9 to be amended

The ATO says it recognises that its views expressed in paras 18, 19, 21 and 71 to 77 of Taxation Ruling TR 98/9 [ie effectively that education expenses would not be deductible against various Commonwealth educational assistance schemes] are contrary to the views expressed by the High Court in this case. It says the Ruling will be amended in the light of the guidance provided by the Court.

## ATO will amend assessments

The ATO says that tax agents do not need to do anything for clients who have lodged returns and are eligible for a deduction. ATO Assistant Commissioner Peter Nash said the ATO would be writing to these taxpayers or their tax agents between 1 March 2011 and 30 April 2011 to advise that it will be amending tax assessments for eligible taxpayers to include tax deductions for study expenses for the 2007, 2008, 2009 and 2010 income years. He said the ATO will amend these assessments to include a deduction of \$550 for each year they are eligible.

Eligible taxpayers are those who lodged a tax return for each year and:

- received Youth Allowance to study full-time and declared it on their tax return;
- did not claim a deduction for these expenses; and
- paid tax.

More information is available on a special "study expense changes" section of the ATO website at <http://www.ato.gov.au/studyexpensechanges>.

*Source: ATO Decision Impact Statement on Anstis case*

<http://law.ato.gov.au/atolaw/view.htm?docid=%22LIT%2FICD%2FM64of2010%2F00001%22>

## No retrospective amendment to the law

Following the release of the ATO's views on the High Court's decision, the Assistant Treasurer, Mr Bill Shorten, announced that the Government would not amend the tax law retrospectively to deny deductions against YA for prior years following the decision in the case. In terms of deductibility against YA for the current and future income years, he said "this will be considered by the Government in the New Year".

Mr Shorten said the ATO had earlier advised that it would allow an automatic deduction of \$550 from the 2006-07 to the 2009-10 income years for eligible taxpayers and potentially higher claims for those eligible taxpayers who can prove their expenses. He said the ATO estimates the average refund taxpayers will receive in their pocket will be \$90 for each year and more if receipts can be provided.

*Source: Assistant Treasurer's media release No 026, 17 December 2010*

[www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/026.htm&pageID=003&min=brs&Year=&DocType=>](http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/026.htm&pageID=003&min=brs&Year=&DocType=>)

## "Loan" from Private Company an "Honest Mistake"?

Taxation Ruling TR 2010/8, released on 15 December 2010, outlines the requirements to be satisfied before the Commissioner can exercise his discretion under s 109RB of the ITAA 1936 to disregard the operation of Div 7A or allow a Div 7A deemed dividend to be franked.

The Commissioner may exercise this discretion where:

- Div 7A applies to deem a private company to have paid a dividend to a particular entity, or where an amount is included in the assessable income of a particular entity in relation to a private company (under Subdiv EA); and
- that result arises because of an honest mistake or inadvertent omission by the recipient of the dividend, the private company or any other entity that contributed to the result.

The Ruling states that a mistake in the context of s 109RB is an incorrect view or opinion or misunderstanding about how Div 7A operates, about facts that are relevant to its operation or about other matters that affect its operation. Such a mistake must be honestly made. An omission in the context of s 109RB is a failure to take action that is relevant to, or affects, the operation of Div 7A. Such an omission must be inadvertent. In each case, it is a question of fact whether an honest mistake or inadvertent omission has occurred.

The onus is on the taxpayer to demonstrate, on the balance of probabilities, that an honest mistake or inadvertent omission has occurred. In determining whether this is the case, the actual state of mind or belief of the person making the mistake or omission is in issue.

A mistake or omission can be the result of ignorance, but deliberate behaviour to remain ignorant of the operation or requirements of Div 7A may not satisfy the meaning of honest mistake or inadvertent omission.

Points made in the Ruling include:

- the fact that a mistake or omission has commonly occurred does not necessarily establish that an honest mistake or inadvertent omission occurred in the taxpayer's circumstances. However, in the absence of direct evidence, the fact that an error is common may support the conclusion it was an honest mistake or inadvertent omission;
- actions or omissions made to circumvent Div 7A cannot satisfy the requirements of honest mistake or inadvertent omission. In addition, a deliberate indifference or wilful blindness would not satisfy the requirement of honesty and would not constitute an honest mistake; and
- a mistake or omission that is recurring will qualify as an honest mistake or inadvertent omission if it recurs for the same reason and the original mistake or omission qualified as an honest mistake or inadvertent omission. This will also be the case in circumstances where an original mistake of law by a tax agent that qualified as an honest mistake or inadvertent omission is applied to other clients.

The Ruling provides 3 useful examples dealing with the following situations: a tax agent accepting summary information received each year without making enquiries about Div 7A transactions; arithmetic error (eg in calculating the minimum yearly repayment for an amalgamated loan); and a mistake in carrying out activities (eg mistakenly using a business cheque book for a private purchase).

The Ruling was previously released as Draft Ruling TR 2010/D3. The final Ruling is substantially the same as the Draft Ruling, although an example discussing the exercise of the discretion where a taxpayer is ignorant of Div 7A has been left out of the final Ruling.

*Source: Taxation Ruling TR 2010/8*

*<<http://law.ato.gov.au/atolaw/DownloadNoticePDF.htm?DocId=TXR%2FTR20108%2FNAT%2FATO%2F0001&filename=pdf/pbr/tr2010-008.pdf&PIT=99991231235958>>*

## **“Stronger Super” Reforms on the Horizon**

On 16 December 2010, the Government released a package of “Stronger Super” reforms in response to the recommendations by the Cooper Super System Review on 5 July 2010. The Government has expressed support for 139 of the 177 recommendations by the Cooper Review aimed at improving the governance, efficiency, structure and operation of the superannuation system. According to the Government, the proposed reforms could potentially boost the retirement savings of a 30 year-old by up to \$40,000.

Mr Shorten said a consultative group will be established in early 2011 to undertake consultation with stakeholders on the implementation of the reforms.

The package is available on the Government's Stronger Super Website at:

*<[http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications/government\\_response/default.htm](http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications/government_response/default.htm)>*

### **MySuper**

Subject to a transitional period, MySuper products will be the only products eligible as a default superannuation fund to accept contributions from employers on behalf of employees who do not choose a fund. The standards that a MySuper product must meet will be enforced by APRA who will be given the power to issue prudential standards in relation to superannuation. The costs of implementing MySuper will be recovered through increases to the annual levy on APRA-regulated funds.

### **SuperStream**

The “SuperStream” measures seek to improve the “back office” administration and processing of transactions. The Government said it is committed to extending the use of an individual's TFN as the primary identifier of member accounts from 1 July 2011 to assist individuals and trustees to locate and consolidate lost accounts. However, a member's right not to quote a TFN will be respected. The use of members' TFNs will continue to be subject to appropriate legislated safeguards to ensure the privacy and security of members' personal information. An enhanced role for the Tax Office is also envisaged in facilitating a more efficient back office for superannuation.

The broader SuperStream package is expected to be in place by 1 July 2015 but the common data standards and electronic transmission of linked personal and financial data will be settled by 1 July 2012.

The Government also noted that its broader Protecting Workers' Entitlements Package includes “Securing Super” measures under which employees will receive information on their payslips about the amount of superannuation actually paid into their account. Superannuation funds will also be required to provide employers and employees with electronic notification if regular superannuation payments are not being made.

## SMSFs

While the Government agreed with most of the 29 SMSF recommendations by the Cooper Review, it has rejected some of the proposals. Key SMSF items include:

- **investments in lifestyle assets** - the Government rejected the recommendations to prohibit in-house assets and ban SMSFs from investing in collectables and personal use assets. Consistent with its election commitment the Government will instead introduce legislation to tighten, from 1 July 2011, the legislative standards on SMSF investments in collectables and personal use assets. Any existing SMSF holdings of collectables and personal use assets that cannot comply with the legislative standards will be required to be disposed of by 1 July 2016;
- **Tax Office rulings** - the Government rejected the recommendation to give the Tax Office the power to issue binding rulings in relation to SMSFs. Rather, the Tax Office will continue to provide non-binding advice to SMSFs;
- **approved auditors** - the Government agreed that ASIC should be appointed as the registration body for approved auditors and given the power to determine the qualifications (including professional body memberships), set competency standards and develop a penalty regime. The Government said ASIC, in consultation with stakeholders, will determine whether there are existing standards that can be used and will develop new auditor independence standards if necessary;
- **administrative penalties** - the Tax Office will be provided with new powers to issue administrative penalties against SMSF trustees on a sliding scale reflecting the seriousness of the breach. The Office will also be given the power to issue a direction to rectify a specified contravention and enforce mandatory trustee education;
- **SMSF registration and rollovers** - the SMSF registration and rollover processes will be amended to require proof of identity checks for all people joining an SMSF, whether they are establishing a new fund or joining an existing fund. However, identification measures will not apply retrospectively except for existing SMSFs wishing to organise rollovers from an APRA-regulated fund;
- **illegal early release** - new penalties will be introduced and the existing tax laws will be amended so that amounts illegally released early are taxed at the superannuation non-complying tax rate (rather than the individual's marginal rate);
- **licensed SMSF advice** - the Government agreed that the accountants' AFSL exemption for providing SMSF advice should be removed. The Government said it is currently consulting with industry on an appropriate alternative to the exemption as part of the Future of Financial Advice process, including a restricted licensing framework.

**Date of effect:** Most of the SMSF measures are proposed to commence on 1 July 2012. The tighter legislative standards for investments in collectibles and personal use assets will apply to new investments from 1 July 2011. Proposed amendments to the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* will commence on 1 July 2013 and amendments to the SMSF registration process will commence on 1 July 2014.

## Governance and regulation

The Government said it supports the Cooper Review's recommendations broadly aimed at heightening the obligations of trustees to manage their fund's assets prudently and in the best interests of all the members of the fund. It will consult further with industry on the recommendation to replace the current capital requirements for superannuation fund trustees with a risk-based approach that requires financial resources to be held against operational risk for all APRA-regulated funds. The Government said it will consult with industry on whether such financial resources should be held in the form of trustee capital or as an operational risk reserve within the fund.

**Date of effect:** The timing for the commencement of the governance measures, including any relevant transitional arrangements, will be determined following consultation via a sub-group to be established in early 2011.

## Background to super reforms

The Super System Review, chaired by Mr Jeremy Cooper, released its final report on 5 July 2010 proposing a simple, low-cost product (MySuper) and a package of "SuperStream" measures. Further information on the Super System Review is available on the Treasury Website at <http://www.supersystemreview.gov.au>.

In August 2010, ahead of the Federal election, the Government indicated that it would introduce MySuper from 1 July 2013. The Government also announced that it would introduce legislation to ensure that, from 1 July 2011, an individual's TFN will be the primary identifier of member accounts. However, the Government rejected the recommendation to ban SMSFs from investing in lifestyle assets. Instead, the Government announced that SMSFs will be able to continue investing in lifestyle assets but new legislative standards would be introduced, effective from 1 July 2011.

The proposed super reforms will also be complemented by the Government's Future of Financial Advice (FOFA) reforms which have proposed a ban on all commissions from 1 July 2012 in relation to the distribution and advice of retail superannuation products.

*Source: Assistant Treasurer's media release No 024, 16 December 2010*

*<<http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/024.htm&pageID=003&min=brs&Year=&DocType=>>*