



Explanatory Memorandum

July 2010

CURRENCY:

This issue of Client Alert takes into account all developments up to and including 17 June 2010.

Trust Income and Bamford: Tax Office View

The Tax Office has issued a Decision Impact Statement outlining the Commissioner's view on the High Court's decision in *FCT v Bamford* [2010] HCA 10 in relation to the meaning of the phrases 'income of the trust estate' and 'that share' in s 97(1) of the ITAA 1936.

The Decision Impact Statement is available on the ATO legal database at <http://law.ato.gov.au/atolaw/view.htm?docid=%22LIT%2FICD%2FS310%2F2009%2F0001%22>.

Background

Broadly, in *Bamford*, the High Court held that a capital gain made by a trust, was 'income of the trust estate' for that year, as a result of the valid exercise by the trustee of a power under the deed to so treat the profit arising on the disposal of the property. In this regard, the High Court decided that the expression in s 97(1) 'income of the trust estate' can include 'statutory income', such as capital gains, which are brought in as assessable income.

The High Court also unanimously confirmed that it is correct to apply the 'proportionate view' where net income of a trust for tax purposes exceeds its accounting income. Under this approach, a beneficiary presently entitled to trust income is assessable on the proportion of the trust's net income equal to the proportion that the trust income to which the beneficiary is presently entitled bears to the income that has been distributed during the income year, or remains to be distributed at the end of the year.

Tax Office view of decision

The Tax Office considers that a number of general propositions have emerged from the High Court's decision:

- the income of a trust estate for trust law purposes and its income for tax purposes are 2 different subject matters which do not necessarily correspond;
- in s 97(1) 'income of the trust estate' takes its meaning from the general law of trusts and not from taxation law;
- under the general law of trusts the concept of 'income' is governed by a set of rules designed to ensure that trustees fairly apportion the receipts and outgoings of a period between those entitled to income and those with an interest in capital;
- the rules of apportionment adopted by the general law of trusts take the form of presumptions about whether particular receipts or outgoings constitute income or capital. The trust law presumptions can be displaced by express provision in the trust instrument;
- the apportionment of receipts and outgoings forms part of the processes in trust administration, explained in *FCT v Totledge Pty Ltd* (1982) 12 ATR 830, whereby the 'surplus or distributable income' to which income beneficiaries may become presently entitled in respect of 'distinct year[s] of income' is ascertained (the 'distributable income');
- once the amount of income to which a beneficiary is presently entitled has been ascertained it is converted into a percentage share of the distributable income (howsoever the entitlement was expressed for trust purposes); and
- that percentage is then applied to the [tax] net income of the trust to work out the amount which is included in the assessable income of the beneficiary under s 97(1)(a). This is a simple mathematical calculation the product of which may not correspond with the beneficiary's actual entitlement.

For practical purposes, the Tax Office states that:

- a provision of a trust instrument, or a trustee acting in accordance with a trust instrument, may treat the whole or part of a receipt as income of a period and it will thereby constitute 'income of the trust estate' for the purposes of s 97;
- if a trust instrument does not specify when a receipt is to be treated as income of a period, and the trustee does not have any special power to characterise receipts, then the question of whether the whole or part of a receipt constitutes 'income of the trust estate' for the purposes of s 97 will fall to be determined in accordance with the general presumptions of trust law;
- the provisions of a trust instrument, or a trustee acting in accordance with a trust instrument, may determine whether an outgoing is properly chargeable against the income of a period (absent which the question will fall to be determined in accordance with the general presumptions of trust law); and
- subject to the possible operation of provisions outside Div 6, the amount included in a beneficiary's assessable income under s 97 consists of an un-dissected or un-allocated proportionate share of the entirety of the [tax] net income.

However, the Commissioner rejected any suggestion that the High Court's observations about the manner in which the taxation law deals with trusts as distinct from companies (see HCA 10 at [19] and [20]) and the way in which it illustrated the differences between the parties' contentions as to 'that share' (see HCA 10 at [15]) support the view that:

- amounts distributed to beneficiaries by trustees always retain the same character in the hands of the beneficiaries for trust and tax law purposes as they had in the hands of the trustees for those purposes; and
- Div 6 of the ITAA 1936 is an exclusive code for the taxation of beneficiaries.

Unresolved trust issues

Whilst the High Court's decision provides guidance for cases which are on all fours with *Bamford*, the Commissioner says a number of issues concerning the application of Div 6 of the ITAA 1936 in other circumstances remain unresolved, including:

- what constitutes a receipt or an outgoing of a trust for the purposes of ascertaining the trust's distributable income of a period;
- the extent to which accounting principles are relevant in identifying and measuring the apportionable receipts and outgoings of a trust and therefore the trust's distributable income of a period (eg cash versus accruals bases);
- whether a trustee can identify and measure the trust's distributable income using an accounting methodology that differs from the accounting methodology the trustee uses to account to beneficiaries as to the condition of the trust estate from period to period;
- the effect for trust law purposes of provisions in trust instruments (or trustee determinations) which purport to equate the trust's distributable income with its [tax] net income where the [tax] net income includes notional amounts (eg franking credits or deemed capital gains) or where the time at which income is recognised for tax purposes differs from the time at which it is recognised for trust accounting purposes (eg where trust assets are accounted for at fair value);
- how a trust's distributable income is to be determined where the trust instrument employs different notions of income for different purposes;
- the principles to be applied in identifying the s 97 'income of the trust estate' if a particular trust does not distinguish between income and capital for the purposes of ascertaining beneficiary entitlements to trust property;
- how ss 97(1)(a), (b) and (c) are to be reconciled;
- how the statutory flow through provisions such as Subdiv 115-C of the ITAA 1997 (capital gains and trusts) and Subdiv 207-B of the ITAA 1997 (franking credits and trusts) interact with Div 6 of the ITAA 1936 given that a beneficiary's liability to be assessed on the [tax] net income of the trust under Div 6 may not correspond with the beneficiary's actual entitlement; and
- the manner in which Div 6 interacts with other provisions which rely on a beneficiary's present entitlement to the income of a trust (eg Div 11A of the ITAA 1936).

Treating income as capital

The Tax Office also states that there is an outstanding issue as to the effect for taxation purposes of a recharacterisation clause that requires or permits the trustee to treat as capital what is otherwise received as income. The Tax Office says those were not the facts before the High Court in *Bamford*.

The Commissioner considers that the manner in which the High Court in *Bamford* dealt with the decision in *FCT v Australia and New Zealand Savings Bank Ltd* (1998) 194 CLR 328; 39 ATR 419 does not assist in the

resolution of this issue. According to the Tax Office, the High Court did not explicitly overrule *ANZ* but it remains unclear how that decision can be reconciled with *Bamford*. Until such time as the decision in *ANZ* is reversed, the Commissioner says he does not feel free to treat the decision as having been wrongly decided.

Recharacterisation clauses

In light of the *Bamford* decision, the Tax Office expects that some taxpayers may now wish to amend their deeds to insert a definition of income where one does not exist and, in particular, insert an income recharacterisation or income equalisation clause. Assuming any such amendment would be within power, the Tax Office warns that its taxation effect would fall to be determined in accordance with the Commissioner's Statement of Principles regarding resettlements.

The Commissioner also warns that a clause that permits or requires the trustee to recharacterise a receipt or outgoing cannot contradict other requirements of the trust instrument. That is, the Commissioner says that what appears to be an unfettered discretion to determine whether receipts are capital or income, may in fact be no more than an administrative power to honestly classify receipts according to law: see Commissioner's Decision Impact Statement in respect of *Forrest v FCT* [2010] FCAFC 6.

Withdrawal of rulings

The Tax Office says the decision in *Bamford* means that the following rulings and practice statements must be withdrawn, with effect from the beginning of the 2010/11 income year:

- Ruling TR 95/29: Div 16 — applicability of averaging provisions to beneficiaries of trust estates carrying on a business of primary production;
- Ruling IT 331: Trustees and beneficiaries: adjustments to estate income as returned to arrive at net income of estate for the purposes of s 95;
- Law Administration Practice Statement (General Administration) PS LA 2005/1 (GA): Taxation of capital gains of a trust.

Franking credits and trust income

The Commissioner also noted that he will be withdrawing Ruling TR 92/13 (trust dividends and franking) as the imputation provisions have been rewritten into Subdiv 207-B of the ITAA 1997. To the extent that taxpayers may have relied on Ruling TR 92/13 as a guide to how Subdiv 207-B will be applied for the 2009/10 and earlier income years, the Commissioner says he will not disturb returns reasonably prepared on that basis. Broadly, the Simplified Imputation System in Subdiv 207-B seeks to ensure that franking credits attaching to dividends received by trustees are passed through to beneficiaries who derive benefits from the trustee having received the dividends.

ATO Practice Statement

As the litigation is now finalised, the Tax Office also issued Practice Statement Law Administration PS LA 2010/1 (dated 2 June 2010) <<http://law.ato.gov.au/atolaw/view.htm?docid=%22PSR%2FPS20101%2FNAT%2FATO%2F00001%22>> setting out the compliance approaches that Tax Office staff should adopt in respect of the 2009/10 and earlier income years (replacing PS LA 2009/7, which will be withdrawn).

Generally, the Commissioner says he will not seek to disturb returns for the 2009/10 or earlier income years if taxpayers have relied on a view of Div 6 that was reasonably open prior to the *Bamford* litigation (unless there has been a deliberate attempt to exploit Div 6 or there is a dispute for some other reason).

Compliance approach

Practice Statement PS LA 2010/1 advises Tax Office staff undertaking active compliance activities not to rely upon a distribution statement contained in a trust's tax return as the sole basis for determining who should be assessed on the trust's [tax] net income. Rather, Tax Office staff are advised to conduct a detailed consideration of the trust deed (including any amendments that have been made to it) and all relevant documents including (but not limited to) relevant trustee resolutions and financial statements.

Deliberate attempts to exploit Div 6

Tax Office staff have also been advised to identify arrangements that may deliberately attempt to exploit Div 6, such as, where:

- there is a deliberate mismatch between the beneficiaries' entitlements and the tax outcomes with the result that some or all of the tax liability in respect of the trust's [tax] net income is avoided;
- there are reasonable arguments to suggest that Pt IVA or s 100A (trust stripping schemes) may apply to alter the way the [tax] net income is allocated between the trustee and the beneficiaries; or
- it is reasonably arguable that aspects of the arrangement are a sham or of no legal effect.

Comments

The Commissioner said he intends to consult with interested practitioners on the prioritisation and resolution of the unresolved issues involving Div 6. Comments are due by 28 July 2010.

Div 7A Loans and Trust Entitlements

The Tax Office has released Taxation Ruling TR 2010/3 which sets out the Commissioner's views on when a private company with an unpaid present entitlement (UPE) from an associated trust is considered to have made a loan to the trust for Div 7A purposes. Broadly, the ruling provides that the company will be considered to have made a 'Div 7A loan' to the trust if the UPE has been satisfied and the company agrees to loan the amount to the trust, or if the company does not call for payment of a subsisting UPE and thereby agrees that it can be used for trust purposes.

Application and meaning of Div 7A loan

Specifically, the ruling considers the application of Div 7A of Pt III of the ITAA 1936 where a private company is a beneficiary of a trust in the following circumstances:

- (a) the trust is an associate of any shareholder of the private company;
- (b) the trust is part of the same 'family group' as the company;
- (c) the company has a present entitlement to an amount from the trust; and
- (d) funds representing the present entitlement remain intermingled with other funds of the trust estate, or otherwise can be used for trust purposes.

The Ruling also provides that for the purposes of Div 7A, a loan (a 'Div 7A loan') includes:

- (a) a loan within its ordinary meaning;
- (b) an advance of money with an expectation of repayment;
- (c) the provision of credit or other financial accommodation under an agreement where a principal sum is ultimately payable;
- (d) a payment of an amount for, on behalf of, of an entity where there is an obligation of repayment; and
- (e) transactions that in substance effect such a Div 7A loan.

It also states that a Div 7A loan need not involve positive action on the part of the private company.

Loans within the ordinary meaning

The ruling states that a subsisting UPE is not of itself an ordinary loan. However, it states that where a UPE is satisfied and loaned back to the trustee under an agreement between the parties (including an implied agreement), then the UPE is effectively replaced by an ordinary loan from the private company to the trust.

Furthermore, the ruling states that such a loan can be effected by an agreed set-off to pay the private company its trust entitlement, rather than as a cash transaction. It also states that, in the absence of evidence to the contrary, where the trust and private company form part of the same family group, the Commissioner takes the view that the private company has knowledge of the trust crediting a loan account in its name.

In addition, the ruling provides that where a trust makes a loan on behalf of the company, by acting pursuant to a term of the trust deed which permits the trustee to pay or apply money to or for the benefit of the company, then the company will also be taken to have made an ordinary loan to the trust.

However, the ruling states that an ordinary loan does not arise if instead of a debtor/creditor relationship being created (or other Div 7A loan arising), it is outside the power of the trustee to treat the funds otherwise than as a UPE and the amount to which the private company is entitled remains a UPE.

Div 7A loans within the extended meaning — subsisting UPEs

The ruling provides that a subsisting UPE does not amount to a Div 7A loan in the following cases:

- (a) within the ordinary meaning of a loan;
- (b) under s 109D(3)(a) of the extended definition (as there is no advance of money involving a payment in advance of a due date or a payment in expectation of repayment); or
- (c) under s 109D(3)(c) of the extended definition (as there is no payment coupled with an obligation to repay).

However, the ruling states that in some circumstances, a private company provides financial accommodation to the trust, or enters into a transaction with the trust which in substance effects a Div 7A loan in respect of

a subsisting UPE (including where an amount is held under a 'sub-trust' arrangement). This will occur where the company does so under a 'consensual agreement' whereby:

- (a) the company supplies or grants some form of pecuniary aid or favour to the trust; and
- (b) a principal sum or equivalent is ultimately payable to the company.

For these purposes, the ruling states that such a consensual agreement arises if the company authorises the trustee's continued use for trust purposes of the funds representing the company's UPE by not calling for either:

- (a) the payment of that UPE; or
- (b) the investment of the funds representing the UPE for the company's sole benefit rather than their use for the benefit of the trust.

Accordingly, the ruling concludes that if a private company has knowledge that funds representing its UPE are being used by the trustee for trust purposes (rather than being held and/or used for that private company's sole benefit) then, in not calling for payment of its UPE, the company provides the trust with financial accommodation and, by extension, therefore makes a Div 7A loan to the trustee.

Note that the ruling also provides that where the trust and beneficiary form part of the same family group, in the absence of sufficient evidence to the contrary, the company will have knowledge of the trustee's use of funds representing the UPE for trust purposes.

Date of effect

The ruling applies both before and after its date of issue — except in relation to the Commissioner's view of when a subsisting UPE may be a loan for the purpose of Div 7A (above). In this case, the ruling does not apply to UPEs arising before 16 December 2009 (being the date of issue of the draft ruling).

Draft Practice Statement

The Tax Office has also released Draft Practice Statement Law Administration PS LA 3362 <<http://law.ato.gov.au/atolaw/view.htm?docid=%22DPS%2FSPSD3362%2FNAT%2FATO%2F0001%22>> to provide practical guidance on the administrative aspects of TR 2010/3.

Commissioner's Discretion to Disregard Deemed Dividend Provisions

The Tax Office has also released Draft Taxation Ruling TR 2010/D3 in which it outlines the requirements to be satisfied before the Commissioner can make a decision under s 109RB of the ITAA 1936 to disregard the operation of Div 7A or to allow a deemed Div 7A 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 draft ruling states that the honest mistake or inadvertent omission must relate to the operation of Div 7A and facts relevant to Div 7A. The types of honest mistakes and inadvertent omissions that are relevant for these purposes could range from honest mistakes or inadvertent omissions arising from a factual error from carrying out an activity, to a misinterpretation or ignorance of a provision of Div 7A which led to the mistake or omission. In each case, it is a question of fact whether an honest mistake or inadvertent omission has occurred.

According to the Tax Office, 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.

The draft ruling also states that the taxpayer must demonstrate on the balance of probabilities that an honest mistake or inadvertent omission has occurred. The facts and circumstances must be sufficiently detailed to demonstrate the existence of the honest mistake or inadvertent omission that is relevant to Div 7A. Evidence must be consistent and support such a finding.

In determining whether a person has made an honest mistake or an inadvertent omission, that person's actual state of mind or belief is in issue. However, that actual state of mind or belief is established on the available evidence.

Not surprisingly, the draft ruling states that 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.

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 draft ruling also provides examples dealing with the following situations:

- the taxpayer ignorant of Div 7A;
- 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).

Vacant Land not Input Taxed as 'Residential Premises'

The Full Federal Court has unanimously dismissed a taxpayer's appeal against an assessment of GST in respect of the sale of two separate blocks of vacant land in 2004 and 2005 respectively. In doing so, the Full Court has held that vacant land is not land capable of being occupied as a residence or for residential accommodation within the s 195-1 definition of 'residential premises' for the purposes of s 40-65(1) of the GST Act: *Vidler v FCT* [2010] FCAFC 59 (Full Federal Court, Sundberg, Bennett and Nicholas JJ, 1 June 2010).

Background

In December 2004, the taxpayer, apparently a property developer, sold a property consisting of 2.7 hectares of vacant land which was zoned Residential Low Density. At the time of sale the property was connected to an electric power supply. It was not connected to, but was able to be connected to, gas, water and sewerage infrastructures at the boundaries of the property. The taxpayer sold the property in the same condition as he had acquired it several months earlier. It was sold as 'vacant residential land'. The taxpayer contended the supply of the land by him was an input taxed supply under s 40-65 of the GST Act on the basis the property was 'residential premises'.

In April 2005, the taxpayer sold another property consisting of 2,428 square metres of vacant land which was zoned Character Mixed Residential. At the time of sale of this property it was able to be connected to, but was not connected to an electric power supply and a water supply available at the boundaries of the property and to a sewerage infrastructure which passed through the property. Again, the property was sold as 'vacant residential land' which, again, the taxpayer contended was input taxed under s 40-65.

The Commissioner disagreed with the taxpayer's contentions and assessed the taxpayer as having made taxable supplies of the respective properties.

First instance decision

At first instance in *Re Vidler and FCT* [2009] AATA 395, the AAT agreed with the Commissioner's submission that 'vacant land (whether zoned for residential use or otherwise) can never be 'capable of being occupied' as a residence or for residential accommodation at the time of its supply [because] land is not capable of being so occupied unless, at the very least, it has upon it a structure that contains facilities required for day to day living' (at [28]).

The taxpayer appealed against the Tribunal's decision to the Federal Court, and in doing so maintained the argument there was no warrant to read the word 'land' to mean 'land with a building on it'.

Second instance decision

Ironically, it was her Honour, Stone J, who heard the taxpayer's appeal to the Federal Court: *Vidler v FCT* [2009] FCA 1426. In this instance, Stone J was of the view that her conclusion in *South Steyne* that the definition of 'residential premises' required only the element of shelter and basic living facilities such as provided by a bedroom and bathroom had been accepted by the Full Federal Court in *South Steyne Hotel Pty Ltd v FCT* (2009) 180 FCR 409; [2009] FCAFC 155.

This left the taxpayer with only the argument that both of the relevant properties were 'intended to be occupied, and [were] capable of being occupied, as a residence or for residential accommodation' (para (b) of the definition of 'residential premises'), in reliance to the relevant explanatory memorandum's reference to permissible use and residential facilities such as water and sewerage. The taxpayer argued that 'serviced' vacant land satisfied the definition whereas 'bare' vacant land did not. On that point Stone J also disagreed, holding that para (b) of the definition of 'residential premises' is focused on the *capacity* of land to be used

at the relevant time for the nominated purpose, and it that it is not concerned with the *potential* for the land to be developed to have that capacity.

The Commissioner also submitted to her Honour that it was open for her to rule that vacant land can never be considered to be 'residential purposes' for the purpose of the GST Act. This she declined to do.

The taxpayer appealed to the Full Federal Court against Stone J's decision. The sole ground of appeal was that her Honour erred in holding that land is not 'residential premises' as defined unless erected on that is some shelter and basic living facilities. In support of its ground of appeal, it was the taxpayer's contention that the Full Federal Court in *South Steyne* had 'not necessarily accepted' Stone J's dictum in the earlier *South Steyne* decision.

Decision

The Full Court in this instance did not agree with the taxpayer's contention, and followed the approach adopted by the Full Court in *South Steyne*. It was the Full Court's view that:

'There is no indication in the [Marana] amendments or in the explanatory memorandum of an intention to remove the requirement of residence identified by the Full Court [in Marana], namely the notion of a dwelling, abode or house in which a person may reside, other than the superadded element of permanent, or at least long term, commitment to dwelling in a particular place.' (at [28])

In terms of para (b) of the definition of 'residential premises' the Full Court considered that the word 'occupied' connotes living within or inhabiting a structure and that it is 'quite artificial' to speak of someone occupying vacant land as a residence or for residential accommodation' (at [37]).

In relation to the taxpayer's submission regarding the relevant explanatory memorandum, the Court considered it a 'very strained reading' and agreed with the Commissioner's contention that 'it would be absurd if the mere existence of a tap in the middle of an acre of vacant land transforms the land into 'residential premises' for the purposes of the GST Act' (at [37]).

Given the Full Court's decision that 'vacant land is not land that is capable of being occupied as a residence or for residential accommodation' (at [34]), it was not necessary for the Court to determine whether, at the time of sale, the properties were intended to be so occupied.

SMSFs and Instalment Warrants: Rules to be Tightened

The *Superannuation Industry (Supervision) Amendment Bill 2010* has been introduced into the House of Representatives. The Bill seeks to amend the SIS Act to reduce the prudential risks for superannuation funds investing in limited recourse borrowing arrangements (eg instalment warrant arrangements).

SIS Act amendments

The Bill proposes to repeal the current provisions in s 67(4A) of the SIS Act and to replace it with a new s 67A (limited recourse borrowing arrangements) and s 67B (replacement assets). These new provisions seek to ensure that:

- the recourse of the lender (or any other person) against a superannuation fund trustee for default on the borrowing is limited to rights relating to the acquirable asset;
- the asset within the arrangement can only be replaced in prescribed circumstances that arise from owning the original asset; and
- the borrowing is referable and identifiable only over a single asset (excluding money) or a collection of assets which are identical and are treated as a single asset.

Acquirable asset

The Bill proposes to define the term 'acquirable asset' in the singular, so that it is not interpreted as permitting borrowing arrangements over multiple non-identical assets. This seeks to prevent a lender from choosing which assets are sold in the event of a default on the loan. However, the definition will permit borrowing arrangements over a collection of assets that are identical and have the same market value. Examples of a collection that can be treated as a single 'acquirable asset' under proposed s 67A include a collection of:

- shares of the same type in a single company;
- units in a unit trust that have the same fixed rights attached to them; and
- economically equal and identical commodities (eg gold bars).

Note that a collection of shares must be acquired and disposed of as a collection. That is, they cannot be sold down over time.

Examples of collections that would not be permissible include a collection of:

- shares in a single company that have different rights (eg ordinary and preference shares);
- units in a unit trust of different classes that have different rights attached to them (or differing trustee discretion);
- shares in different entities; and
- buildings each under separate strata title, irrespective of whether the buildings are substantially the same at the time of acquisition.

The definition of acquirable asset will also exclude limited recourse borrowing arrangements that involve money as an asset.

Real property

In the case of the purchase of real property, a single title for land and the accompanying house on it would be considered a single acquirable asset, but additional items such as furnishings (ie non-fixtures) would not be allowed to be purchased through the same limited recourse borrowing arrangement.

However, the proposed provisions are not intended to prevent the acquisition of leased property. For the purposes of proposed s 67A, the lease itself should not be considered as a separate asset as long as it is dealt with together with the property under the arrangement.

Acquisition and expenses

For the purposes of proposed s 67A(1)(a), an acquirable asset is considered to be 'acquired' at the time when the trustee of the holding trust (security trustee) gains a legal interest in the asset. At the same time, the regulated superannuation fund (RSF) trustee gains a beneficial interest in the asset as required by s 67A(1)(b). This beneficial interest arises on creation of the security trust over the acquirable asset. The RSF trustee has a right to acquire the legal interest upon repayment of the loan.

Proposed s 67A(1)(a)(i) allows associated expenses in acquiring the underlying asset to be included as part of the borrowing. Associated expenses include items that are intrinsically linked to the purchase of the acquirable asset, eg conveyancing fees, stamp duty, brokerage or loan establishment costs. It also includes expenses incurred in maintaining or repairing the asset to ensure that its functional value is not diminished, but not to improve the asset.

Proposed s 67A(1)(a)(ii) also seeks to clarify that the trustee can refinance an existing limited recourse borrowing.

Replacement assets

Currently, uncertainty exists over what constitutes a 'replacement' asset under the requirement in s 67(4A)(b) that the borrowing must be used to acquire or maintain the original asset, or another asset (the replacement).

To provide greater clarity regarding eligible replacement assets, the Bill proposes to insert a new s 67B to list specific circumstances permitting a replacement asset. Those listed are the only circumstances where replacement assets will be allowed. Where the replacement asset consists of shares in a company or units in a unit trust, the original asset and the replacement asset must have the same market value at the time the replacement occurs. The Bill also specifically addresses the situation where a replacement asset consists of shares in another company (or units in another unit trust or a stapled security) as a result of a takeover, merger, demerger, restructure or a scheme of arrangement. The amended legislation provides for the regulations to prescribe additional circumstances permitting a replacement asset.

Examples of circumstances not permitting a replacement asset include:

- money or cash;
- a replacement asset arising from an insurance claim;
- replacement by way of improvement of real property; and
- a series of titles over land replacing a single title over land that has been subdivided or re-zoned.

The Bill also provides for regulations to further specify circumstances in which an acquirable asset ceases to be one.

Personal guarantees

The Bill seeks to address the industry practice whereby some providers of limited recourse borrowing arrangements require trustees, or third parties such as fund members, to provide guarantees of the borrowing to underwrite the lender's risk from the limited recourse nature of an instalment warrant arrangement.

To this extent, the Bill proposes to specifically protect fund assets from such claims by limiting the rights of the lender or any other person against the RSF trustee, for or in connection with or as a result (direct or

indirect) of a default on a borrowing or charges related to the borrowing, to rights relating to the acquirable asset. In this way, a guarantor's rights against the RSF trustee are limited as the rights of the lender are limited, so that no claim against the RSF trustee should arise which could give rise to a claim for indemnity from fund assets. That is, a charge may be given over an asset that is acquired through a borrowing arrangement in order to secure that borrowing, but no other charge is permitted.

RSF trustee breach of duty

The Bill also proposes to ensure that the amendments do not inadvertently prohibit members and co-trustees from being able to claim damages against a trustee that makes a decision to acquire an asset under a limited recourse borrowing arrangement in breach of its obligations as trustee.

Date of effect

The amendments are proposed to commence on the day after the Bill receives Royal Assent, applicable to all limited recourse borrowing arrangements entered into on or after that commencement date. However, the Bill will not apply retrospectively to existing arrangements (although the refinancing of an arrangement entered into before, on or after that commencement, will be subject to the amended legislation). A re-negotiation of a borrowing with the same lender that is simply a variation of a loan contract that continues to exist will not be subject to the Bill, unless the re-negotiation amounts to a rescission or replacement of the original contract.

Superannuation Co-contribution: Proposed Changes

The *Tax Laws Amendment (2010 Measures No 3) Bill 2010* has been introduced into the House of Representatives. It proposes, among other amendments, to implement the Government's 2010/11 Budget measure to modify the operation of the Government superannuation co-contribution scheme.

Eligible income thresholds frozen: The Bill proposes amendments to freeze for 2010/11 and 2011/12 the indexation applied on the income threshold above which the maximum superannuation co-contribution begins to phase down. As a result, the lower and higher income thresholds will remain at \$31,920 and \$61,920 (the current thresholds for the 2009/10 income year), respectively, for two years. The Bill provides for indexation to recommence for the 2012/13 and later income years.

Co-contribution \$1,000 maximum: The Bill also proposes amendments to ensure that the previously-legislated increase in the matching rate to 125% for 2012/13 and 2013/14 (and 150% for 2014/15 and later years) will not proceed. As a result, for the 2009/10 and later income years, eligible personal superannuation contributions will be matched at one dollar for every dollar contributed up to a maximum co-contribution of \$1,000 for individuals on incomes at or below the lower income threshold. The maximum co-contribution will be reduced by 3.333 cents for each dollar by which an individual's total income for the income year exceeds the lower income threshold.

Date of effect

The amendments will apply to the 2009/10 and later income years.

Henry Tax Recommendations to Watch Out For

On Sunday, 2 May 2010, four months and nine days after the Government received the final report of the Australia's Future Tax System review team (the Henry Report, as it has become known), the Government publicly released the report and its initial response. There are a number of recommendations made by the Government which, if implemented, will impact many taxpayers. Below is a snapshot of some of the main reforms put forward by the Government:

Business taxation

Reduction of company tax rate: The company tax rate will be reduced to 28%. The timing of this will depend on whether an entity qualifies as an 'eligible small business company' (which has yet to be defined by the Government).

The reduction in company tax rate is to be done in two stages, commencing from the 2013/14 income year. Eligible small business companies, however, will move straight to the 28% rate with effect from the 2012/13 income year.

Income year	Corporate tax rate (%)
2012/13 (ie current rate)	30
2013/14	29
2014/15	28

The Henry Report had recommended that the company tax rate be reduced to 25% over the 'short to medium term': Recommendation 27.

Small business asset write-off: From 1 July 2012, the existing capital allowance concessions available for small businesses will be expanded by:

- allowing small businesses to immediately write-off assets valued at under \$5,000 (\$1,000 under the present law); and
- allowing small businesses to write-off all other assets (except buildings) in a single depreciation pool at a rate of 30% (currently, small businesses allocate assets to two different depreciation pools).

This proposal adopts Recommendation 29 of the Henry Report.

Superannuation

Superannuation guarantee (SG) rate phased increase: The SG rate will increase from 9% to 12%, phasing in from 1 July 2013. The increases will be by increments of 0.25% in the first two years and 0.5% thereafter.

Commencing	SG rate (%)
Current SG rate (ie until 30 June 2013)	9
1 July 2013	9.25
1 July 2014	9.5
1 July 2015	10
1 July 2016	10.5
1 July 2017	11
1 July 2018	11.5
1 July 2019 and thereafter	12

Interestingly, the Henry Report made no specific recommendations about the SG rate.

\$500 Government contribution for low-income earners: From 1 July 2012, the Government will provide a contribution of up to \$500 for workers with incomes up to \$37,000. This ensures that no tax will be paid on super guarantee contributions for those with incomes up to that amount in 2012/13.

The amount payable under this measure will be calculated by applying a 15% matching rate to the concessional contributions made by or for individuals on adjusted taxable incomes of up to \$37,000, with an annual maximum amount payable of \$500 (not indexed). The amount will be paid into the individual's super fund.

The Henry Report made no specific recommendation about superannuation concessions for low-income earners.

Further information

The Henry Report is available on the Australia's Future Tax System Review website at <<http://taxreview.treasury.gov.au/Content/Content.aspx?doc=html/home.htm>>.

The Government's response entitled, Stronger, Fairer, Simpler: A tax plan for our future, is available on the Treasury's Future Tax website at <<http://www.futuretax.gov.au/pages/default.aspx>>.

Various Rates and Thresholds for 2010/11

The Tax Office has released the following Determinations:

- Taxation Determination TD 2010/17 states that the car limit for the 2010/11 financial year is \$57,466. The car limit is used to work out decline in value deductions of certain cars under the income tax law.
- Luxury Car Tax Determination LCTD 2010/1 states that the luxury car tax threshold for the 2010/11 financial year is \$57,466. If the GST-inclusive value of a car exceeds the luxury car tax threshold of \$57,466, luxury car tax may be payable. The Determination also states that the fuel efficient car limit for the 2010/11 financial year is \$75,375. If the GST-inclusive value of a fuel efficient car exceeds the fuel efficient car limit, luxury car tax may be payable.
- Taxation Determination TD 2010/16 states that the CGT improvement threshold for the 2010/11 income year (under s 108-85 of the ITAA 1997) is \$126,619 (up from \$124,258 that applied for the 2009/10 year). The improvement threshold is determined for the purposes of s 108-70 of the ITAA 1997 (about when a capital improvement to a pre-CGT asset is a separate asset) and s 108-75 of the ITAA 1997 (about capital improvements to CGT assets for which a rollover may be available).

GIC and SIC Rates for Jul–Sep 2010

The Tax Office has advised that the General Interest Charge (GIC) and Shortfall Interest Charge (SIC) rates for the first quarter of the 2010/11 financial year (ie 1 July 2010 – 30 September 2010) are as follows:

- GIC rate is 11.80%;
- GIC daily compounding rate is 0.03232877%;
- SIC rate is 7.80%; and
- SIC daily compounding rate is 0.02136986%.

The Tax Office also advised that the Interest on Overpayments, Interest on Early Payments and Delayed Refunds Interest rate is 4.80%.