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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAX LAWS AMENDMENT (2011 MEASURES No. 7) BILL 2011

EXPLANATORY MEMORANDUM

(Circulated by the authority of the
Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP)

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
ABR	Australian Business Register
APRA	Australian Prudential Regulation Authority
ATO	Australian Taxation Office
CGT	capital gains tax
Commissioner	Commissioner of Taxation
DGRs	deductible gift recipients
FMD	farm management deposits
FMD Regulations	<i>Income Tax (Farm Management Deposits) Regulations 1998</i>
GST	goods and services tax
GST Act	<i>A New Tax System (Goods and Services Tax) Act 1999</i>
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
NSWCA	New South Wales Court of Appeal
PAYGI	pay as you go instalments
Review	<i>Australian Independent Screen Production Sector Review</i>
SDT	special disability trust
TAA 1953	<i>Taxation Administration Act 1953</i>
TOFA	taxation of financial arrangements
TOFA Act	<i>Tax Laws Amendment (Taxation of Financial Arrangements) Act 2009</i>

General outline and financial impact

Removing tax issues facing special disability trusts

Schedule 1 to this Bill amends the *Income Tax Assessment Act 1997* to provide:

- a capital gains tax (CGT) exemption for an asset transferred into a special disability trust (SDT) for no consideration;
- a CGT main residence exemption for a trustee of an SDT;
- a CGT exemption for a recipient of the principal beneficiary's main residence, if their ownership interest ends within two years of the principal beneficiary's death; and
- equivalent taxation treatment amongst SDTs established under different Acts.

Date of effect: These amendments apply to income tax assessments for the 2006-07 income year and later income years.

These amendments, which are beneficial to taxpayers, are retrospective so as to ensure transactions that have occurred since SDTs were first able to be established are covered by these amendments.

Proposal announced: The original measure to provide a CGT main residence exemption to SDTs was announced jointly by the Minister for Families, Housing, Community Services and Indigenous Affairs and the then Parliamentary Secretary for Disabilities and Children's Services in Media Release *Extra support for people with disability and their carers* on 12 May 2009 as part of the 2009-10 Budget.

Extensions to this measure were announced in the Assistant Treasurer and Minister for Financial Services and Superannuation's and the Parliamentary Secretary for Disabilities and Carers' joint Media Release No. 070 of 10 May 2011, as part of the 2011-12 Budget.

Financial impact: These amendments have a small unquantifiable cost to revenue over the forward estimates, expected to be between \$0 and \$10 million per annum.

Compliance cost impact: Low overall, comprising of a low implementation impact and a low decrease in ongoing compliance costs relative to the affected group.

Pacific Seasonal Workers — reduction in marginal tax rate

Schedule 2 to this Bill amends the *Income Tax Rates Act 1986* to reduce the lowest marginal tax rate for workers participating in the Pacific Seasonal Worker Pilot Scheme (Scheme) from 29 per cent to 15 per cent. All other tax brackets for participants in the Scheme will remain unchanged. This change only applies to non-residents who hold a Special Program Visa (subclass 416) and who are employed by an ‘Approved Employer’ under the Scheme. Tax rates for other non-residents remain unchanged.

This measure is designed to achieve two things, namely, to address equity issues associated with the high effective tax rate that currently applies to participants in the Scheme and to deliver better remittance outcomes for participants in the Scheme.

Date of effect: This measure applies to the 2011-12 year of income.

Proposal announced: This measure was announced in the 2011-12 Budget.

Financial impact: The measure will have the following cost to revenue:

<i>2011-12</i>	<i>2012-13</i>	<i>2013-14</i>	<i>2014-15</i>
\$0.8m	nil	nil	nil

The Government has not yet made a decision about the future of the Scheme beyond its end date of 30 June 2012, so later financial impacts are not recorded.

Compliance cost impact: Low. This measure will only affect a very small number of employers and employees. Employers will be required to make minimal system changes as a result of the change.

Taxation of financial arrangements and pay as you go instalments

Schedule 3 to this Bill amends the *Taxation Administration Act 1953* so that instalment income of a taxpayer who is required to apply

Division 230 of the *Income Tax Assessment Act 1997* to their financial arrangements also includes their net gains from their Division 230 financial arrangements (to the extent the gains equal or exceed the losses) as worked out under the taxation of financial arrangements (TOFA) provisions.

Date of effect: These amendments commence on Royal Assent. The amendments generally apply from the first instalment quarter of an income year following the lodgment of the first income tax return in which a taxpayer reported an assessable gain or deductible loss from their Division 230 financial arrangements.

Proposal announced: These amendments were announced in the then Assistant Treasurer's Media Release No. 145 of 29 June 2010. The Media Release advised that amendments would be made to ensure that the TOFA provisions would interact appropriately with the pay as you go instalments provisions to lower compliance costs for taxpayers.

Financial impact: Nil. However, some small but unquantifiable timing differences may arise over the first two years of implementation.

Compliance cost impact: These amendments will reduce compliance costs for taxpayers who are required to apply the TOFA provisions to their financial arrangements.

Commissioner's discretion to extend the time for notifying taxation of financial arrangements transitional elections

Schedule 4 to this Bill amends the *Tax Laws Amendment (Taxation of Financial Arrangements) Act 2009* (TOFA Act) to give the Commissioner of Taxation (Commissioner) a limited discretion to extend the time for a taxpayer to notify the Commissioner of the making of the transitional election to apply Division 230 of the *Income Tax Assessment Act 1997* and related consequential and transitional amendments (TOFA provisions) to its existing financial arrangements.

Date of effect: These amendments commence the day after Royal Assent and apply in relation to lodgment dates mentioned in paragraph 104(5)(b) of the TOFA Act, whether the lodgment dates occur before, on, or after the commencement of these amendments.

Proposal announced: These amendments were announced in the Assistant Treasurer and Minister for Financial Services and Superannuation's Media Release No. 019 of 29 November 2010.

Financial impact: Nil.

Compliance cost impact: These amendments will reduce compliance costs for taxpayers who have elected to apply the TOFA provisions to their existing financial arrangements, but have failed to notify the Commissioner of this election on or before the first lodgment date that occurs on or after the start of their first TOFA applicable income year.

Farm management deposits

Schedule 5 to this Bill amends Division 393 of the *Income Tax Assessment Act 1997* (ITAA 1997) to allow a farm management deposit (FMD) owner affected by an applicable natural disaster to access their FMDs within 12 months of making a deposit while retaining concessional tax treatment.

Schedule 5 to this Bill also amends:

- section 398-5 of Schedule 1 to the *Taxation Administration Act 1953* to require FMD providers to report certain information about FMDs to the Agriculture Secretary on a monthly basis before the 11th day after the end of a calendar month;
- Division 393 of the ITAA 1997 to allow FMD owners to hold FMDs simultaneously with more than one FMD provider; and
- section 69 of the *Banking Act 1959* so that an FMD becomes unclaimed moneys only if the FMD has not been operated on for a period of at least seven years and the authorised deposit-taking institution (which is the FMD provider) is unable to contact the FMD owner after making reasonable efforts.

Date of effect: The amendment to allow FMD owners affected by applicable natural disasters to access their FMDs within 12 months of making a deposit applies from 1 July 2010. This measure is retrospective to enable FMD owners who were affected by applicable natural disasters in the 2010-11 income year to benefit from the amendments.

The amendment relating to reporting requirements apply from 1 July 2012. The amendment allowing owners to have FMDs with more than one FMD provider applies in relation to agreements made before, on or after 1 July 2012.

The amendment relating to the unclaimed moneys provision applies in relation to statements to be delivered within three months after 31 December 2012 and within three months after the end of each later calendar year.

Proposal announced: The amendments were announced as part of the 2011-12 Budget.

Financial impact: Only the amendment to allow FMD owners who are affected by applicable natural disasters to access their FMDs within 12 months will have an ongoing unquantifiable revenue impact.

Compliance cost impact: These amendments are expected to have a medium overall compliance cost impact.

There will be an impact on FMD owners affected by applicable natural disasters as the conditions prescribed by the *Income Tax (Farm Management Deposits) Regulations 1998* must all be met before access within 12 months of the deposit is allowed.

There will be an impact on FMD providers by requiring more frequent reporting and requiring FMD providers that are authorised deposit-taking institutions to make reasonable efforts to contact FMD owners before FMDs become unclaimed moneys.

Extend the temporary loss relief for merging superannuation funds by three months

Schedule 6 to this Bill amends the *Tax Laws Amendment (2009 Measures No. 6) Act 2010* to extend the end date of the temporary loss relief for complying superannuation fund mergers by three months — from 30 June 2011 to 30 September 2011. This will provide additional time for mergers to be completed and still meet the eligibility requirements of the loss relief. The requirement that affected mergers are completed in a single income year of the transferring fund is also relaxed to permit funds to benefit from the extension.

Date of effect: The measure commences on Royal Assent and applies in respect of transfer events in the period 1 July 2010 to 30 September 2011 for the purpose of determining eligibility for the temporary loss relief. The measure benefits affected taxpayers by extending the period of the temporary loss relief.

Proposal announced: This measure was announced in the Assistant Treasurer and Minister for Financial Services and Superannuation's Media Release No. 066 of 3 May 2011.

Financial impact: This measure has an unquantifiable but small revenue impact.

Compliance cost impact: As the measure extends the period of operation of an existing temporary measure, its compliance cost impact is expected to be small.

Penalty notice validation

Schedule 7 to this Bill ensures the ongoing validity of certain director penalty notices, notwithstanding the New South Wales Court of Appeal (NSWCA) decision in *Soong v Deputy Commissioner of Taxation* [2011] NSWCA 26 (*Soong*).

Date of effect: These amendments apply from 10 December 2007.

This application date ensures that all director penalty notices issued by the Commissioner of Taxation, which relied on the earlier NSWCA decision in *Deputy Commissioner of Taxation v Meredith* [2007] NSWCA 354 (*Meredith*), continue to remain valid.

Technically, these amendments will have an adverse impact on those directors who would otherwise seek to challenge the validity of their director penalty notices in light of the NSWCA's later decision in *Soong*.

Substantively though, no taxpayers will be adversely affected because these amendments merely restore the precedential view on the issue during this period (as enunciated in *Meredith*).

Proposal announced: This measure has not previously been announced.

Financial impact: Nil.

Compliance cost impact: Negligible.

Public ancillary funds

Schedule 8 to this Bill amends the *Income Tax Assessment Act 1997*, the *Taxation Administration Act 1953* and the *A New Tax System (Australian*

Business Number) Act 1999 to improve the integrity of public ancillary funds. These amendments among other things:

- rename the funds as public ancillary funds (their more commonly used name);
- give the Treasurer the power to make legislative guidelines about the establishment and maintenance of public ancillary funds; and
- give the Commissioner of Taxation (Commissioner) the power to impose administrative penalties on trustees that fail to comply with the guidelines and to remove or suspend trustees of non-complying funds.

Date of effect: These amendments will apply from 1 January 2012.

Proposal announced: These amendments were announced in the then Assistant Treasurer and Minister for Financial Services and Superannuation's Media Release No. 093 of 11 May 2010 and in the 2010-11 Budget.

Financial impact: These amendments are expected to result in a revenue gain of \$3 million over the forward estimates period as a result of improved compliance.

Compliance cost impact: Low.

Film tax offsets

Schedule 9 to this Bill amends Division 376 of the *Income Tax Assessment Act 1997* to make a number of changes to the film tax offsets.

Changes affecting the producer offset include:

- amending the qualifying expenditure threshold for feature films, single episode dramas and documentary programs to \$500,000;
- disallowing eligibility for those documentaries which receive financial assistance under the Producer Equity Program;
- allowing additional screen production costs to be claimed as qualifying expenditure;

- allowing television series to benefit for their first 65 broadcast hours;
- allowing films with qualifying expenditure of less than \$15 million to use actual exchange rates rather than existing averaging rules;
- removing the 20 per cent cap on development expenditure or remuneration provided to the principal director, producers and principal cast associated with the documentary;
- allowing certain distribution and marketing costs to be included in qualifying expenditure;
- allowing short-form animated documentaries access to the offset; and
- excluding goods and services tax (GST) from an amount of expenditure for the purpose of applying the offset.

Changes affecting the location and post, digital and visual effects offsets include:

- increasing the rate of the location offset from 15 per cent to 16.5 per cent;
- increasing the post, digital and visual effects offset from 15 per cent to 30 per cent;
- permitting some additional screen production costs to be claimed as qualifying expenditure; and
- excluding GST from an amount of expenditure for the purpose of applying these offsets.

Date of effect: The amendments as they relate to the producer offset apply to:

- films for which production assistance (other than development assistance) has been approved by the film authority on or after 1 July 2011; or
- in any other case, films for which production expenditure is first incurred in, or in relation to, pre-production of the film on or after 1 July 2011.

The amendments as they relate to the location offset apply retrospectively to films commencing principal photography or production of the animated image on or after 10 May 2011.

The amendments as they relate to the post, digital and visual effects offset apply retrospectively to post, digital and visual effects production that commence on or after 1 July 2011.

Consistent with the 2011-12 Budget, the net retrospective application dates benefit affected taxpayers.

Proposal announced: This measure was announced in the 2011-12 Budget and in the Minister for the Arts' Media Release No. SC056/2011 of 10 May 2011.

Financial impact: This measure is estimated to increase expenditure on the film tax offsets by \$8 million over the forward estimates.

<i>2011-12</i>	<i>2012-13</i>	<i>2013-14</i>	<i>2014-15</i>
–	\$2m	\$3m	\$3m

Compliance cost impact: This measure is expected to reduce compliance costs for affected taxpayers.

Chapter 1

Removing tax issues facing special disability trusts

Outline of chapter

1.1 Schedule 1 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to provide:

- a capital gains tax (CGT) exemption for an asset transferred into a special disability trust (SDT) for no consideration;
- a CGT main residence exemption for a trustee of an SDT;
- a CGT exemption for a recipient of the principal beneficiary's main residence, if their ownership interest ends within two years of the principal beneficiary's death; and
- equivalent taxation treatment amongst SDTs established under different Acts.

Context of amendments

1.2 SDTs were introduced in 2006 to assist families and carers to make private financial provision for the current and future care and accommodation needs of a family member with severe disability — referred to as the principal beneficiary.

1.3 There are two key benefits of establishing an SDT:

- Immediate family members making gifts to an SDT may access a concession of up to a combined total of \$500,000 from the social security or veterans' entitlements gifting rules.
- Assets of an SDT up to \$578,500 (current as at 1 July 2011 and indexed annually) plus the principal beneficiary's principal place of residence do not impact upon the principal beneficiary's ability to access income support payments.

1.4 In order to access these concessions, the trust must operate in accordance with Part 3.18A of the *Social Security Act 1991* or Division 11B of Part IIIB of the *Veterans' Entitlements Act 1986*.

1.5 The Senate referred a number of matters relating to SDTs to its Community Affairs Committee for inquiry and report in 2008. In particular, the Committee considered why more families of dependants with disabilities are not making use of the current provisions to establish SDTs.

1.6 In its report of 16 October 2008, the Committee highlighted that the taxation arrangements that apply to SDTs diminish their value for carers and people with disabilities.

1.7 The Government announced in the 2009-10 Budget that it would extend the CGT main residence exemption to include a dwelling that is held by a trustee of an SDT and used by the principal beneficiary as their main residence, with effect for CGT events that happen on or after 1 July 2009.

- The existing CGT main residence exemption ensures an individual will disregard a capital gain or capital loss on their main residence, subject to various conditions being satisfied.

1.8 Without these changes, the CGT main residence exemption requirements cannot be satisfied by a trustee of an SDT. This is because the trustee holds the dwelling and is responsible for claiming the CGT main residence exemption, but the dwelling is used by the principal beneficiary as their main residence. In addition, the principal beneficiary cannot access the exemption as they do not own the dwelling.

1.9 During the policy design of this measure, stakeholders raised concerns that the potential CGT liability on transferring an asset into an SDT is a major disincentive to setting up an SDT. Stakeholders were also concerned that a trustee of an SDT may have realised a CGT liability where they disposed of a dwelling before 1 July 2009, even though the dwelling was effectively being used as the principal beneficiary's main residence.

1.10 During the development of this measure, it was identified that a recipient who receives a principal beneficiary's main residence after the principal beneficiary's death would not be eligible for the CGT main residence exemption that applies to a trustee or a beneficiary of a deceased person's estate, as the dwelling does not pass to the recipient from the principal beneficiary's estate.

1.11 It was also identified that the definition of SDTs in the ITAA 1997 is limited to SDTs established under the *Social Security Act 1991* and does not include SDTs established under the *Veterans' Entitlements Act 1986*.

1.12 The Government announced in the 2011-12 Budget that in order to remove further income tax barriers that impede families from making contributions to an SDT and to make SDTs more beneficial for families, it would:

- provide a CGT exemption for an asset transferred into an SDT for no consideration (ignoring any interest in the trust);
- backdate the application date of the CGT main residence exemption for SDTs to apply from when SDTs were first able to be established;
- provide a CGT exemption for a recipient of a principal beneficiary's main residence, if their ownership interest ends within two years of the principal beneficiary's death; and
- ensure SDTs established under the *Veterans' Entitlements Act 1986* have equivalent taxation treatment as those established under the *Social Security Act 1991*.

1.13 These changes apply to income tax assessments for the 2006-07 income year and later income years. The changes are beneficial to taxpayers.

Summary of new law

1.14 These amendments will ensure that a capital gain or capital loss is disregarded when an asset is transferred directly into an SDT for no consideration, or where an asset passes from a deceased person's estate to an SDT.

1.15 In addition, a trustee of an SDT will disregard any capital gain or capital loss on the principal beneficiary's main residence, to the extent that the principal beneficiary would have been able to do so had they owned the main residence directly. These amendments will also ensure that a recipient of the principal beneficiary's main residence will disregard any capital gain or capital loss on the principal beneficiary's main residence, if their ownership interest ends within two years of the beneficiary's death.

1.16 Finally, these amendments provide that SDTs established under the *Veterans' Entitlements Act 1986* will have equivalent taxation treatment as those established under the *Social Security Act 1991*.

Comparison of features of new law and current law

<i>New law</i>	<i>Current law</i>
Assets transferred into an SDT for no consideration will be exempt from CGT.	Assets transferred into an SDT for no consideration may be subject to CGT.
A trustee of an SDT that holds a dwelling for use by the principal beneficiary will qualify for the CGT main residence exemption to the extent the principal beneficiary would have, had the principal beneficiary owned the interest in the dwelling directly.	A trustee of an SDT that holds a dwelling for use by the principal beneficiary does not qualify for the CGT main residence exemption.
A recipient of a principal beneficiary's main residence may be able to access a CGT exemption if the recipient's ownership interest ends within two years of the beneficiary's death.	A recipient of a principal beneficiary's main residence would be subject to CGT if the recipient's ownership interest ends within two years of the beneficiary's death.
SDTs established under the <i>Veterans' Entitlements Act 1986</i> will have the same taxation treatment as those established under the <i>Social Security Act 1991</i> .	Only SDTs established under the <i>Social Security Act 1991</i> are eligible to access the taxation rules that apply to SDTs.

Detailed explanation of new law

1.17 For the purposes of this explanatory memorandum, the term *trustee of an SDT* refers to a trustee of a trust that was an SDT at some point in the ownership period of the dwelling. In addition, the term *principal beneficiary* refers to a beneficiary who was the principal beneficiary of an SDT at some point in the ownership period of the dwelling.

Income tax definition of SDT

1.18 In the ITAA 1997, ‘special disability trust’ and ‘principal beneficiary’ have the meanings given by sections 1209L and 1209M of the *Social Security Act 1991* respectively.

1.19 These amendments expand the definition of special disability trust and principal beneficiary in the ITAA 1997 to also include SDTs established under the *Veterans’ Entitlements Act 1986*. This ensures SDTs established under that Act will also be covered by these amendments. These SDTs will also be able to access the rules in Division 6 of the *Income Tax Assessment Act 1936* (ITAA 1936) that ensure the unexpended income of an SDT is taxed at the principal beneficiary’s personal income tax rate, rather than automatically at the top personal tax rate plus the Medicare Levy, with effect for income tax assessments for the 2008-09 income year and later income years. *[Schedule 1, Part 3, items 10 and 11, definitions of ‘principal beneficiary’ and ‘special disability trust’ in subsection 995-1(1)]*

CGT exemption on an asset transferred into an SDT

An asset transferred directly to an SDT

1.20 When there is a change of ownership of an asset for no consideration, the market value substitution rule in section 116-30 of the ITAA 1997 applies and the taxpayer will determine a capital gain or capital loss based on the difference between the cost base (or reduced cost base) of the asset and its market value at the time of the CGT event.

1.21 The law is amended so that any capital gain or capital loss that the taxpayer would have made is disregarded when the asset is transferred into the SDT for no consideration. *[Schedule 1, Part 2, item 6, section 118-85]*

1.22 When determining whether a taxpayer receives consideration for transferring an asset into an SDT, any interest in the trust is disregarded. This ensures that where an asset is transferred into an SDT and the transferor is entitled to receive the asset at the ending of the trust, a CGT exemption is still available. *[Schedule 1, Part 2, item 6, subsection 118-85(2)]*

1.23 If an asset is transferred into a trust that is not yet an SDT, a CGT exemption will still be available provided the trust becomes an SDT as soon as practicable after the asset is transferred into it. Whether a trust satisfies this requirement will depend on the circumstances of each case.

- For example, a trust will satisfy this requirement if it applies to become an SDT within a reasonable time and the application is later approved.

[Schedule 1, Part 2, item 6, paragraph 118-85(1)(b)]

Example 1.1

Bright Pty Ltd (Bright) is the trustee of an SDT established for Jessica, who is the principal beneficiary. In 2007, Suban, Jessica's father, transfers ownership of a townhouse for no consideration to Bright as trustee of the SDT.

Suban acquired the townhouse in 1990 and it was not his main residence during his ownership period. Suban may be entitled to receive the asset back when the SDT comes to an end.

Based on the market value of the townhouse, Suban would make a capital gain of \$100,000 (apart from these amendments) at the time the townhouse is transferred to the SDT.

As Suban has transferred the townhouse to an SDT, he disregards the capital gain of \$100,000.

An asset passes to an SDT from a deceased person's estate

1.24 Typically, where an asset with an unrealised capital gain or capital loss passes from a deceased person's estate to a beneficiary of the estate, there is no taxing point for the deceased person or their legal personal representative. Instead, any unrealised capital gain or capital loss is typically deferred until a later dealing with the asset by the beneficiary of the estate.

1.25 To ensure that a trustee of an SDT disregards any unrealised capital gain or capital loss when an asset passes to the trustee from a deceased person's estate, the trustee will use the market value of the asset on the day the deceased died as the first element of its cost base (and reduced cost base).

- This effectively exempts any unrealised capital gain or capital loss that has accrued up until the transferor's death.

[Schedule 1, Part 2, items 7 and 8, subsection 128-15(4) (item 1 in the table) and (after item 3A in the table)]

1.26 If the trust is not an SDT at the time the asset passes to it from the deceased person's estate, the trust must become an SDT as soon as it

is practicable after the asset passes to it. This provides consistent treatment with what is available when an SDT is established outside of a deceased person's estate (see paragraph 1.23).

1.27 If the trust is not an SDT or does not become an SDT as soon as practicable, the normal deceased estate cost base rules will apply.

Example 1.2

Further to Example 1.1, Jessica's grandfather, Muhammad passes away and leaves shares in his will to Bright as trustee of the SDT, who is a beneficiary of Muhammad's estate. The shares are worth \$20,000 at the time of Muhammad's death.

Muhammad and his legal personal representative disregard any capital gains or capital losses on the shares using the normal deceased estate provisions.

These amendments ensure Bright obtains a market value cost base (and reduced cost base) of \$20,000 for the shares. One year later, Bright sells the shares for \$21,000. Assuming that Bright has not incurred any other costs in relation to the shares, Bright makes a capital gain of \$1,000 on the shares.

CGT main residence exemption

1.28 If a trustee of an SDT holds a dwelling (or an ownership interest in the dwelling) for the benefit of the principal beneficiary, the trustee will be eligible for the CGT main residence exemption if the principal beneficiary used the dwelling as their main residence and the dwelling was not used to produce assessable income [*Schedule 1, Part 1, item 4, section 118-215 and subsections 118-218(1) to (3)*].

- The existing CGT main residence exemption, which is located in Subdivision 118-B, disregards all or part of a capital gain or capital loss on an individual's main residence, provided certain conditions are satisfied.

1.29 The trustee of the SDT will be eligible for the CGT main residence exemption in the same way as the principal beneficiary would have been had they owned the dwelling directly.

- This is achieved by treating the trustee of the SDT as holding the asset personally and using the asset in the same particular way as the principal beneficiary on each day the trust is an SDT [*Schedule 1, Part 1, item 4, subsections 118-218(1) and (2)*].

- Where the trustee is not an individual, they are treated as if they were an individual [*Schedule 1, Part 1, item 4, subsection 118-218(3)*].

1.30 The map of the CGT main residence provisions, which is located in section 118-105, is amended to include references to the new provisions. [*Schedule 1, Part 1, item 3, section 118-105*]

Example 1.3: Basic case

Debbie and Marina are the trustees of an SDT established for Jack, who is the principal beneficiary.

The trustees purchase a dwelling for the benefit of Jack. Settlement occurs on 1 January 2008 and Jack moves in as soon as practicable after minor modifications are made to the dwelling to assist Jack with his independent occupation of the dwelling.

The trustees later sell the dwelling, making a capital gain of \$20,000 (apart from these amendments). Jack continues to live in the dwelling until settlement occurs on 31 December 2011.

The dwelling was never used to produce assessable income and the trust is an SDT throughout the entire ownership period.

If Jack owned the dwelling directly, he would have been able to disregard the entire capital gain. Therefore, the trustees will be able to disregard the entire capital gain.

1.31 There are specific rules that extend the existing CGT main residence exemption (sections 118-135 to 118-160). These rules allow an individual to treat a dwelling as their main residence even when it is not their main residence.

1.32 A trustee of an SDT will access these extensions, to the extent the principal beneficiary could access them if they owned the dwelling (or interest in the dwelling) directly. [*Schedule 1, Part 1, item 4, subsections 118-218(1) to (3)*]

Example 1.4: Absence rule

Further to Example 1.3, assume that in mid-2010, Jack moved out of the dwelling into a nursing home, with the dwelling being rented out at market value until the dwelling was sold in 2011. The trust remains an SDT for all of the ownership period.

If Jack owned the dwelling directly, he could access the absence rule under section 118-145. Therefore, the trustees can decide to continue to treat the dwelling as a main residence during this period under the absence rule and disregard the \$20,000 capital gain when the dwelling is sold.

1.33 An individual may make a capital gain or capital loss where a dwelling is their main residence for only part of the ownership period or where the dwelling was used for income producing purposes.

1.34 A trustee of an SDT will access the partial CGT main residence exemption and the income producing rules to the extent the principal beneficiary could have accessed these rules if they owned the dwelling (or an interest in the dwelling) directly. [*Schedule 1, Part 1, item 4, subsections 118-218(1) to (3)*]

A trust is not an SDT for part of the ownership period

1.35 For any day that a trust is not an SDT, that day will be treated as a non-main residence day for the purposes of the CGT main residence exemption. This outcome arises as the trustee cannot use these amendments to treat themselves as using the dwelling as their main residence on that day.

- For example, the trustee cannot use the absence rule in section 118-145 for any day when the trust is not an SDT.

[*Schedule 1, Part 1, item 4, subsections 118-218(1) and (2)*]

1.36 This treatment will not apply where the trust becomes an SDT as soon as practicable after a dwelling is transferred into it (see paragraphs 1.23 and 1.26) or after the trustee purchases a dwelling. That is, where the dwelling is the principal beneficiary's main residence in the time leading up to the trust becoming an SDT, those days will be main residence days.

Example 1.5

Respect Pty Ltd (Respect) is the trustee of an SDT established for Mark. Respect, in its capacity as trustee, purchases a dwelling for the benefit of Mark, with settlement occurring on 1 January 2007. Mark moves in on this day.

Respect sells the dwelling with settlement occurring on 31 December 2010. Mark moves out on this day. Respect would make a capital gain of \$15,000 (apart from these amendments).

The trust is not an SDT during the calendar year of 2010 (including at the time of the CGT event) as during this period, the trustee paid a weekly allowance of \$200 to Mark's mother for her personal expenditure.

When Respect sells the dwelling in 2010, the trustee is required to use the partial main residence formula in subsection 118-185(2). For the year of 2010, the days are counted as *non-main residence days*.

Therefore, Respect will be taken to have made a capital gain of \$3,747 — calculated as follows:

$$\text{CG amount} \times \frac{\text{Non-main residence days}}{\text{Days in Respect's ownership period}}$$
$$\$15,000 \times \frac{365}{1,461} = \$3,747.$$

A trustee inherits a dwelling from a deceased person's estate

1.37 If a trustee of an SDT inherits a dwelling from a deceased person's estate, the trustee may be able to disregard or reduce a capital gain or capital loss on a later dealing with that dwelling (or an ownership interest in it).

1.38 The trustee will determine the extent to which they can access the exemption by applying either section 118-195 (for a complete exemption) or 118-200 (for a partial exemption) as if they were a trustee or a beneficiary of the deceased person's estate. [*Schedule 1, Part 1, item 4, subsections 118-218(1) to (3)*]

1.39 These amendments provide a market value cost base for any asset that passes to an SDT from a deceased person's estate (see paragraphs 1.24 to 1.27). Therefore when the trustee of the SDT calculates any applicable CGT liability on a later dealing with that dwelling using the CGT main residence rules, any use of the dwelling by the deceased is ignored. This ensures that the trustee of the SDT will be able to access section 118-195 even where the dwelling was not the deceased's main residence or the dwelling was used to produce assessable income. [*Schedule 1, Part 1, item 4, subsection 118-218(4)*]

Example 1.6

Radovan purchased a dwelling, with settlement occurring on 1 January 2000. He died on 31 December 2009. Just before Radovan's death, the dwelling was his main residence although part of the dwelling was used to produce assessable income.

Radovan had set up a testamentary trust in his will to become an SDT for the benefit of Sue (the principal beneficiary). Sue had undergone the beneficiary assessment process prior to Radovan's death and the trust is recognised as an SDT at the time the asset passes to it. Kind Pty Ltd (Kind) is the trustee of the SDT.

The dwelling is used by Sue as her main residence until the dwelling is sold and settlement occurs on 2 March 2014. During the ownership period, the trust was an SDT.

Kind makes a capital gain of \$20,000 (apart from these amendments).

These amendments disregard any income producing use before the deceased's death. Therefore, as the dwelling was Sue's main residence during all of Kind's ownership period, Kind disregards the capital gain of \$20,000 when the dwelling is sold.

Death of the principal beneficiary

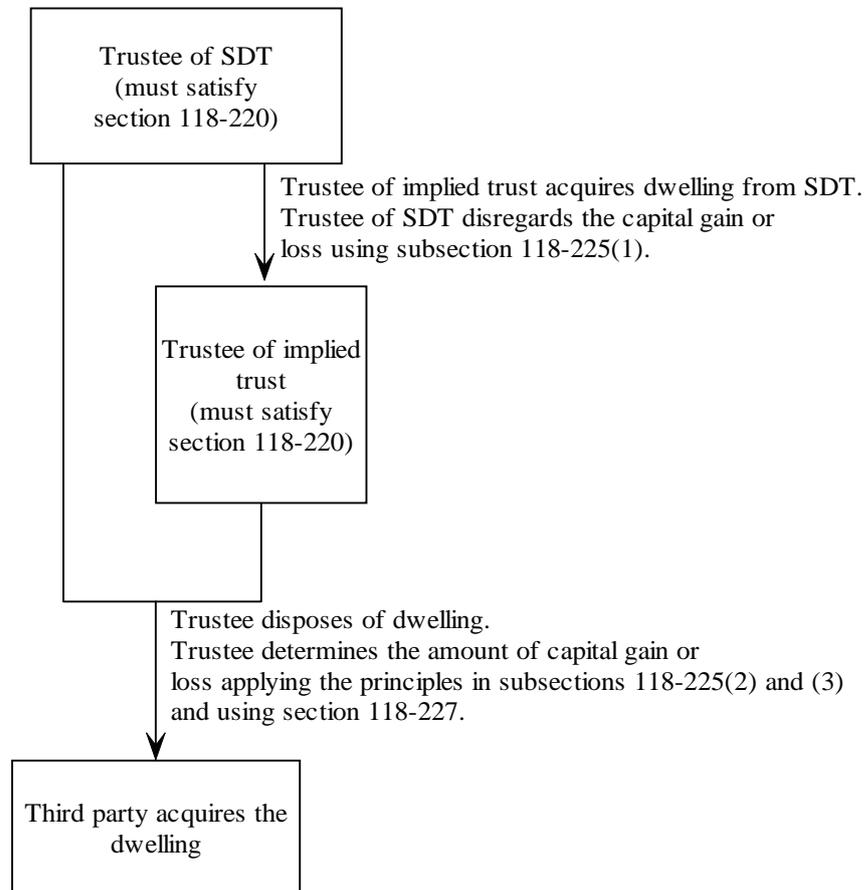
1.40 The social security and veterans' entitlements rules provide that an SDT ends on the death of the principal beneficiary, with assets being disposed of by a trustee or passed to the relevant beneficiary as determined by the trust deed. An implied trust may arise over the assets of the SDT. The assets are then transferred out of the implied trust to the beneficiary.

The dwelling is disposed of by either a trustee of the SDT or a trustee of the implied trust with proceeds given to the beneficiary

1.41 After the death of the principal beneficiary, the terms of the trust deed may require the dwelling to be disposed of, with the proceeds being distributed to the beneficiary or beneficiaries. This disposal may be by a trustee of the SDT or a trustee of the implied trust (the trustee). Under the amendments, the trustee will access a complete or partial CGT main residence exemption, based on the use of the dwelling by the principal beneficiary.

1.42 Diagram 1.1 highlights this outcome where the dwelling is disposed of by the trustee.

Diagram 1.1: Overview of the operation of the amendments where the trustee disposes of a dwelling



Conditions for the trustee

1.43 In order for the trustee to qualify for the treatment available following a principal beneficiary's death, the following conditions must be satisfied:

- the CGT event must happen at or after the principal beneficiary's death;
- the dwelling must have been owned by a trust that was an SDT at some point in the dwelling's ownership period (at or before the principal beneficiary's death); and

- when the CGT event happens, the dwelling must be owned by a trustee of the SDT or a trustee of an implied trust arising because of the principal beneficiary's death.

[Schedule 1, Part 1, item 4, section 118-220]

1.44 Prior to determining whether a full or partial CGT main residence exemption is available, to work out the amount of the capital gain or capital loss, the trustee will use the following as the first element of the cost base (and reduced cost base) as appropriate:

- Where the trustee of the SDT disposes of the dwelling and distributes the proceeds to a beneficiary — the trustee will retain its original cost base, unless it satisfies the requirements of a market value cost base (see paragraph 1.45).
- Where the trustee of the implied trust disposes of the dwelling and distributes the proceeds to a beneficiary — the trustee will use the trustee of the SDT's cost base of the asset just before the deceased's death (unless the market value cost base rule in paragraph 1.45 applies) *[Schedule 1, Part 1, item 4, subsection 118-227(2)]*.

1.45 The trustee of the SDT and the trustee of the implied trust will use the market value of the asset just before the principal beneficiary's death as the first element of the asset's cost base provided certain conditions are met. These conditions require that the dwelling was used by the principal beneficiary as their main residence, it was not used to produce assessable income and the dwelling was owned by the trust that was an SDT just before the principal beneficiary's death. This provides consistent outcomes with the Division 128 treatment that is available to a legal personal representative.

- This effectively exempts any unrealised capital gain or loss that has accrued up until the principal beneficiary's death.

[Schedule 1, Part 1, item 4, subsection 118-227(1)]

Calculation of the CGT liability by the trustee

1.46 Where the trustee of the implied trust acquires the dwelling from the trustee of the SDT, any capital gain or loss is disregarded by the trustee of the SDT. This ensures that any CGT liability is deferred until the trustee of the implied trust disposes of the asset. *[Schedule 1, Part 1, item 4, subsection 118-225(1)]*

1.47 The trustee of the SDT or the implied trust that ultimately disposes of the dwelling will determine their eligibility for the CGT main residence exemption by decreasing the amount of the capital gain or capital loss they would have made by an amount that is reasonable. Factors that may affect the availability of the exemption include the time the dwelling was the principal beneficiary's main residence, the time the trust was an SDT and whether the dwelling was used to produce assessable income during the relevant period.

- The 'relevant period' for the trustee is generally the period starting when the trustee of the SDT first acquired the dwelling and ending when the relevant trustee disposes of the dwelling.

[Schedule 1, Part 1, item 4, paragraphs 118-225(2)(a), (3)(a) and (c) and subsection 118-225(4)]

1.48 In determining what is a reasonable decrease in the capital gain or capital loss, the taxpayer should have regard to the principles applying in Subdivision 118-B, assuming the dwelling passed to the trustee as a trustee in a deceased person's estate. *[Schedule 1, Part 1, item 4, paragraphs 118-225(2)(a), (3)(a) and (c) and subsection 118-225(4)]*

Example 1.7: Full exemption for the trustee on disposal

Caring Pty Ltd (Caring) is the trustee of an SDT established for Peter, who is the principal beneficiary. Caring purchases a dwelling for the benefit of Peter. Settlement occurs on 1 January 2007 and Peter moves in on that day.

On 31 December 2012, Peter dies. Immediately, the trustee of an implied trust acquires the dwelling from the trustee of the SDT. Six months later, the trustee of the implied trust disposes of the dwelling and gives the proceeds to John.

In this situation, the trustee of the SDT disregards any capital gain or capital loss when the trustee of the implied trust acquires the dwelling.

Using the principles of section 118-195, the trustee of the implied trust determines that it is reasonable to disregard any capital gain or capital loss on the dwelling because:

- the trustee's ownership interest ends within two years of Peter's death; and

- just before Peter's death:
 - the dwelling was Peter's main residence;
 - it was not used to produce assessable income; and
 - the trust was an SDT.

The trustee passes the dwelling to the beneficiary

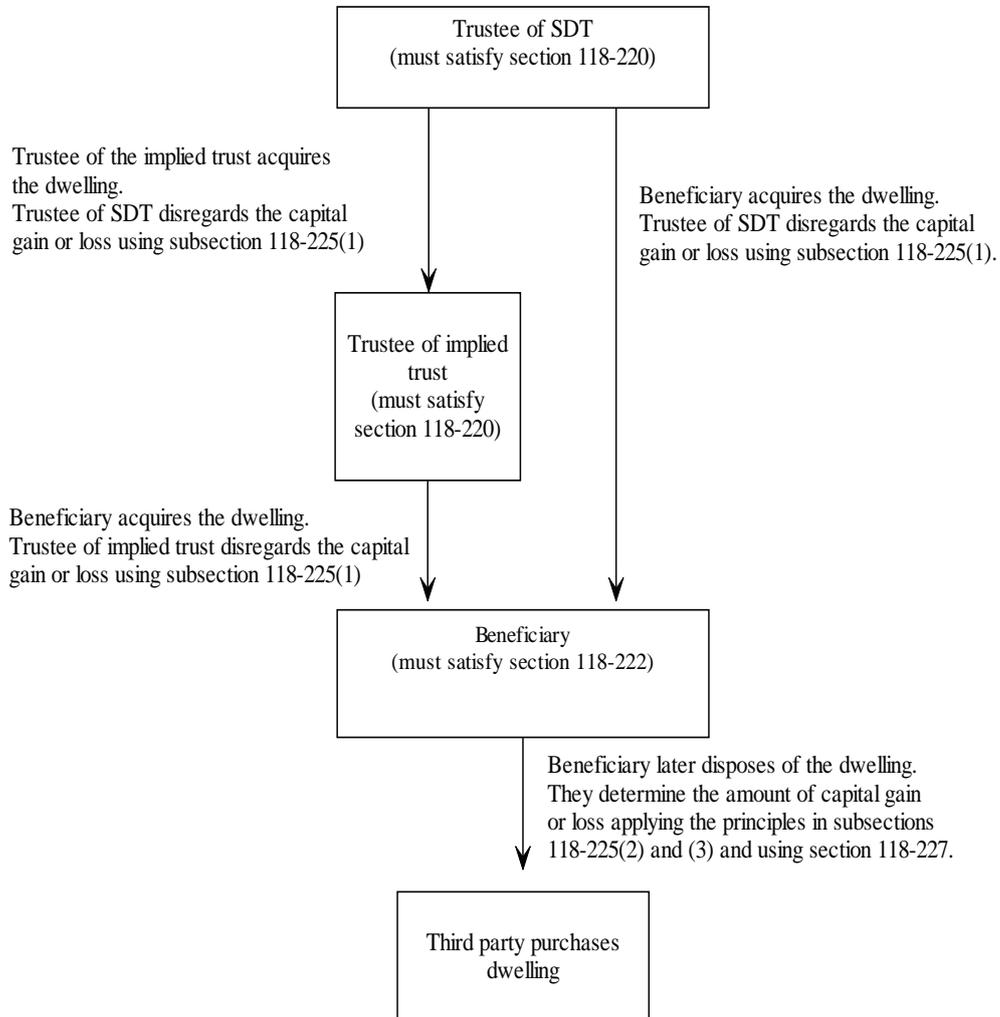
1.49 On the death of an individual, typically there is no CGT taxing point on an asset of the deceased. Instead, any CGT liability is typically deferred until a later dealing with the asset by a beneficiary of the deceased person's estate.

1.50 For main residence dwellings, a beneficiary of the deceased estate may be eligible for a complete CGT main residence exemption, provided certain conditions in section 118-195 are satisfied. Where these conditions are not satisfied, a partial CGT main residence exemption may be provided. In these cases, section 118-200 requires the beneficiary to take into account the extent to which the dwelling was the deceased's main residence and whether it was used to produce assessable income.

1.51 To ensure comparable treatment for SDT cases, when a beneficiary acquires the main residence dwelling (including where it acquires the dwelling from an implied trust), no CGT taxing point will occur for a trustee of the SDT or a trustee of an implied trust (the trustee). This ensures that where there is an unrealised CGT liability in the hands of the trustee, this is deferred until a later dealing with the asset by the beneficiary. [*Schedule 1, Part 1, item 4, section 118-220 and subsection 118-225(1)*]

1.52 Diagram 1.2 highlights this outcome where the trustee passes the dwelling to a beneficiary.

Diagram 1.2: An overview of the operation of the amendments where the trustee passes a dwelling to a beneficiary



CGT consequences for the trustee

1.53 To ensure that any applicable CGT liability flows through to a beneficiary, the trustee of the SDT and the trustee of the implied trust (if relevant) will disregard any capital gain or capital loss on the dwelling. This is on the condition that the relevant trustee satisfies the conditions in paragraph 1.43. [Schedule 1, Part 1, item 4, subsection 118-225(1)]

Calculation of the CGT liability on the subsequent disposal by the beneficiary

1.54 In order for a beneficiary to qualify for the treatment available following the principal beneficiary's death, the beneficiary must acquire the asset from a trustee of an SDT or trustee of an implied trust. *[Schedule 1, Part 1, item 4, section 118-222]*

1.55 Prior to determining whether a complete or partial CGT main residence exemption is available, to work out the amount of the capital gain or capital loss, the beneficiary will use the following as first element of cost base (and reduced cost base) as appropriate:

- where the beneficiary acquires the dwelling from a trustee of an implied trust — the trustee's cost base for the asset, just before the beneficiary acquired the asset (further information about the trustee's cost base is in paragraphs 1.44 and 1.45); or
- where the beneficiary acquires the asset directly from a trustee of an SDT — the trustee of the SDT's cost base for the asset just before the beneficiary acquired the asset.

[Schedule 1, Part 1, item 4, subsection 118-227(3)]

1.56 The relevant trust will use the market value of the asset just before the principal beneficiary's death for the first element of the asset's cost base provided certain conditions are met. These conditions require that the dwelling was used by the principal beneficiary as their main residence, it was not used to produce assessable income, and the trust was an SDT just before their death. This use will flow through to the beneficiary, providing outcomes consistent with the Division 128 treatment that is available to a beneficiary of a deceased person's estate. *[Schedule 1, Part 1, item 4, subsection 118-227(1)]*

1.57 The beneficiary determines the extent of their main residence exemption by decreasing the amount of capital gain or capital loss they would have made without the exemption by an amount that is reasonable. In determining what is a reasonable decrease in the capital gain or capital loss, the taxpayer should use the principles that apply in paragraphs 1.47 and 1.48, assuming the dwelling passed to them as a beneficiary in a deceased person's estate. *[Schedule 1, Part 1, item 4, paragraphs 118-225(2)(b), (3)(b) and (c) and subsection 118-225(4)]*

Example 1.8: Full exemption for the beneficiary

Health Pty Ltd (Health) is the trustee of an SDT established for John, who is the principal beneficiary. Health purchases a dwelling for the benefit of John. Settlement occurs on 1 January 2007 and John moves in on that day.

On 31 December 2012, John dies. Immediately, the trustee of the implied trust acquires the dwelling from the trustee of the SDT, as the SDT ends on the death of the principal beneficiary. Three months later, the beneficiary of the trust, Casey, acquires the dwelling. Casey later disposes of the dwelling, with settlement occurring on 1 July 2014.

Both the trustee of the SDT and the trustee of the implied trust will disregard any capital gain or capital loss as a result of the CGT event happening to the dwelling.

In addition, using the principles of section 118-195, Casey determines that it is reasonable to disregard any capital gain or capital loss on the dwelling because:

- Casey's ownership interest ends within two years of John's death; and
- just before John's death:
 - the dwelling was John's main residence;
 - it was not used to produce assessable income; and
 - the trust was an SDT.

Example 1.9: Partial exemption for the beneficiary

Further to Example 1.8, assume that during Health's entire ownership period, a part of the dwelling was used for income producing purposes.

Casey, as beneficiary of the SDT, takes into account the cost base of the dwelling in the hands of the trustee of the implied trust and determines that, without a partial CGT main residence exemption, a \$14,000 capital gain would be made when he sells the dwelling in 2014.

As there was income producing use of the dwelling just before John's death, Casey decides it is reasonable to use the principles in sections 118-190 and 118-200 to determine the amount of capital gain or capital loss that will be disregarded.

When Casey disposes of the dwelling, he considers that it is reasonable that 25 per cent of the dwelling was used for income producing purposes. Therefore, of this total capital gain, the following amount is *not* disregarded due to the income producing use:

$$\$14,000 \times 25\% = \$3,500$$

Therefore, Casey would make a capital gain of \$3,500 as it is reasonable for Casey to reduce the capital gain of \$14,000 by \$10,500.

Other issues relating to the CGT main residence exemption

Exception for the beneficiary's interest in the trust

1.58 To ensure the main residence exemption at the trustee level is not unwound at the beneficiary level, the beneficiary will disregard a capital gain or capital loss on their interest in the trust ending. This is on the condition that the trustee of the SDT or implied trust is eligible for a CGT main residence exemption.

- This will apply where the beneficiary becomes absolutely entitled to the dwelling (CGT event E5) or where the trustee disposes of the dwelling in satisfaction of the beneficiary's interest in the trust (CGT event E7).

[Schedule 1, Part 1, items 1 and 2, subsections 104-75(6) and 104-85(6)]

Additional CGT events relevant for SDTs

1.59 The list of CGT events that is required to happen in order for a taxpayer to access a CGT main residence exemption is expanded for SDT cases to include CGT event E5 (where a beneficiary becomes absolutely entitled to a dwelling held in an SDT) and CGT event E7 (where the trustee disposes of the dwelling in satisfaction of the beneficiary's interest in the SDT). *[Schedule 1, Part 1, item 4, section 118-230]*

Interaction with the trustee's personal dwelling

1.60 The trustee will disregard the use of their personal dwelling when determining whether they are eligible for the CGT main residence exemption in their capacity as trustee of an SDT. Under subsection 960-100(3) of the ITAA 1997, the trustee of an SDT is taken to be a different entity for tax purposes to the individual who accesses the main residence exemption in their personal capacity.

1.61 For the same reason, the trustee can ignore the deemed use of the dwelling held in the SDT when the trustee accesses the CGT main residence exemption in their personal capacity.

Application and transitional provisions

1.62 These amendments apply to income tax assessments for the 2006-07 income year and later income years. These amendments, which are beneficial to taxpayers, are retrospective so as to ensure transactions that have occurred since SDTs were first able to be established are covered by these amendments. *[Schedule 1, Parts 1 to 3, items 5, 9 and 12]*

1.63 The operation of section 170 of the ITAA 1936 is modified so that taxpayers are able to seek an amended assessment to take advantage of these amendments in circumstances where their original assessment was made before the commencement of these amendments but their period for seeking an amendment to their tax return has expired. Taxpayers have two years following the commencement of these amendments in which their amended assessment must be made. *[Schedule 1, Clause 4]*

Chapter 2

Pacific Seasonal Workers — reduction in marginal tax rate

Outline of chapter

2.1 Schedule 2 to this Bill amends the *Income Tax Rates Act 1986* to reduce the lowest marginal tax rate for non-resident workers participating in the Pacific Seasonal Worker Pilot Scheme (Scheme) from 29 per cent to 15 per cent. This change will apply for the 2011-12 year of income.

Context of amendments

2.2 The Scheme was announced in August 2008. It is an important element of the Pacific Engagement Strategy, a whole-of-government strategy to advance our engagement in the Pacific, a key objective announced in the March 2008 *Port Moresby Declaration*.

2.3 The key objectives of the Scheme are to:

- assist Australian horticulturalists to source seasonal workers;
- encourage both skills transfer between Australia and the Pacific Islands, and *remittances home to Pacific Islands*; and
- support Australia's Pacific Engagement Strategy and Pacific Partnerships.

2.4 The proposed changes announced by the Government are designed to:

- improve remittance outcomes for participants in the Scheme; and
- address equity concerns raised by the current high effective tax rates applicable to participants in the Scheme.

Improve remittance outcomes

2.5 An important element of the Scheme is developing a remittance stream, providing income directly to households to improve living

standards. Remittances are especially important to many Pacific Island countries because their small size, geographic isolation and rapidly growing populations mean that there are very limited employment opportunities.

2.6 As well as raising living standards, remittances allow Pacific Seasonal Workers (and their families) to make investments in human capital and small enterprises. Remittance flows are also an important earner of foreign exchange for many Pacific Island countries.

Reduce high effective tax rate

2.7 Under the tax laws, Pacific Seasonal Workers are likely to be non-residents for income tax purposes. As non-residents, Pacific Seasonal Workers are subject to the higher marginal tax rates that apply to non-residents. They will also not have access to the tax-free threshold or the low income tax offset.

2.8 This can result in relatively high effective tax rates for participants in the Scheme and also undermines the remittance and development goals of the Scheme.

2.9 From a policy perspective, Australia taxes non-residents at a higher rate and denies access to the tax-free threshold on the basis that the taxpayer's home country will address equity concerns through its own progressive rate scale. While this approach may be appropriate for high-income earners from developed tax jurisdictions (the traditional focus of non-resident tax policy), the appropriateness may be questionable for low-income earners from these developing countries. In New Zealand the lowest rate (10.5 per cent) applies to similar workers.

2.10 In addition, there may be logistical difficulties for workers in remote villages to properly access any foreign tax credits from their tax administrations.

2.11 Therefore, in order to address these equity concerns, and to ensure that the remittance objectives of the Scheme are achieved, the Government announced in the 2011-12 Budget that it would reduce the lowest marginal tax rate for Pacific Seasonal Workers to 15 per cent (down from 29 per cent).

Summary of new law

2.12 The lowest marginal tax rate for participants in the Scheme will be reduced from 29 per cent to 15 per cent, effective for the 2011-12 year of income. All other tax brackets for Pacific Seasonal Workers will

remain unchanged. The rates for other non-residents will be unaffected by this change.

2.13 The reduced rate will only apply to holders of a Special Program Visa (subclass 416) who are employed by Approved Employers under the Scheme.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
The lowest marginal tax rate for Pacific Seasonal Workers will be reduced to 15 per cent. The reduced rate will apply from the first dollar of income up to \$37,000. All other tax brackets remain unchanged.	Pacific Seasonal Workers are subject to the normal non-resident tax rates. This means the lowest marginal tax rate of 29 per cent applies from the first dollar of income earned up to \$37,000.
No change – Pacific Seasonal Workers will continue to be treated as non-residents for all other tax purposes, including not being able to access the tax-free threshold or the low income tax offset.	Non-residents do not have access to the tax-free threshold or the low income tax offset.

Detailed explanation of new law

2.14 Item 1, of this Schedule inserts new Clause 1A into Part II of Schedule 7 to the *Income Tax Rates Act 1986*. New Clause 1A modifies the table in Clause 1 by replacing the 29 per cent rate with the new 15 per cent rate in item 1 in the table.

2.15 Item 2, of this Schedule repeals Clause 1A from 1 July 2016. This allows a sufficient amendment period after the Scheme expires (on 30 June 2012) and also ensures the *Income Tax Rates Act 1986* does not contain inoperative provisions.

2.16 Should the Scheme be extended beyond 30 June 2012, appropriate amendments will be made at that time.

Application and transitional provisions

2.17 This measure will apply for the 2011-12 year of income.

Chapter 3

Taxation of financial arrangements and pay as you go instalments

Outline of chapter

3.1 Schedule 3 to this Bill amends Division 45 of Part 2-10 of Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953) to ensure that, for taxpayers who apply Division 230 of the *Income Tax Assessment Act 1997* (ITAA 1997) to their financial arrangements, the interaction between the taxation of financial arrangements (TOFA) provisions and the pay as you go instalments (PAYGI) provisions does not impose significant compliance costs.

Context of amendments

3.2 The PAYGI provisions contained in Division 45 of Part 2-10 of Schedule 1 to the TAA 1953 ensure the efficient collection of, among other things, income tax. In general, the PAYGI provisions operate so that as taxpayers earn instalment income, they pay instalments after the end of each instalment quarter worked out on the basis of their instalment income for that quarter.

3.3 Generally, under the PAYGI provisions, instalment income for a period includes ordinary income derived during the period, but only to the extent that it is assessable income of the income year that is or includes that period. For certain types of entities it may also include statutory income. As stated in subsection 6-5(1) of the ITAA 1997, ordinary income is income according to ordinary concepts. This generally means gross income before taking expenses into account.

3.4 The TOFA provisions were inserted by the *Tax Laws Amendment (Taxation of Financial Arrangements) Act 2009* which commenced on 26 March 2009. The TOFA provisions apply mandatorily for income years commencing on or after 1 July 2010, unless a taxpayer elects to apply the TOFA provisions for income years commencing on or after 1 July 2009. The TOFA provisions generally only apply in relation to gains and losses from financial arrangements held by certain taxpayers who do not satisfy certain asset or turnover threshold tests.

3.5 For a taxpayer who is required or elects to apply the TOFA provisions in relation to gains and losses from their financial arrangements (TOFA entities), the gains and losses from their financial arrangements are taken into account in determining their taxable income. That is, their assessable income includes a gain they make from a Division 230 financial arrangement and their allowable deductions include a loss they make from a Division 230 financial arrangement. Gains and losses from Division 230 financial arrangements may constitute either or both ordinary income and statutory income.

Summary of new law

3.6 These amendments extend the definition of 'instalment income' in section 45-120 to also include net gains (to the extent the gains equal or exceed the losses) from Division 230 financial arrangements. For TOFA entities (excluding individuals, or those entities that only have qualifying securities), this enables their instalment income from Division 230 financial arrangements to be worked out more easily from gains and losses worked out under the TOFA provisions.

3.7 These amendments also ensure that to the extent an amount of statutory or ordinary income is included in working out a gain or loss from Division 230 financial arrangements under the extended definition; that amount of statutory or ordinary income is excluded from other categories of instalment income.

3.8 The extension of the 'instalment income' definition commences from the first quarter of an income year following a TOFA entity's (other than individuals, or entities where the entity's only financial arrangements are qualifying securities) first base assessment that applied the TOFA provisions to their Division 230 financial arrangements. The income year to which the first base assessment relates must generally commence on or after 1 July 2010.

3.9 Under certain circumstances, taxpayers may elect to commence the extended 'instalment income' definition earlier.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>Net gains (to the extent the gains equal or exceed the losses) from Division 230 financial arrangements (as worked out under Division 230 of the ITAA 1997) are also included in instalment income except for individuals, and entities whose only gains and losses are from financial arrangements that are qualifying securities.</p> <p>Where a statutory income or ordinary income amount is included in working out a gain or loss from Division 230 financial arrangements, that statutory or ordinary income amount is excluded from other categories of instalment income.</p>	<p>Instalment income generally includes an entity's ordinary income derived during a period but only to the extent that it is assessable in the income year that includes that period.</p> <p>For certain entities, statutory income is also included.</p>

Detailed explanation of new law

Instalment income extended to include a net TOFA gain

3.10 This Schedule extends the definition of 'instalment income' in section 45-120 of Schedule 1 to the TAA 1953 so that a TOFA entity's instalment income for an instalment period includes the difference between:

- gains from financial arrangements that are assessable under Division 230 of the ITAA 1997 and reasonably attributable to the instalment period; and
- losses from financial arrangements that are allowable deductions under Division 230 of the ITAA 1997 and reasonably attributable to the instalment period, but only to the extent that the losses do not exceed the gains [*Schedule 3, item 1, subsection 45-120(2C)*].

3.11 **Financial arrangement** has the meaning given by sections 230-45 and 230-50 of the ITAA 1997. Broadly, financial arrangements are arrangements where the rights and obligations under the arrangement are cash settleable, subject to certain add-ons and exceptions. A financial arrangement is a **Division 230 financial arrangement** if

Division 230 of the ITAA 1997 applies in relation to gains and losses from the arrangement.

3.12 The extended definition allows TOFA entities to include net gains from their Division 230 financial arrangements in their instalment income calculations for an instalment period, as opposed to ordinary income derived from their financial arrangements. Net gains from Division 230 financial arrangements (net TOFA gains) equal total assessable gains from their Division 230 financial arrangements for an instalment period (TOFA gains) reduced by deductible losses from their Division 230 financial arrangements for that period (TOFA losses), but only to the extent that the TOFA losses do not exceed the TOFA gains.

3.13 Without the extension, for TOFA entities to work out their instalment income from the TOFA gains and losses, the taxpayer would generally be required to add back expenses to work out the gross income amount and then subtract any statutory income amounts. This process would increase compliance costs for taxpayers.

3.14 With respect to derivatives which are generally fair valued for financial accounting purposes, the current 'instalment income' definition may not include fair value gains as they are unlikely to be ordinary income and also it may be very difficult to work out the gross income amount because expenses are generally not readily identifiable.

3.15 The words *reasonably attributable* are intended to have their ordinary meaning. TOFA gains and TOFA losses that accrue over more than one instalment period should be apportioned to one or more instalment period(s) on a reasonable basis. [*Schedule 3, item 1, subparagraphs 45-120(2C)(a)(ii) and 45-120(2C)(b)(ii)*]

3.16 For some TOFA entities, TOFA gains and losses from certain financial arrangements may be taken into account for income tax purposes under an elective tax-timing method where TOFA gains and losses are spread in an un-systematic way, for example the fair value tax-timing method. Under this tax-timing method, the gain or loss from a financial arrangement for a particular period is the increase or decrease in its fair value (broadly, the market value) between the beginning and end of the period. In such situations, instalment income should include the net fair value changes of a financial arrangement for an instalment period where the fair value changes are readily ascertainable; for example, where the financial arrangement is quoted in an active market or where reliable valuation methodologies can be used.

3.17 Where fair value changes of a financial arrangement for an instalment period are not readily ascertainable, it is reasonable for the fair value changes to be included in instalment income for an instalment

period in which the fair value of the financial arrangement is required to be determined for financial accounting or commercial purposes.

Example 3.1

CFD Co is a TOFA taxpayer that has made a valid election to apply the fair value tax-timing method to its financial arrangements that are classified or designated as at fair value through profit or loss for financial accounting purposes.

CFD Co has two portfolios of listed securities (financial arrangements) during the instalment period from 1 July 2013 to 30 September 2013 — listed shares in Company A and listed units in Property Trust B — that are being classified as at fair value through profit or loss for financial accounting purposes.

At the beginning of 1 July 2013, the listed shares portfolio has a market value of \$65 million and the listed units portfolio has a market value of \$10 million. At the end of 30 September 2013, the listed shares portfolio has a market value of \$70 million and the listed units portfolio has a market value of \$8 million. For the instalment period, CFD Co has a fair value gain of \$5 million from the listed shares portfolio and a fair value loss of \$2 million from the listed units portfolio. CFD Co's instalment income for the period includes the net TOFA gain of \$3 million from its financial arrangements.

3.18 To reduce complexities, the extended 'instalment income' definition does not apply to TOFA entities who are individuals, or only apply Division 230 of the ITAA 1997 in relation to amounts from their qualifying securities. [*Schedule 3, item 1, subsection 45-120(2D)*]

3.19 'Qualifying security' is defined in Division 16E of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936). Generally, qualifying securities are long-term (more than 12 months), discounted and deferred interest securities with tax deferral characteristics.

3.20 To ensure no double counting of an ordinary or statutory income amount in instalment income calculations for any instalment period; where an amount of ordinary or statutory income is taken into account in working out a net TOFA gain for an instalment period, it is not taken into account again in the instalment income calculations for any instalment period. [*Schedule 3, item 1, subsection 45-120(2E)*]

3.21 Even where the net TOFA gain is a nil amount, due to the TOFA losses equalling or exceeding the TOFA gains, the ordinary or statutory income amounts used in working out the TOFA gains should not be included again as instalment income for any instalment period. Where such an amount has already been included in an earlier instalment period,

the amount should be subtracted from the instalment income calculations for the current period.

Example 3.2

Charter Co has \$100 interest income (TOFA gains) and \$200 interest expense (TOFA losses) from its Division 230 financial arrangements for the instalment period from 1 July 2013 to 30 September 2013. As Charter Co's TOFA losses are greater than its TOFA gains for the instalment period, no amount in relation to its Division 230 financial arrangements is included in its instalment income for the period.

While the \$100 interest income is an amount of ordinary income which would otherwise have been included in Charter Co's instalment income for the instalment period under subsection 45-120(1) of Schedule 1 to the TAA 1953, this amount is not to be taken into account in calculating instalment income for any instalment period because it has been taken into account in working out the nil amount of net TOFA gains for the purposes of calculating instalment income for the instalment period from 1 July 2013 to 30 September 2013.

Application of the extended 'instalment income' definition

Definition

3.22 The instalment income definition as extended is defined as the *amended instalment income definition*. [Schedule 3, item 2]

3.23 A taxpayer's **first TOFA year** is defined as the first income year commencing on or after 1 July 2010 where the taxpayer has an assessable gain or deductible loss from its Division 230 financial arrangements (other than a qualifying security). [Schedule 3, item 2]

Main rule

3.24 Subject to the early opt-in provisions (explained below), a taxpayer applies the amended instalment income definition when:

- the Commissioner of Taxation (Commissioner) issues an instalment rate under section 45-15 of Schedule 1 to the TAA 1953 after this Bill receives Royal Assent and in the first quarter of a taxpayer's income year; and
- the base year that applies in working out the instalment rate is the taxpayer's first TOFA year or a later year.

[Schedule 3, subitems 3(1) and (2)]

3.25 Under the PAYGI provisions, the Commissioner is required to use the taxpayer's base assessment instalment income to work out the instalment rate. **Base assessment instalment income** is defined in subsection 45-320(2) of Schedule 1 to the TAA 1953 to mean so much of the taxpayer's assessable income, as worked out for the purposes of the base assessment, as the Commissioner determines is instalment income for the base year. **Base year** is the income year to which the base assessment relates. Broadly, the base assessment is the latest assessment for the taxpayer's most recent income year for which an assessment has been made.

3.26 The main application rule operates so that taxpayers, who use the instalment rate method to work out their PAYGI amounts, only start to apply the amended instalment income definition from the instalment period in which the Commissioner issued an instalment rate that is worked out by using the amended instalment income definition in calculating the base assessment instalment income. This is to ensure that the Commissioner has sufficient TOFA-related information to issue a TOFA-related instalment rate.

3.27 The amended instalment income definition will only have an effect where a taxpayer has gains or losses calculated under Division 230 of the ITAA 1997. In other words, applying the amended instalment income definition to any periods prior to a taxpayer's first TOFA year gives the same instalment income amounts as applying the existing instalment income definition.

3.28 To reduce complexities of the law in terms of the various amendments to the PAYGI provisions that would be required consequential to starting the amended instalment income definition part way through an income year, the amended instalment income definition commences in the first instalment quarter of a taxpayer's income year.

Example 3.3

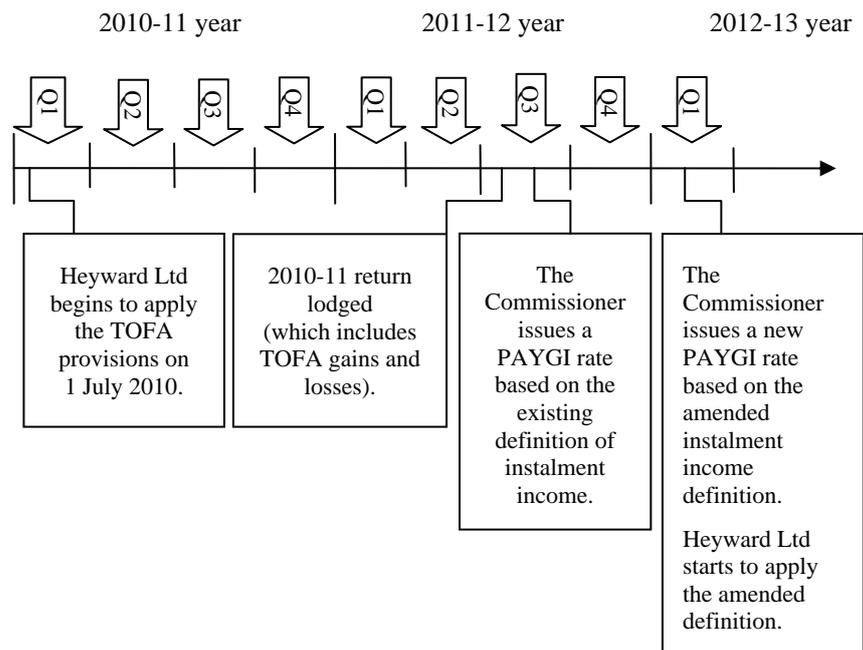
Heyward Ltd is a full self-assessment taxpayer with an income year ending on 30 June. The TOFA provisions mandatorily apply to Heyward Ltd for income years commencing on or after 1 July 2010 (that is, from the 2010-11 income year). Heyward Ltd's first TOFA year is 2010-11 income year.

In compliance with its tax agent's lodgment program it lodges its income tax return for the 2010-11 income year through its tax agent on 15 January 2012. Assuming a similar lodgment due date applies in subsequent years, the 2010-11 income year is the base year for the third and fourth instalment periods of the 2011-12 income year and the first and second instalment periods of the 2012-13 income year.

As per the diagram below, the Commissioner issues Heyward Ltd with:

- an instalment rate based on the base assessment instalment income worked out using the existing instalment income definition in Heyward Ltd's third instalment period (that is, Q3 — 1 January 2012 to 31 March 2012) of the 2011-12 income year (in line with current practice for non-TOFA entities); and
- another instalment rate based on the base assessment instalment income worked out using the amended instalment income definition in Heyward Ltd's first instalment period (that is, Q1 — 1 July 2012 to 30 September 2012) of the 2012-13 income year.

In this situation, Heyward Ltd continues to use the existing instalment income definition to work out its instalment income for the third and the fourth instalment periods of the 2011-12 income year. Heyward Ltd starts to use the amended instalment income definition to work out its instalment income from the first quarter of the 2012-13 income year.



Example 3.4

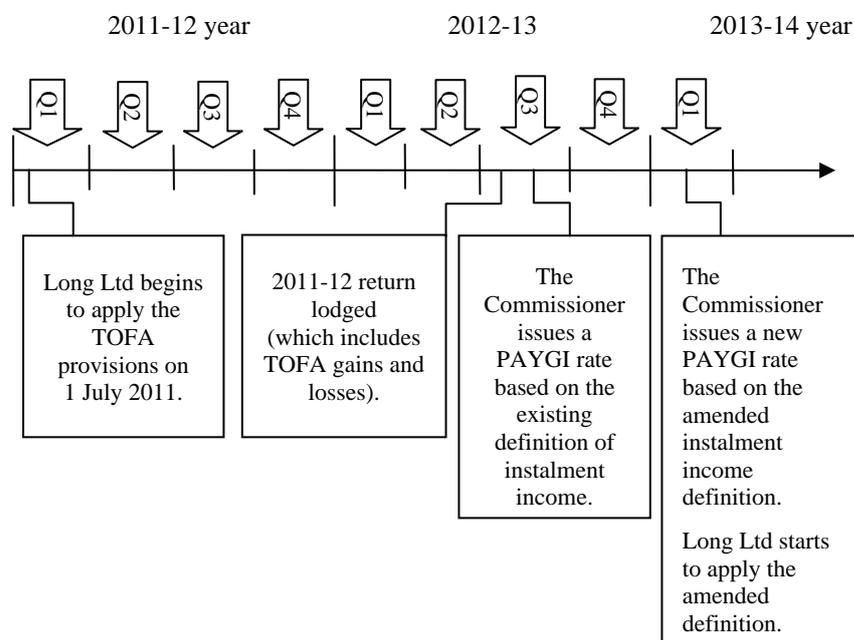
Long Ltd is a full self-assessment taxpayer with an income year ending on 30 June. It is required to apply the TOFA provisions to its financial arrangements from the 2011-12 income year due to the breach of the asset threshold tests in the TOFA provisions in the 2010-11 income year. Long Ltd's first TOFA year is the 2011-12 income year.

In compliance with its tax agent's lodgment program it lodges its income tax return for the 2011-12 income year through its tax agent on 15 January 2013. Assuming a similar lodgment due date applies in subsequent years, the 2011-12 income year is the base year for the third and fourth instalment periods of the 2012-13 income year and the first and second instalment periods of the 2013-14 income year.

As per the diagram below the Commissioner issues Long Ltd with:

- an instalment rate based on the base assessment instalment income worked out using the existing instalment income definition in Long Ltd's third instalment period (that is, Q3 — 1 January 2013 to 31 March 2013) of the 2012-13 income year (in line with current practice); and
- another instalment rate based on the base assessment instalment income worked out using the amended instalment income definition in Long Ltd's first instalment period (that is, Q1 — 1 July 2013 to 30 September 2013) of the 2013-14 income year.

In this situation, Long Ltd continues to use the existing instalment income definition to work out its instalment income for the third and fourth instalment periods for the 2012-13 income year. Long Ltd starts to use the amended instalment income definition from the first instalment period (Q1) for its 2013-14 income year.



Application — Partnerships and trusts

3.29 Under sections 45-260 (partnerships) and 45-280 (trusts) of Schedule 1 to the TAA 1953, a partner of a partnership's or a beneficiary of a trust's instalment income for an instalment period includes their share of the partnership's or trust's instalment income for the period worked out in accordance with the formula specified in the respective sections.

3.30 For the purposes of sections 45-260 and 45-280, TOFA entities who are partnerships or trusts apply the amended instalment income definition in working out the partnership's or the trust's instalment income for 'the last income year' and 'the current period' in the applicable formula where:

- 'the current period' starts after this Bill receives Royal Assent; and
- 'the last income year' in the formula is the partnership/trust's first TOFA year or a later year.

[Schedule 3, subitems 3(3) and (5)]

3.31 To ease compliance costs and avoid the potential for a mismatch between the:

- instalment income for ‘the last income year’ in the numerator of the two formulae; and
- instalment income of the current period which is the multiplier in the two formulae,

the application rules for partnerships and trusts defers the application of the amended instalment income definition in working out the partnership’s or trust’s instalment income for the current period until a partner’s or a beneficiary’s last income year is on or after the partnership’s or trust’s first TOFA year. [*Schedule 3, subitems 3(4) and (6)*]

Example 3.5

XYZ Trust is a TOFA entity with an income year ending on 30 June, and has reported assessable TOFA gains and deductible TOFA losses in its income tax return for the 2011-12 income year. This is XYZ Trust’s first TOFA year.

Michael is a beneficiary of XYZ Trust. Michael’s most recent income year for which there is an assessment is the 2011-12 income year. The assessment was issued on 2 December 2012 (which is in Michael’s second instalment period of the 2012-13 income year). As such, from the second instalment period, Michael’s last income year under subsection 45-280(2) is the 2011-12 income year. This is also the first TOFA year for XYZ Trust.

Accordingly, from the second instalment period of the 2012-13 income year the trustee of XYZ Trust starts to use the amended instalment income definition in working out the XYZ Trust’s instalment income for ‘the last income year’ (2011-12 income year) and ‘the current period’ for Michael.

Example 3.6

The ABC Partnership was created on 1 July 2011 and is constituted by two equal partners, David Co and Sonida Co investment banks. The ABC Partnership was created to borrow money from the wholesale market and on-lend it to DEF Co. The ABC Partnership, David Co and Sonida Co have an income year ending on 30 June.

On 1 July 2011, the ABC Partnership borrowed \$1 billion at 5 per cent per annum fixed for three years, and on-lent the funds to DEF Co on the same day at 6 per cent per annum fixed for three years (that is, ABC Partnership will have assessable TOFA gains of \$60 million for the next three years, and deductible TOFA losses of \$50 million in

each of those years). Both loans are Division 230 financial arrangements.

The 2011-12 income year was the first TOFA year for the ABC Partnership, and for that year:

- the ABC Partnership had assessable income of \$60 million, allowable deductions of \$50 million and net income of \$10 million; and
- each partner had \$5 million assessable income from the partnership.

Both David Co and Sonida Co lodged their 2011-12 income tax returns on 3 September 2012. In working out the partners' instalment income for the first instalment period of their 2012-13 income year (that is, Q1 — 1 July 2012 to 30 September 2012) for the ABC Partnership, the amended instalment income definition applies:

- the partnership's instalment income for the period is \$2.5 million — this is worked out as the TOFA gain attributable to the period (\$15 million) less the TOFA loss attributable to the period (\$12.5 million), and
- the partnership's instalment income for the last income year is \$10 million (being a TOFA gain of \$60 million less a TOFA loss of \$50 million)

Using the formula in subsection 45-260(1) of Schedule 1 to the TAA 1953, David Co and Sonida Co each includes \$1.25 million in their instalment income for that period from the ABC Partnership calculated as follows:

- $\$5 \text{ million} / \$10 \text{ million} \times \2.5 million .

Application — Early application of the amended instalment income definition

3.32 Under the main application rules, the amended instalment income definition commences for a taxpayer from the first instalment period of an income year where the base year, for the purposes of the Commissioner calculating an instalment rate for that first quarter, is the taxpayer's first TOFA year. This means that TOFA entities generally cannot apply the amended instalment income definition in the instalment period when they lodge their first TOFA tax return. Rather, it does not generally apply until the first instalment period of the income year that follows the year in which that first TOFA return is lodged. This generally involves an 18 month delay.

3.33 For TOFA entities that do not wish to maintain the gross income system for PAYGI purposes and the net gain or loss system for income tax purposes, they may elect to start applying the amended instalment income definition where the base year, for the purposes of the Commissioner calculating an instalment rate, is an income year before the taxpayer's first TOFA year. *[Schedule 3, subsection 3(7)]*

3.34 The election only applies where the Commissioner is satisfied that it would be reasonable to do so having regard to the objects of the PAYGI provisions. *[Schedule 3, paragraph 3(7)(d)]*

3.35 Given the base year is an income year before the taxpayer's first TOFA year, the base assessment will generally not contain amounts resulting from the application of the TOFA provisions for the Commissioner to issue an instalment rate based on the amended instalment income definition.

3.36 Taxpayers can only apply the amended instalment income definition for an instalment period, where the base year for the purposes of calculating the corresponding instalment rate is an income year before the taxpayer's first TOFA year, if the Commissioner has sufficient TOFA related information for the base year to issue a TOFA related instalment rate for a relevant current period. This is to ensure the instalment income and instalment rate for an instalment period are both worked out using the amended instalment income definition, and therefore ensure the integrity of the PAYGI provisions. *[Schedule 3, subitems 3(7) and (8)]*

3.37 Where the early opt in results in the base year being an income year before a taxpayer's first TOFA year, the TOFA provisions are taken to apply to the taxpayer's financial arrangements for the base year in the same way that they would have applied in the taxpayer's first TOFA year. *[Schedule 3, subitem 3(9)]*

Example 3.7

Evan Ltd is a TOFA entity from the beginning of its income year commencing 1 January 2012 (that is, its 2012-13 income year). Assume that the amended instalment income definition commences on 1 January 2012.

It lodges the following income tax returns:

- for the 2011-12 income year (which commences on 1 January 2011) on 6 June 2012; and
- for the 2012-13 income year (which commences on 1 January 2012) on 6 June 2013.

It lodges its 2012-13 income tax return in the second quarter (Q2) of its 2013-14 income year (that commences on 1 January 2013).

Under the main application rules, Evan Ltd starts to apply the amended instalment income definition from the first instalment period of the 2014-15 income year (which commences on 1 January 2014).

Instead, Evan Ltd elects to apply the amended instalment income definition from the first instalment period of the 2013-14 income year (which commences 1 January 2013).

For the first instalment quarter of the 2013-14 income year, the base year is the 2011-12 income year as Evan Ltd's most recent assessment is in relation to that income year.

Because the base year is an income year before Evan Ltd's first TOFA year, Evan Ltd's base assessment does not include information for the Commissioner to work out the base assessment instalment income using the amended instalment income definition (that is, the net TOFA gains from Evan Ltd's Division 230 financial arrangements). As such, in making the election, Evan Ltd needs to provide sufficient information for the Commissioner to calculate a new instalment rate on the basis that the TOFA provisions had relevantly applied to Evan Ltd in that income year.

Chapter 4

Commissioner's discretion to extend time for notifying taxation of financial arrangements transitional elections

Outline of chapter

4.1 Schedule 4 to this Bill amends the *Tax Laws Amendment (Taxation of Financial Arrangements) Act 2009* (TOFA Act) to give the Commissioner of Taxation (Commissioner) a limited discretion to extend the time for a taxpayer to notify the Commissioner of the making of the transitional election to apply Division 230 of the *Income Tax Assessment Act 1997* (ITAA 1997) and related consequential and transitional amendments (TOFA provisions) to its existing financial arrangements.

Context of amendments

4.2 The TOFA Act received Royal Assent on 26 March 2009. The TOFA Act introduced Division 230 into the ITAA 1997. Division 230 defines what a financial arrangement is and sets out the methods under which gains and losses from financial arrangements are brought to account for tax purposes. The two objectives underpinning the Division are greater efficiency and the lowering of compliance costs.

4.3 The TOFA provisions generally have prospective application. They apply to financial arrangements a TOFA taxpayer starts to have during income years commencing on or after 1 July 2010 on a mandatory basis and during income years commencing on or after 1 July 2009 on an elective basis (first TOFA applicable income year). Existing financial arrangements that a TOFA taxpayer starts to have prior to the taxpayer's first TOFA applicable income year are not subject to the application of the TOFA provisions, unless the taxpayer elects to have the TOFA provisions apply to those arrangements.

4.4 To reduce compliance costs by relieving taxpayers of the burden of complying with two sets of income tax rules for financial arrangements, taxpayers may, in certain circumstances, make a one off election under the transitional provisions to apply the TOFA provisions to their existing financial arrangements.

4.5 The transitional election, and the notification of it, must be made on or before the first lodgment date that occurs on or after the start of the taxpayer's first TOFA applicable income year. This is an integrity measure designed to prevent taxpayers from waiting until the end of their first TOFA applicable income year to 'pick and choose' favourable tax outcomes once an ex-post analysis has been made in respect of their existing financial arrangements.

4.6 Since the commencement of the TOFA provisions, the Australian Taxation Office (ATO) has identified a number of taxpayers who, despite electing to bring their existing financial arrangements into the TOFA regime by the due date for the making of the election, inadvertently failed to notify the Commissioner of the election by the due date. The failure to notify the transitional election by the due date invalidates the election and therefore prevents the TOFA provisions from applying to existing financial arrangements which may result in significant compliance consequences.

4.7 To address this issue, the Assistant Treasurer and Minister for Financial Services and Superannuation announced on 29 November 2010 that the Commissioner would be given a limited discretion to specify a later notification due date in certain circumstances.

Summary of new law

4.8 This Schedule introduces a new item 104A to Part 3 of Schedule 1 to the TOFA Act. Under this item, the Commissioner is given a discretion to extend the time (for a maximum period of three months) for the notification of the making of a transitional election to apply the TOFA provisions to existing financial arrangements in either of the following circumstances:

- the taxpayer did not notify the Commissioner by the due date because of circumstances beyond the control of the taxpayer (or taxpayer's agent) and the taxpayer (or the taxpayer's agent) has taken reasonable steps to mitigate the effects of those circumstances; or
- the taxpayer did not notify the Commissioner by the due date because of an honest mistake or an inadvertent omission by the taxpayer (or the taxpayer's agent).

4.9 These amendments commence the day after Royal Assent and apply to lodgment dates mentioned in paragraph 104(5)(b) of the TOFA Act.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
The Commissioner is given a discretion to extend the time (for a maximum period of three months) that the taxpayer has for notifying the Commissioner of their transitional election under certain circumstances.	The taxpayer must notify the Commissioner of their transitional election to apply the TOFA provisions to their existing financial arrangements by the first lodgment date that occurs on or after the start of their first TOFA applicable income year.

Detailed explanation of new law

4.10 This Schedule inserts a new item 104A into Part 3 of Schedule 1 to the TOFA Act. Where a taxpayer has made the transitional election to apply the TOFA provisions to its existing financial arrangements in accordance with subitem 104(2), but has failed to notify the Commissioner of the election by the first lodgment date that occurs on or after the start of their first TOFA applicable income year, the new item gives the Commissioner a discretion to specify a later notification date (that occurs no later than three months after the first lodgment date) in limited circumstances. *[Schedule 4, item 2]*

4.11 Under the current law, the taxpayer must make and notify the Commissioner of its transitional election on or before the first lodgment date that occurs on or after the start of the first TOFA applicable income year. Not satisfying these requirements renders the election ineffective and therefore prevents the taxpayer from applying the TOFA provisions to its existing financial arrangements.

4.12 These amendments give the Commissioner a limited discretion to extend the time for the notification of a transitional election only; the taxpayer must still have made the transitional election under subitem 104(2) of the TOFA Act by the first lodgment date that occurs on or after the start of the taxpayer's first TOFA applicable income year.

4.13 The discretion to be exercised by the Commissioner is intended to allow a certain degree of administrative flexibility while not compromising the integrity of the requirements.

4.14 The Commissioner can only extend the notification time by a maximum period of three months.

4.15 The Commissioner may specify a later notification due date if he (or she) is satisfied that he (or she) was not notified of the transitional election by the required date due to an honest mistake or an inadvertence by the taxpayer (or the taxpayer's agent).

Example 4.1: Honest mistake

David Co was required to apply the TOFA provisions to the income year commencing 1 July 2010. David Co's first lodgment date after the start of its first TOFA applicable income year is 17 January 2011 — the lodgment date for David Co's 2009-10 income tax return. On 14 January 2011, David Co made the transitional election under subitem 104(2) of the TOFA Act to apply the TOFA provisions to all its financial arrangements, including those financial arrangements that it started to have prior to 1 July 2010 and still held as at 1 July 2010. However, David Co did not notify the Commissioner of the election until 19 January 2011.

Thus, the transitional election was ineffective because the requirement to notify the Commissioner of the election by 17 January 2011 was not met.

David Co requests that the Commissioner exercise the discretion under item 104A of the TOFA Act to specify 19 January 2011 as the due date for the notification of the making of the transitional election on the basis that the failure to notify the election on time was due to its honest mistake.

David Co informs the Commissioner that the notification was late because there was a communication error where one employee mistakenly thought that another employee was notifying the Commissioner of the election, however that other employee did not receive the instruction. The election was notified to the Commissioner as soon as the first employee realised the mistake.

Based on these facts, the Commissioner specifies a later notification due date of 19 January 2011 on the basis that he (or she) is satisfied that the notification delay was due to David Co's honest mistake.

Example 4.2: Inadvertence

Jonathan Co was incorporated 1 July 2005 and the first income year to which Jonathan Co was required to apply the TOFA provisions commenced on 1 July 2010.

On 14 January 2011, Jonathan Co's tax agent signed the transitional election form and attempted to notify the Commissioner of the election using the ATO Tax Agent Portal.

However the tax agent inadvertently omitted to attach the transitional election form to the message. On 20 February 2011 the tax agent realised his error and resent a message using the ATO Tax Agent Portal with the form attached. The Commissioner therefore receives notification on 20 February 2011.

While Jonathan Co made the transitional election on 14 January 2011, it did not notify the Commissioner of the election by its first lodgment date on or after the start of its first TOFA applicable income year, which was 17 January 2011. The transitional election is therefore ineffective.

Jonathan Co requests that the Commissioner exercise the discretion under item 104A of the TOFA Act to specify 20 February 2011 as the due date for the notification of the making of the transitional election because of the inadvertent omission of its agent.

Based on these facts, the Commissioner specifies a later notification due date of 20 February 2011 on the basis that he (or she) is satisfied that the delay in notifying the transitional election was due to Jonathan Co's tax agent's inadvertence.

4.16 The Commissioner may also specify a later notification due date if he (or she) is satisfied that the taxpayer did not notify the Commissioner of the transitional election by the due date because of circumstances beyond the control of the taxpayer (or taxpayer's agent) and the taxpayer (or the taxpayer's agent) took all reasonable steps to notify the Commissioner by the due date.

Example 4.3: Circumstances beyond the taxpayer's control

Russell Co was incorporated 1 July 2005 and the first income year to which Russell Co was required to apply the TOFA provisions commenced on 1 July 2010.

On 12 January 2011, Russell Co's Public Officer completed and signed Russell Co's transitional election form. However, later that day the Public Officer's office building was evacuated and could not be re-occupied until 19 January 2011. On returning to the office the Public Officer immediately delivered the election form to the Commissioner.

Russell Co's first lodgment date on or after the start of its first TOFA applicable income year was 17 January 2011, but because Russell Co only notified the Commissioner of the making of the transitional election on 19 January 2011, the transitional election is ineffective.

Russell Co requests that the Commissioner exercise the discretion under item 104A of the TOFA Act to specify 19 January 2011 as

the due date for the notification of the making of the transitional election because circumstances outside of its control prevented it from notifying the Commissioner of its election by its first lodgment date.

Based on these facts, the Commissioner specifies a later notification due date of 19 January 2011 on the basis that he (or she) is satisfied that the delay in notifying the transitional election was the result of circumstances outside the taxpayer's control and that the taxpayer had taken all reasonable steps to notify the Commissioner of the election.

Application and transitional provisions

4.17 These amendments commence the day after Royal Assent and apply in relation to lodgment dates mentioned in paragraph 104(5)(b) of the TOFA Act, whether the lodgment dates occur before, on, or after the commencement of the item. *[Schedule 4, item 4]*

Consequential amendments

4.18 Item 1 of this Schedule inserts a note under subitem 104(5) to direct the reader to the new item. *[Schedule 4, item 1]*

4.19 Item 3 ensures that the Commissioner's specified later notification due date also applies in relation to Subdivision 775-F (of the ITAA 1997) arrangements under item 105 of the TOFA Act. *[Schedule 4, item 3]*

Chapter 5

Farm management deposits

Outline of chapter

5.1 Schedule 5 to this Bill amends Division 393 of the *Income Tax Assessment Act 1997* (ITAA 1997) to allow an owner of a farm management deposit (FMD) affected by applicable natural disasters to access their FMDs within 12 months of making a deposit while retaining concessional tax treatment under the FMD scheme.

5.2 This Schedule also makes some minor changes to the administration of the FMD scheme by amending Division 393 of the ITAA 1997, section 398-5 in Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953) and section 69 of the *Banking Act 1959*.

5.3 All legislative references in this chapter are to the ITAA 1997 unless otherwise stated.

Context of amendments

Background

5.4 The FMD scheme, which replaced the income equalisation deposits scheme, commenced on 2 January 1999. The FMD scheme's legislative provisions are in Division 393 of the ITAA 1997.

5.5 These amendments are intended to:

- afford the same tax treatment to FMD owners who qualify for concessional tax treatment under the existing exceptional circumstances exception;
- facilitate FMD owners' ability to negotiate competitive interest rates on their FMD deposits;
- enable more timely provision of information to the Agriculture Secretary to allow for efficient administration of the FMD scheme; and

- afford the owner of an FMD additional protection under the unclaimed moneys provision which is not available to ordinary depositors.

5.6 The FMD scheme provides an incentive in the form of a tax concession to individuals carrying on a primary production business in Australia to encourage those individuals to carry over income from years of good cash flow and to draw down on that income in years of reduced cash flow. This enables the individual to defer the income tax on their taxable primary production income from the income year in which they make the deposit until the income year in which the deposit is repaid, when they may face a lower marginal tax rate.

5.7 Division 393 of the ITAA 1997 allows a deduction for an FMD made if:

- it is an individual carrying on a primary production business (including a primary production business that the individual carries on as a partner in a partnership or as a beneficiary of a trust);
- the individual holds the deposit for at least 12 months; and
- the individual meets some other tests.

This deduction for an FMD allows an individual to defer the income tax on their taxable primary production income in the income year in which they make the deposit.

5.8 An FMD owner is an individual who at the time of making the deposit carries on a primary production business in Australia (including a primary production business carried on as a partner in a partnership or as a beneficiary of a trust).

Repayment of farm management deposits within the first 12 months

5.9 The deduction for an FMD is conditional on a deposit not being repaid within 12 months (section 393-40), (the 12-month requirement). This prevents FMD owners from inappropriately deferring tax.

5.10 Ordinarily, any part of a deposit repaid within 12 months is taken never to have been an FMD. The FMD owner is required to amend their earlier tax return if a deduction was claimed for a deposit that is later taken not to have been an FMD.

5.11 Repayments are not subject to the 12-month requirement in the following circumstances:

- the repayment is made in exceptional circumstances; or
- the repayment is made in the case of death, bankruptcy or ceasing to carry on a primary production business.

5.12 The exceptional circumstances exception allows FMD owners to access their funds without foregoing concessional tax treatment (a tax deduction), enabling them to recover and rebuild their farm businesses more quickly and/or provide an income in times of severe hardship.

5.13 Among other things, exceptional circumstances requires that at the time the FMD is repaid, the FMD owner is eligible for an 'exceptional circumstances certificate' within the meaning of the *Farm Household Support Act 1992* that relates to a primary production business of that FMD owner. Such a certificate must be issued within three months after the end of the income year in which the repayment is made.

5.14 Exceptional circumstances include situations of severe drought, but specifically excludes those events covered by the Natural Disaster Relief and Recovery Arrangements such as bushfires and floods.

Frequency of reporting

5.15 An ***FMD provider*** means an entity that:

- is an authorised deposit-taking institution;
- carries on the business of banking in Australia, provided deposits are guaranteed by the Commonwealth, a state or a territory; or
- carries on a business in Australia that includes taking money on deposit, provided deposits are guaranteed by the Commonwealth, a state or a territory.

5.16 FMD providers must provide certain information to the Agriculture Secretary within 60 days after the end of each financial quarter (section 398-5 in Schedule 1 to the TAA 1953).

5.17 The information to be provided to the Agriculture Secretary includes the number of FMDs held at the end of each month in the quarter, the number of depositors in respect of such deposits at the end of each month in the quarter, and the sum of the balances of such deposits at

the end of each month in the quarter (subsection 398-5(3) in Schedule 1 to the TAA 1953).

Farm management deposits with more than one FMD provider

5.18 An FMD owner cannot hold FMDs simultaneously with more than one FMD provider (item 5 in the table in section 393-35). This requirement was initially put in place to facilitate aspects of the administration of the FMD scheme.

Requirements relating to unclaimed moneys

5.19 Authorised deposit-taking institutions are required to forward certain unclaimed moneys to the Commonwealth (section 69 of the *Banking Act 1959*). Generally, this applies to those moneys to the credit of an account that has not been operated on either by deposit or withdrawal for at least seven years.

5.20 FMD owners not operating on their FMD for seven years would ordinarily be at risk of having their deposit transferred to the Commonwealth through the operation of this unclaimed moneys provision. Currently, this outcome is avoided by the Australian Prudential Regulation Authority (APRA) issuing an exemption order in relation to FMDs under the unclaimed moneys provision.

Summary of new law

Repayment within 12 months in the event of an applicable natural disaster

5.21 FMD owners affected by applicable natural disasters may access their FMDs within 12 months of deposit, without losing their deduction.

5.22 The deduction for the deposit is retained for early repayment of FMDs if:

- Commonwealth Government Natural Disaster Relief and Recovery Arrangements apply as specified in the *Income Tax (Farm Management Deposits) Regulations 1998* (FMD Regulations) to the FMD owner; and
- all of the other circumstances specified in the FMD Regulations are satisfied.

Frequency of reporting

5.23 FMD providers now have to meet existing reporting requirements before the 11th day after the end of each calendar month.

FMDs with more than one FMD provider

5.24 FMD owners may now hold FMDs simultaneously with more than one FMD provider.

Requirements relating to unclaimed moneys

5.25 FMD providers that are authorised deposit-taking institutions are required to forward unclaimed moneys to the Commonwealth only where the FMD provider is unable to contact the FMD owner after making reasonable efforts to do so.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Repayments made within 12 months of deposit retain concessional tax treatment where the FMD owner is affected by an applicable natural disaster and the circumstances specified in the FMD Regulations are satisfied.	No equivalent.
FMD owners may have FMDs with more than one FMD provider.	An FMD owner is unable to hold FMDs with multiple FMD providers.
FMD providers must provide the required information about FMDs to the Agriculture Secretary on a monthly basis before the 11 th day after the end of a calendar month.	FMD providers must provide the required information about FMDs to the Agriculture Secretary on a quarterly basis within 60 days after the end of the quarter.
FMD providers that are authorised deposit-taking institutions are required to forward unclaimed moneys in relation to FMDs to the Commonwealth only where the FMD provider is unable to contact the FMD owner after making reasonable efforts to do so.	Authorised deposit-taking institutions are required to forward certain unclaimed moneys to the Commonwealth. Generally, this applies to those moneys to the credit of an account that has not been operated on either by deposit or withdrawal for at least seven years.

Detailed explanation of new law

Repayment within 12 months in the event of an applicable natural disaster

5.26 Despite the 12-month requirement, FMD owners affected by applicable natural disasters may access their FMDs within 12 months of deposit, without losing their deductions. (That is, such FMD owners will not be required to amend their previous year's tax return to remove the deduction claimed upon deposit.)

5.27 The deduction is retained despite early repayment of the whole or a part of an FMD if:

- Natural Disaster Relief and Recovery Arrangements made by or on behalf of the Commonwealth apply as specified in the FMD Regulations to a primary production business of the FMD owner; and
- all of the other circumstances specified in the FMD Regulations are satisfied.

[Schedule 5, Part 1, item 5, subsection 393-40(3A)]

5.28 The Natural Disaster Relief and Recovery Arrangements is a program that provides financial assistance to disaster-affected community members, primary producers, small businesses, and local and state Governments to assist with the recovery from applicable natural disasters. Such natural disasters include bushfires and floods (but not drought, frost or heatwaves).

5.29 The details of this exception are to be set out in the FMD Regulations to more easily accommodate any future changes to the way in which the Natural Disaster Relief and Recovery Arrangements are defined or operate. Currently, the FMD Regulations require that the FMD owner receive recovery assistance in the form of a Category C primary producer recovery grant.

5.30 This exception affords the same taxation treatment to FMD owners who qualify for concessional tax treatment under the existing exceptional circumstances exception, that is, those affected by severe drought. It allows FMD owners to access their own funds without foregoing concessional tax treatment, enabling them to recover and rebuild their primary production businesses more quickly and/or providing an income in times of severe hardship.

Example 5.1: FMD owner benefits from repayment within 12 months in the event of an applicable natural disaster

Arthur is an individual partner in a partnership. The partnership carries on a primary production business in Queensland, Australia.

On 30 June 2010, Arthur deposited \$200,000 of his primary production income from the partnership into an FMD. In Arthur's 2009-10 tax return, he claimed the \$200,000 deposit as a deduction.

In January 2011, the partnership was affected by the floods in Queensland. The primary producer Category C measure under the Natural Disaster Relief and Recovery Arrangements made by the Commonwealth applies to the area in which the primary production business is located. Arthur is eligible to receive a recovery grant for primary producers under the Category C of the National Disaster Relief and Recovery Arrangements and makes an application.

Following the receipt of the recovery grant, Arthur withdrew \$200,000 from his FMD on 1 April 2011 to assist in rebuilding the primary production business. Arthur will have to declare the \$200,000 income in his 2010-11 tax return. However he will not be required to amend his 2009-10 tax return to remove the deduction claimed in that year.

5.31 Any later deposit that is made by, or on behalf of, the FMD owner in the income year in which the repayment is made is not (and is taken never to have been) an FMD. This mirrors the existing provision in relation to early repayment as a result of exceptional circumstances. It prevents an FMD owner from benefiting from concessional tax treatment on an FMD that is repaid early and, within the income year, obtaining an additional deduction on a new FMD. *[Schedule 5, Part 1, item 6, subsection 393-40(4)]*

5.32 Minor amendments have been made to a number of provisions as a result of the inclusion of this new provision. *[Schedule 5, Part 1, item 1, section 393-1, item 2, paragraph 393-15(2)(d), item 3, note 1 to subsection 393-40(1), item 4, note 1 to subsection 393-40(2), and item 7, paragraph (d) of note 1 to subsection 393-55(2)]*

Frequency of reporting

5.33 FMD providers must provide the required information about FMDs to the Agriculture Secretary on a monthly basis before the 11th day after the end of a calendar month. *[Schedule 5, Part 2, item 11, subsection 398-5(1) in Schedule 1 to the TAA 1953]*

5.34 This amendment requires FMD providers to meet existing reporting requirements more frequently. More timely provision of

information to the Agriculture Secretary will enable more efficient administration of the FMD scheme.

5.35 Information is to be given if the FMD provider holds any FMDs at the end of the calendar month and the required information pertains to the information available at the end of the month (for example, the number of FMDs held at the end of the month and the sum of the balances of FMDs at the end of the month.). [*Schedule 5, Part 2, item 12, subsection 398-5(1) in Schedule 1 to the TAA 1953, items 13 to 15, paragraphs 398-5(3)(a) to (d) in Schedule 1 to the TAA 1953*]

5.36 Information may be given on the tenth day of the following month.

Example 5.2

XYZ Bank is an authorised deposit-taking institution and FMD provider that holds FMDs on 31 August. On 10 September, XYZ Bank provides the required information about the FMDs held on 31 August to the Agriculture Secretary. XYZ Bank meets the requirement to provide the information before the 11th day after the end of a calendar month.

5.37 Minor amendments have been made to a number of provisions to reflect this change to the frequency of reporting. [*Schedule 5, Part 2, item 9, note to section 393-1, and item 10, heading to subsection 398-5(1) in Schedule 1 to the TAA 1953*]

Farm management deposits with more than one FMD provider

5.38 The prohibition on having FMDs with more than one FMD provider has been removed. FMD owners may now have FMDs simultaneously with more than one FMD provider. [*Schedule 5, Part 3, item 17, item 5 in the table in section 393-35*]

5.39 The prohibition was initially put in place to facilitate aspects of the administration of the FMD scheme. It may have restricted existing FMD owners' ability to negotiate competitive interest rates on new deposits (although FMD owners remain free to transfer all their FMDs to a competing institution if they are dissatisfied with the interest rate they are obtaining).

5.40 As a consequence of this change, item 10 in the table in section 393-35 has been amended to maintain a single overarching \$400,000 cap for all FMDs across all FMD providers. Subsections 393-55(4) and (5) are also repealed as they refer to the requirement in item 5 in the table in section 393-35 and, as such, are no longer required. (Section 393-55 deals with FMDs arising from FMDs

with authorised deposit-taking institutions which are subject to the financial claims scheme.) [Schedule 5, Part 3, item 18, item 10 in the table in section 393-35, item 19, subsections 393-55(4) and (5)]

Requirements relating to unclaimed moneys

5.41 FMD providers that are authorised deposit-taking institutions are required to forward unclaimed moneys to the Commonwealth only if the FMD provider is unable to contact the FMD owner after making reasonable efforts to do so.

5.42 Section 69 of the *Banking Act 1959* requires authorised deposit-taking institutions to forward certain unclaimed moneys to the Commonwealth. Generally, this applies to money to the credit of an account that has not been operated on either by deposit or withdrawal for at least seven years. Retirement savings accounts are exempt from these provisions, in recognition of their long-term nature, and unclaimed moneys in relation to first home saver accounts are dealt with in the *First Home Saver Accounts Act 2008*.

5.43 This Schedule adds an additional exclusion to the *Banking Act 1959* for FMDs in certain circumstances. FMDs are unclaimed moneys where:

- they are to the credit of an account with an authorised deposit-taking institution;
- no contributions have been made to, and no repayments have been made from the FMD for a period of at least seven years; and
- after the end of each seven year period, the authorised deposit-taking institution has been unable to contact the FMD owner after making reasonable efforts.

[Schedule 5, Part 4, item 21, subsection 69(1A) of the *Banking Act 1959*]

5.44 ‘Reasonable efforts’ would include trying to contact the FMD owner at their last known address.

5.45 FMDs are often held for several years without being operated on, which is consistent with the policy intent of the scheme as a risk-management tool. Under the current law, FMD owners not operating on their FMD for seven years would ordinarily be at risk of losing their deposit through the operation of the unclaimed moneys provision. However, in past years, this outcome has been avoided by APRA issuing

an exemption order in relation to FMDs under the unclaimed moneys provision.

5.46 A minor amendment has been made to reflect this change to the unclaimed moneys provision. *[Schedule 5, Part 4, item 22, subsection 69(2) of the Banking Act 1959]*

Application and transitional provisions

5.47 The amendments made by Part 1 of this Schedule (Early repayments in the event of applicable natural disasters) apply in relation to repayments of FMDs made on or after 1 July 2010. The retrospective application of this Part will benefit FMD owners by allowing them to retain deductions claimed in the 2009-10 income year, despite early repayment of FMDs as a result of hardship suffered during applicable natural disasters in 2010-11 such as floods and bushfires around Australia. *[Schedule 5, Part 1, item 8]*

5.48 The amendments made by Part 2 of this Schedule (Providers must report monthly) apply in relation to the calendar months in the 2012-13 financial year and each later financial year. That is, they apply from 1 July 2012. *[Schedule 5, Part 2, item 16]*

5.49 The amendments made by Part 3 of this Schedule (Owners may have farm management deposits with more than one FMD provider) apply in relation to agreements made before, on or after 1 July 2012. *[Schedule 5, Part 3, item 20]*

5.50 The amendments made by Part 4 of this Schedule (Contacting owners before forfeiting FMD deposits as unclaimed money) apply in relation to statements to be delivered within three months after 31 December 2012 and within three months after the end of each later calendar year. *[Schedule 5, Part 4, item 23]*

Consequential amendments

5.51 Consequential amendments are also made to the FMD Regulations.

Chapter 6

Extend the temporary loss relief for merging superannuation funds by three months

Outline of chapter

6.1 Schedule 6 to this Bill amends the *Tax Laws Amendment (2009 Measures No. 6) Act 2010* to extend the end date of the temporary loss relief for complying superannuation fund mergers by three months — from 30 June 2011 to 30 September 2011, to provide additional time for mergers to take place before the loss relief expires.

Context of amendments

6.2 Capital gains tax (CGT) is the primary code for calculating gains and losses of ‘complying superannuation entities’, which are defined in section 995-1 of the *Income Tax Assessment Act 1997* (ITAA 1997).

6.3 The transfer of assets from one superannuation fund to another under a merger between the two funds will typically trigger CGT event A1 (section 104-10 of the ITAA 1997) or may trigger CGT event E2 (section 104-60 of the ITAA 1997), and the realisation of capital gains or capital losses for the transferring fund. Following this asset transfer, and the transfer of members’ accounts to the receiving fund, the transferring fund will generally be wound up.

6.4 Net capital losses are extinguished on the ending of an entity. As capital losses can be used to offset present and future capital gains, they carry value broadly equal to the tax liability that would otherwise be payable on the reduced capital gains if not for the offsetting losses. This value is extinguished on the winding up of the transferring superannuation fund following the asset and member transfer.

6.5 The current temporary loss relief was introduced in response to the severe economic and financial market conditions faced by superannuation funds in late 2008. The loss relief has allowed funds to transfer losses when they merge that would have otherwise been extinguished when the merging fund was wound up. The period of

operation of the temporary loss relief was granted for CGT events between 24 December 2008 and 30 June 2011.

6.6 The current loss relief is conditional on the requirement that all the transfer events for an eligible merger and the completion time for the losses choice, must happen in a single income year of the transferring entity. This rule was included to avoid the complexities arising from mergers occurring over more than one income year, and to avoid the need for claw-back rules where the loss relief was claimed in one year but where the merger does not ultimately satisfy the eligibility requirements for the loss relief, or does not proceed at all, in a later year.

6.7 The three-month extension responds to concerns expressed to the Government that due to the complexity of fund mergers, existing transactions may well be completed after 30 June 2011, meaning superannuation funds would not qualify for the tax relief, disadvantaging their members.

Summary of new law

6.8 This measure provides an extension to the period during which superannuation funds may transfer assets and members in mergers and continue to be eligible for the temporary loss relief. The period is extended to cover transfer events under a merger that are commenced on or after 1 July 2010 and completed on or before 30 September 2011.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>A merging superannuation fund may choose loss relief where the transferring entity transfers assets to the continuing entity between 24 December 2008 and 30 September 2011.</p> <p>An entity will meet the requirements for loss relief where the completion time of the merger is during the extended period.</p>	<p>A merging superannuation fund may choose loss relief for an eligible fund merger where the transferring entity transfers assets to the continuing entity between 24 December 2008 and 30 June 2011.</p>

Detailed explanation of new law

6.9 The application provisions for the temporary loss relief for merging superannuation funds in the *Tax Laws Amendment (2009 Measures No. 6) Act 2010* are amended to extend the period for superannuation funds to complete mergers and continue to be eligible to choose the loss relief. The extension is for three months, to 30 September 2011. Specifically, the loss relief may be obtained if the eligibility conditions of the temporary loss relief are satisfied during the period starting on 1 July 2010 and ending at the end of 30 September 2011 and all the transfer events occur during the period starting on 1 July 2010 and ending on 30 September 2011. [*Schedule 6, item 5, subitem 11(2) of Schedule 2 to the Tax Laws Amendment (2009 Measures No. 6) Act 2010*]

6.10 The extension to 30 September 2011 is noted in the main temporary loss relief provisions in Division 310 of the ITAA 1997. [*Schedule 6, item 1, section 310-1 (note 1) of the ITAA 1997*]

6.11 The application provision for Schedule 2 to the *Tax Laws Amendment (2009 Measures No. 6) Act 2010* is also amended to reflect the insertion of the additional subitem. [*Schedule 6, items 2 to 4, item 11 of Schedule 2 to the Tax Laws Amendment (2009 Measures No. 6) Act 2010*]

6.12 The current loss relief also includes a requirement that the transfer events for the merger must all happen in the income year for the transferring entity that includes the completion time for the losses choice.

6.13 The three-month extension of the loss relief is provided for transfer events in respect of mergers that are completed in the period 1 July 2010 and 30 September 2011. The extension does not cover mergers that commenced in earlier income years, which must be completed on or before 30 June 2010 in order to be eligible for the loss relief.

Treatment of losses transferred during the extended period

6.14 The three-month extension of the loss relief means that certain transactions of eligible superannuation funds may occur after 30 June 2011. This extension applies only for the purpose of determining eligibility for the loss relief.

6.15 Accordingly, the existing CGT rules will apply for the purposes of determining how transferred losses and assets will be dealt with for the continuing fund. In particular, where asset transfers occur during the extended period, they will be taken into account by the continuing entity in the income year of the transfer.

Example 6.1

Bronze Super (the transferring entity) merges with Gold Super (the continuing entity) on 30 June 2011. Bronze Super ceases to have any members on 30 June 2011. This is the completion time of the merger as defined by the loss relief provisions.

Most of Bronze Super's assets are transferred to Gold Super on 30 June 2011. However, a small number of the transferring entity's assets were subject to legal impediments such that they cannot be transferred until 31 August 2011.

In the hands of Gold Super, the losses transferred before 1 July 2011 will be available for Gold Super to utilise in determining its net capital gain for the 2010-11 income year. Applying the existing CGT rules, capital losses transferred on 31 August 2011 will be available for Gold Super in calculating its net capital gain for the 2011-12 income year.

Application and transitional provisions

6.16 A transitional provision is included to treat a completion time for a merger finishing during the period starting on 1 July 2010 and ending on 30 September 2011 as happening in the 2010-11 income year for the transferring entity. The provision also treats a transfer event happening during the extended period as happening during the 2010-11 income year. These transitional provisions apply for the purpose of determining eligibility for the loss relief only. As noted in paragraph 6.15, for all other purposes transfer events during the period 1 July 2011 and 30 September 2011 will occur in the 2011-12 income year. [*Schedule 6, item 6, Schedule 2 to the Tax Laws Amendment (2009 Measures No. 6) Act 2010*]

6.17 This transitional provision ensures that the three-month extension of the loss relief is available for entities that commenced merger transfer events on or after 1 July 2010 by treating the additional three-month period as part of the 2010-11 income year for these mergers.

6.18 The measure applies for transfer events in the period 1 July 2010 to 30 September 2011 for the purpose of determining eligibility for the temporary loss relief. The measure has an element of retrospectivity in that some of the mergers it applies to involve some CGT events happening in the period 1 July 2011 to 30 June 2011 and some CGT events happening after 30 June 2011. However, the measure benefits taxpayers affected by these and other mergers by extending the period of the temporary loss relief to mergers that would otherwise be completed too late to qualify for the loss relief.

Example 6.2

Green Super has been undertaking preparatory work to merge with Blue Super in the first half of 2011 but is unable to undertake the transfer of any members or assets to Blue Super until 15 August 2011.

Green Super begins transferring assets and members to Blue Super on 15 August 2011, with the final tranche of assets and members being transferred on 20 September 2011. The completion time for the merger of Green Super and Blue Super is 20 September 2011.

For the purposes of determining eligibility for the loss relief, this completion time is taken to have occurred during the 2010-11 income year. Also, the transfer of assets occurring between 15 August 2011 and 20 September 2011 are taken to have occurred in the 2010-11 income year for the purpose of determining Green Super's eligibility for the loss relief.

Provided that the other requirements for loss relief are satisfied, Green Super will be eligible for the loss relief as if the member and asset transfers had occurred during the 2010-11 income year. However, it should be noted that for general tax purposes the transfer of assets and losses are taken to have happened in the 2011-12 income year.

Chapter 7

Penalty notice validation

Outline of chapter

7.1 Schedule 7 to this Bill will ensure the ongoing validity of certain director penalty notices, notwithstanding the New South Wales Court of Appeal (NSWCA) decision in *Soong v Deputy Commissioner of Taxation* [2011] NSWCA 26 (*Soong*).

Context of amendments

7.2 A director penalty notice is a notice issued by the Commissioner of Taxation (Commissioner) to the director of a company which has failed to send an amount of money it has withheld, being amounts of pay as you go withholding, to the Commissioner.

7.3 Former Part VI of the *Income Tax Assessment Act 1936* (ITAA 1936) contained provisions which authorised the Commissioner to issue director penalty notices to the directors of companies. These provisions were effective until 30 June 2010, as former Part VI of the ITAA 1936 was repealed and new director penalty notice provisions were inserted into Part 4-15 of Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953) with effect from 1 July 2010.

7.4 Under former section 222AOE of the ITAA 1936, the Commissioner was required in a director penalty notice to inform the relevant director that they were personally liable to pay a penalty equal to their company's unpaid amount. However, the director penalty notice was also required to state that this penalty would be remitted if, at the end of 14 days after the notice was given:

- the liability had been discharged;
- a payment agreement relating to the liability had been entered into;
- the company was under administration; or
- the company was being wound up.

7.5 If the director did not comply with one of these penalty remission conditions by the end of 14 days after the director penalty notice was given, the Commissioner would then be entitled to commence recovery proceedings against them.

7.6 On 10 December 2007, a two judge majority of three judges of the NSWCA in *Deputy Commissioner of Taxation v Meredith* [2007] NSWCA 354 (*Meredith*) considered (the now former) section 222AOE, and determined that a director penalty notice is considered to be ‘given’ to a director on the date it was sent by post. As such, the director’s 14-day notice period would commence from the date on which the director penalty notice was posted by the Commissioner.

7.7 In reliance on *Meredith*, the Commissioner proceeded to issue director penalty notices which explicitly stated that the director had 14 days from the date of postage (which was displayed on the director penalty notice) in which to act so as to have the penalty remitted. The Commissioner continued this practice until 30 June 2010, when former Part VI of the ITAA 1936 was repealed with effect from 1 July 2010.

7.8 However, on 25 February 2011 a full bench of five judges of the NSWCA in *Soong* unanimously overturned the earlier decision in *Meredith*, and determined that a director penalty notice that was issued under former section 222AOE of the ITAA 1936 is considered to be ‘given’ to a director on the date the director penalty notice was delivered, instead of the date on which the director penalty notice was sent by post. As such, the director’s 14-day notice period commenced from the date on which the director penalty notice was delivered.

7.9 The Commissioner sought special leave to appeal the *Soong* decision in the High Court, however this was denied on 12 August 2011.

7.10 The effect of this decision by the High Court is that approximately 17,000 director penalty notices which were issued by the Commissioner between 10 December 2007 and 30 June 2010 (inclusive) did not advise the recipients of the correct period of time in which they could act to have their penalty remitted. As such, these director penalty notices may be invalid.

7.11 These amendments will ensure that the understanding and operation of the law at the time these director penalty notices were issued (in reliance on *Meredith*) is maintained. As such, the validity of these director penalty notices will not be able to be questioned merely because of the NSWCA’s later construction (in *Soong*) of the former director penalty notice provisions.

7.12 The validity of those director penalty notices issued by the Commissioner on or after 1 July 2010 is not in doubt as a result of the decision in *Soong*. This is because the new director penalty notice provisions (specifically section 269-25 in Schedule 1 to the TAA 1953) explicitly provide that a director penalty notice is to be taken as ‘given’ either when the Commissioner leaves it with, or posts it to, the director penalty notice recipient. Section 269-25 also excludes the operation of section 29 of the *Acts Interpretation Act 1901*, so as to confirm that a director penalty notice cannot be taken as ‘given’ only from the time at which it is delivered.

Summary of new law

7.13 These amendments ensure that all director penalty notices issued by the Commissioner between 10 December 2007 and 30 June 2010, inclusive, will not be invalid because of the NSWCA decision in *Soong*.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Any director penalty notice issued by the Commissioner on or after 10 December 2007, pursuant to former section 222AOE of the ITAA 1936, is to be treated as having been given at the time the Commissioner sends it by pre-paid post, notwithstanding the NSWCA decision in <i>Soong</i> .	Any director penalty notice issued by the Commissioner pursuant to former section 222AOE of the ITAA 1936 may be invalid as a result of the NSWCA decision in <i>Soong</i> .

Detailed explanation of new law

Effect of the *Soong* decision

7.14 In overturning *Meredith*, the NSWCA’s subsequent (and unanimous) finding in *Soong* clarified that a director penalty notice issued pursuant to former section 222AOE of the ITAA 1936 should have been taken as ‘given’ at the time the director penalty notice was delivered to the director. This meant that a director should have had 14 days, from the date the director penalty notice was delivered, to act to achieve penalty remission.

7.15 After the Commissioner was denied special leave to appeal the *Soong* decision on 12 August 2011, the validity of all those director penalty notices issued between 10 December 2007 (the date of the *Meredith* judgment) and 30 June 2010 (the last day section 222AOE had effect) could be brought into question. This is because these director penalty notices did not advise the directors of the correct period of time in which they could act to have their penalty remitted.

Ensuring penalty notices are not made invalid

7.16 These amendments will ensure that the operation of the law, as understood at the time of issuing these director penalty notices, is maintained. As such, the validity of these director penalty notices will not be able to be questioned merely because of the NSWCA's later construction (in *Soong*) of the former director penalty notice provisions.

7.17 To achieve this, any director penalty notice issued between 10 December 2007 and 30 June 2010 (inclusive) will be treated as having been 'given' at the time the Commissioner sent it by pre-paid post. [*Schedule 7, item 1*]

Example 7.1

On 1 June 2009 the Commissioner posted director penalty notices to both Garry and Ruth, the two directors of Tootison Pty Ltd. Garry's director penalty notice was delivered to his place of residence on 3 June 2009, and he received it on 4 June 2009. However, Ruth's director penalty notice was delivered to her place of residence and received by her on 5 June 2009. On 8 June 2009, Garry appointed an administrator to Tootison Pty Ltd. The Commissioner acknowledged that Garry acted in sufficient time to achieve remission of the penalty for which Garry and Ruth would otherwise have remained personally liable.

The director penalty notices are to be treated as having been given to both Garry and Ruth at the time of postage. Since Garry caused the company to comply with a condition for penalty remission within 14 days of the director penalty notice being posted, the remission of the penalty for both directors cannot be called into question.

Example 7.2

On 1 February 2010 the Commissioner posted a director penalty notice to Erin, the sole director of Willowed Pty Ltd. The director penalty notice was delivered to Erin's place of business on 4 February 2010, and she received it on the same day. Erin made no effort to comply with the director penalty notice. After the passage of several weeks,

the Commissioner contended that Erin did not act in time, and subsequently initiated recovery proceedings against her for the penalty.

This director penalty notice is to be treated as having been given to Erin at the time of postage. Since Erin did not satisfy a condition for penalty remission within 14 days of the director penalty notice being posted, neither the Commissioner's efforts to recover this money, nor the actual collection of this penalty, can be called into question.

7.18 As a consequence, these amendments also ensure that penalty remission is only available to those directors who complied with a penalty remission condition within 14 days of the director penalty notice having been sent by pre-paid post (and not within 14 days of the director penalty notice having been delivered).

Example 7.3

On 1 March 2010 the Commissioner posted a director penalty notice to Meg, the sole director of Aphaele Pty Ltd. The director penalty notice was delivered to Meg's place of residence on 3 March 2010, and she received it on the same day. On 16 March 2010 Meg appointed an administrator to Aphaele Pty Ltd. The Commissioner later contended that Meg did not act in time, and subsequently initiated recovery proceedings against her for the penalty.

This director penalty notice is to be treated as having been given to Meg at the time of postage. Since Meg did not satisfy a condition for penalty remission within 14 days of the director penalty notice being posted, neither the Commissioner's efforts to recover this money, nor the actual collection of this penalty, can be called into question.

It is irrelevant that Meg would have satisfied a condition for penalty remission in time had the 14-day period commenced from when the director penalty notice was delivered to her place of residence.

Application and transitional provisions

7.19 These amendments apply from 10 December 2007, the date on which the NSWCA gave judgment in *Meredith*.

7.20 This application date is necessary to ensure all those director penalty notices which were issued in reliance on *Meredith*, and pursuant to (the now former) section 222AOE of the ITAA 1936, cannot be regarded as being invalid because of the later NSWCA decision in *Soong*.

7.21 These amendments affect all director penalty notice recipients who were issued a director penalty notice between 10 December 2007 and 30 June 2010, inclusive.

7.22 Technically, these amendments will have an adverse impact on those directors who would otherwise seek to challenge the validity of their director penalty notices in light of the later *Soong* construction.

7.23 Substantively though, no taxpayers will be adversely affected because these amendments merely restore the precedential view on the issue during this period (as enunciated in *Meredith*) — that is, that a director had 14 days from the date the director penalty notice was sent by post in which to act to achieve penalty remission.

7.24 However, these amendments do not affect the rights or liabilities of parties to a proceeding which may be determined by a court on or before the commencement of these amendments, insofar as these rights or liabilities were affected by a director penalty notice issued between 10 December 2007 and 30 June 2010, inclusive.

Chapter 8

Public ancillary funds

Outline of chapter

8.1 Schedule 8 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997), the *Taxation Administration Act 1953* (TAA 1953) and the *A New Tax System (Australian Business Number) Act 1999* to improve the integrity of public ancillary funds. These amendments among other things:

- rename this type of ancillary fund as a public ancillary fund (their more commonly used name);
- give the Treasurer the power to make legislative guidelines about the establishment and maintenance of public ancillary funds; and
- give the Commissioner of Taxation (Commissioner) the power to impose administrative penalties on trustees that fail to comply with the guidelines and to remove or suspend trustees of non-complying funds.

Context of amendments

8.2 A public ancillary fund is one of two types of ancillary trust fund that can qualify for deductible gift recipient (DGR) status and income tax exempt status under the ITAA 1997. A public ancillary fund collects tax deductible donations from the public which they on-distribute to DGRs covered by item 1 in the table in subsection 30-15(1) of the ITAA 1997 that they consider to be for worthwhile causes.

8.3 The other type of ancillary fund is a private ancillary fund, which allows businesses, families and individuals to establish and donate to a charitable trust of their own, without the need to seek contributions from the public, for the purposes of disbursing funds to a range of other DGRs.

8.4 A public ancillary fund is distinct from a private ancillary fund in that it must invite the public to contribute to the fund. These funds are commonly used for community and fund raising appeals. These funds have been in existence for some time.

8.5 Public ancillary funds are required to meet the DGR conditions in the income tax law (item 2 in the table in subsection 30-15(2) of the ITAA 1997) and also comply with the public fund requirements as described in Australian Taxation Office (ATO) Taxation Ruling TR 95/27.

8.6 TR 95/27 sets out the rules for public funds and ensures a reasonable standard of governance as these rules are intended to ensure that moneys and property donated to the fund are applied for the purpose for which the fund was established.

8.7 A fund is a public ancillary fund where: it is the intention of the promoters or founders that the public will be invited to contribute to the fund; the public, or a significant part of it, does in fact contribute to the fund; and the public participates in the administration of the fund (see *Bray v FC of T* 78 ATC 4179 (1978) 8 ATR 569). These requirements are intended to ensure that moneys and property donated to the fund, and which attract a taxation concession, are used for the purpose for which the fund has been granted DGR status.

8.8 A public ancillary fund currently requires endorsement by the Commissioner to be a DGR and to receive tax deductible donations. To be eligible for endorsement, the fund must have (under item 2 in the table in subsection 30-15(2) of the ITAA 1997) the following characteristics:

- the fund is a public fund;
- it is established and maintained under a will or instrument of trust;
- it is allowed, by the terms of the will or instrument of trust, to invest gift money only in ways that an Australian law allows trustees to invest trust money; and
- it is established and maintained solely for:
 - the purpose of providing money, property or benefits to DGRs; or
 - the establishment of DGRs.

8.9 A public ancillary fund must be exclusively for these purposes. It must not carry on any other activities and must not distribute to other ancillary funds. It is like a conduit or temporary repository for channelling gifts to other DGRs.

8.10 From 1 October 2009, changes were made to improve the integrity of private ancillary funds. To provide similar treatment for public ancillary funds, the Government announced in the 2010-11 Budget, similar changes to improve the integrity of public ancillary funds. The changes are:

- providing the Treasurer with the power to make legislative guidelines about the establishment and maintenance of public ancillary funds; and
- providing the Commissioner with greater regulatory powers in respect of trustees for breaches of the guidelines including the ability to impose administrative penalties.

8.11 The amendments in the exposure draft implement the Government's Budget announcement to give the Treasurer the power to make legislative guidelines and to give the ATO greater regulatory powers.

8.12 The guidelines will be implemented by way of a legislative instrument and will be the subject of further consultation.

8.13 The proposed changes for public ancillary funds are similar to those for private ancillary funds but take into account the differences between the two types of funds.

Consultation

8.14 The Government released a discussion paper in November 2010 seeking public input into the implementation of the new integrity arrangements. Forty-six submissions were received in response to the paper.

8.15 Many respondents to the discussion paper were encouraged by the Government's interest in the philanthropic sector, and in giving the ATO greater regulatory powers. However, the majority of respondents also cautioned against applying a minimum distribution rate for public ancillary funds to a point where these funds are unable to exist in perpetuity. These matters will be considered by the Government along with other matters before the new guidelines are finalised.

8.16 An exposure draft of Schedule 9 to this Bill was released on 14 July 2011. Eight submissions were received. There was general support for the changes proposed in the exposure draft. However, some refinements have been made to allow additional time to transition to the new requirements.

Summary of new law

8.17 These amendments rename public ancillary funds in the income tax law and thus ensure that public ancillary funds still require the endorsement of the Commissioner.

8.18 The amendments give the Treasurer the power to make guidelines about the establishment and maintenance of public ancillary funds. Those guidelines are enforced through the imposition of administrative penalties.

8.19 The Commissioner will also have the power to suspend or remove trustees of public ancillary funds that breach the guidelines or other relevant Australian laws. The Commissioner's decisions can be reviewed by the Administrative Appeals Tribunal and the Federal Court of Australia.

8.20 It is necessary to require that all of the trustees of public ancillary funds are corporate trustees. This ensures there is an increased range of regulatory powers available to protect the charitable funds of public ancillary funds. This requirement will not apply where the trustee is the Public Trustee of a state or territory as these trustees are subject to an appropriate level of supervision under state and territory legislation and by Auditor-Generals in their respective jurisdictions. In addition, not all states and territories have created their Public Trustees as constitutional corporations. It will also not apply where a trustee is prescribed by regulation.

8.21 These amendments also ensure that the Australian Business Register (ABR) can identify public ancillary funds.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>No change.</p> <p>However these funds are renamed as public ancillary funds in the taxation laws.</p>	<p>In order to be a DGR, a public ancillary fund must be endorsed by the Commissioner.</p> <p>A public ancillary fund (a 'public fund') must meet the requirements in item 2 in the table in subsection 30-15(2) of the ITAA 1997. The public fund requirements are described in ATO Ruling TR 95/27.</p> <p>The Commissioner's decision is reviewable by the Administrative Appeals Tribunal and the Courts.</p>
<p>The Treasurer will have the power to make binding guidelines about the establishment and maintenance of public ancillary funds.</p> <p>The guidelines are a legislative instrument and are subject to review or disallowance by the Parliament.</p>	<p>No equivalent.</p>
<p>The guidelines are enforced through a tailored system of administrative penalties.</p>	<p>No equivalent. The ATO must revoke the DGR status of non-complying funds.</p>
<p>The Commissioner will have the power to suspend or remove the corporate trustees of public ancillary funds that consistently breach the guidelines or other relevant Australian laws.</p>	<p>No equivalent.</p>
<p>For constitutional reasons, all of the trustees of public ancillary funds must be corporate trustees. This requirement will not apply where the trustee is the Public Trustee of a state or territory or where the trustee is prescribed by regulation.</p>	<p>Trustees of public ancillary funds can be either individuals or corporations.</p>
<p>Portability of funds between ancillary fund types will be permitted in limited circumstances to provide additional flexibility in the management of funds.</p>	<p>Ancillary funds are not able to transfer their assets to another ancillary fund.</p>

<i>New law</i>	<i>Current law</i>
The ABR will identify whether an entity is a public ancillary fund.	The ABR currently only identifies as to whether an entity is a DGR and whether it is an ancillary fund.

Detailed explanation of new law

Endorsement as a DGR

8.22 The Commissioner will maintain the role for considering whether a public ancillary fund is entitled to be endorsed as a DGR.

8.23 To ensure this outcome, amendments are made to item 2 in the table in subsection 30-15(2) to replace references to ‘public fund’ and ‘private ancillary fund’ to ‘ancillary fund’ to cover both private and public ancillary funds. *[Schedule 8, items 2, 3, and 7, item 2 in the table in subsection 30-15(2) of the ITAA 1997; definition of ‘ancillary fund’ in subsection 995-1(1) of the ITAA 1997]*

8.24 A definition of ‘public ancillary fund’ is included in the ITAA 1997 and in the TAA 1953. A trust fund that meets the definition will be entitled to be endorsed as a DGR (subject to the fund meeting all other requirements that apply to public ancillary funds seeking endorsement as a DGR). *[Schedule 8, items 8 and 16, definition of ‘public ancillary fund’ in subsection 995-1(1) of the ITAA 1997 and section 426-102 in Schedule 1 to the TAA 1953]*

8.25 The Commissioner will be responsible for considering whether a trust fund meets the definition of a ‘public ancillary fund’ and whether that fund is then entitled to be endorsed as a DGR. *[Schedule 8, items 4 and 5, subsection 30-125(1) of the ITAA 1997]*

8.26 This Schedule makes amendments to Subdivision 426-D in Schedule 1 to the TAA 1953 which deals with private ancillary funds to ensure that it applies to both private and public ancillary funds (‘ancillary funds’). *[Schedule 8, items 11 to 15]*

8.27 A trust is a *public ancillary fund* if:

- all the trustees of the trust are constitutional corporations; and
- all the trustees have agreed to comply with the guidelines made by the Treasurer.

[Schedule 8, item 16, section 426-102 in Schedule 1 to the TAA 1953]

8.28 Public ancillary funds were not previously required to have corporate trustees. However, for constitutional reasons, it has been necessary to impose this new requirement on public ancillary funds in order to provide the Commissioner with additional regulatory powers.

8.29 An exception from this requirement will be provided for:

- Public Trustees of the states and territories. The requirement to be a corporate trustee should not prevent the Public Trustee of each of the states and territories from being trustees of public ancillary funds as they are subject to an appropriate level of prudential supervision under state and territory legislation and oversight by Auditors-General. In addition, not all states and territories have created their Public Trustees as constitutional corporations; and
- trustees prescribed by regulation. This mechanism will permit the granting of additional time for certain new public ancillary funds to comply with the requirement to have a trustee that is a constitutional corporation. The need for a limited exemption mechanism was identified during consultation and is intended to be exercised in limited number of cases where a need for additional transitional relief can be demonstrated.

[Schedule 8, item 16, subparagraph 426-102(1)(a)(ii) in Schedule 1 to the TAA 1953]

8.30 A constitutional corporation is a corporation covered by paragraph 51(xx) of the *Constitution*. A corporation established and operated solely as a trustee of a public ancillary fund would be considered a constitutional corporation. Professional trustee corporations would also be considered constitutional corporations.

8.31 Imposing a requirement for public ancillary funds to have a corporate trustee also ensures that directors meet a minimum standard of behaviour. The *Corporations Act 2001* details the circumstances under which an individual will automatically be disqualified from managing corporations. These include where the person has:

- a conviction on indictment of an offence in relation to decisions that affect the business of a corporation or its financial standing;
- an offence involving a contravention of the *Corporations Act 2001* punishable by imprisonment for 12 months or more;

- an offence involving dishonesty punishable by more than three months imprisonment;
- a conviction for an offence against the law of a foreign country punishable by more than 12 months imprisonment; or
- become an undischarged bankrupt.

8.32 In order for a trust fund to become a public ancillary fund, the trustee(s) will need to agree to be bound by the public ancillary fund guidelines. The trustee(s) will indicate their agreement to be bound in a form approved by the Commissioner. *[Schedule 8, item 16, section 426-102 in Schedule 1 to the TAA 1953]*

8.33 If the Commissioner refuses to endorse a prospective public ancillary fund as a DGR, the fund can request a review of the decision by the Commissioner, the Administrative Appeals Tribunal or appeal the decision to a Court under section 426-35 in Schedule 1 to the TAA 1953.

Public ancillary fund guidelines

8.34 The Treasurer will be able to make binding guidelines about the establishment and maintenance of a public ancillary fund. *[Schedule 8, items 9 and 16, definition of 'public ancillary fund guidelines' in subsection 995-1(1) of the ITAA 1997 and section 426-103 in Schedule 1 to the TAA 1953]*

8.35 Compliance with guidelines is a requirement for a public ancillary fund's continued endorsement as a DGR. *[Schedule 8, items 4 and 5, subsection 30-125(1) of the ITAA 1997]*

8.36 Similar to the *Private Ancillary Fund Guidelines 2009*, the guidelines will be a legislative instrument and are therefore subject to disallowance by either House of Parliament.

8.37 The guidelines may specify requirements about purpose, structure and governing rules of a public ancillary fund. The guidelines may also specify matters about the ongoing governance and permitted and prohibited activities of the fund.

8.38 It is envisaged that the guidelines will specify a similar range of matters as the *Private Ancillary Fund Guidelines 2009*. These matters include the role and purpose of public ancillary funds; the class of entities that the fund may donate to; that the fund be not-for-profit in character; the individuals that may be directors of the fund's trustees; the minimum distribution requirements of the fund; the permitted investment strategies of the fund; and any ongoing audit requirements.

8.39 The guidelines will ensure that public ancillary funds have appropriate governance arrangements, are properly accountable and act in a manner consistent with an entity holding philanthropic funds for a broad public benefit.

Income tax returns

8.40 Commencing from the 2011-12 income year, public ancillary funds will be required to lodge an annual income tax return. The income tax return for public ancillary funds will be similar to the current annual information statement that is required to be lodged by private ancillary funds.

8.41 Public ancillary funds that fail to lodge their income tax return by the relevant due date will be subject to the general penalty regime that applies to all taxpayers who do not provide their income tax return to the Commissioner by the due date.

8.42 Similar to private ancillary funds, it is anticipated that information provided on the income tax returns will be used by the ATO to provide publicly available annual statistics on these funds. It is expected that the statistics will provide information on the number of public ancillary funds, donations and assets and a breakdown of public ancillary fund donations by DGR category.

8.43 Similar to private ancillary funds, it is anticipated that information provided in these returns will also be used by Treasury to provide additional information in its annual taxation expenditure statement publication.

Administrative penalties

8.44 Similar to private ancillary funds, administrative penalties will apply to trustees and the directors of trustees that hold a public ancillary fund out as being endorsed; entitled to be endorsed; or entitled to remain endorsed, as a DGR and where they fail to comply with the guidelines.

8.45 The administrative penalties will apply to public ancillary funds in the same way as they apply to private ancillary funds. This outcome is achieved by amending the references in section 426-120 in Schedule 1 to the TAA 1953 so that it applies to both private and public ancillary funds. *[Schedule 8, items 18 to 22]*

8.46 These amendments will have the following affect:

- the amount of the penalties will be determined by the guidelines;

- trustees of a public ancillary fund are jointly and severally liable to any administrative penalty;
- the penalty can only be imposed on directors where any of the penalty cannot reasonably be recovered from a trustee;
- a director that did not take part in the management of the trustee at the time the public ancillary fund breached its obligations may in certain circumstances avoid an administrative penalty:
 - the circumstances that the director must demonstrate are that the director was not aware of the breach and it would not have been reasonable to expect them to have been aware of the breach; or the director took all reasonable steps to ensure that the breach did not occur; or there were no such steps that the director could have taken;
- an administrative penalty must not be reimbursed from the fund; and
- the *Corporations Act 2001* cannot apply to provide relief to a director from the administrative penalties.

8.47 The Public Trustee of each state or territory can be the trustee of a public ancillary fund. An exception is provided so that, in addition to directors of trustees that are licensed trustee companies, directors and statutory office holders of Public Trustees will not be personally liable to administrative penalties. Public Trustees have an appropriate level of prudential supervision and regulation to cover their liabilities so similar to licenced trustee companies, there is no need to extend the administrative penalty regime to their directors. Public Trustees are those trustees that are governed by the relevant state and territory Public Trustee legislation. *[Schedule 8, item 20, subparagraph 426-120(2)(b)(ii)]*

8.48 The machinery provisions on administrative penalties in Division 298 in Schedule 1 to the TAA 1953 will also apply to the new administrative penalty regime for public ancillary funds. Under these rules, the Commissioner has the discretion to remit all or a part of the penalty under the normal machinery provisions for penalties.

Suspension or removal of trustees

8.49 As for private ancillary funds, the Commissioner will also be given the power to remove or suspend a trustee of a public ancillary fund that breaches the guidelines or any other Australian law. The references in section 425-125 in Schedule 1 to the TAA 1953 are amended so that the

rules for suspending or removing a trustee, apply to both private and public ancillary funds. *[Schedule 8, items 23 to 34]*

8.50 However, the Commissioner will not be provided with the power to suspend or remove Public Trustees of each state and territory as this is a matter for the states and territories. *[Schedule 8, item 16, subsection 426-102(3) in Schedule 1 to the TAA 1953]*

8.51 If the Commissioner suspends a trustee, the amendments provide that:

- the suspension will be for a period that the Commissioner determines by reference to the circumstances and it is subject to modification; and
- the Commissioner must provide the suspended trustee a written notice advising them of the decision, explaining the reasons why the decision was taken and in the cases of suspension, setting out the period of suspension:
 - the trustee may seek a review of the decision by the Administrative Appeals Tribunal or a court following the process outlined in Part IVC of the TAA 1953 (taxation objections, reviews and appeals).

8.52 If a trustee is suspended or removed, the amendments provide that:

- the Commissioner must appoint an acting trustee to undertake the duties of trustee until the suspension period has ended or a replacement trustee is appointed (as the case may be):
 - an acting trustee may be an individual, body corporate or a government agency or the Commissioner. The acting trustee must have agreed to comply with the public ancillary fund guidelines. The Commissioner cannot appoint an acting trustee who is not a constitutional corporation for a period exceeding six months;
 - the Commissioner may determine the terms and conditions upon which an acting trustee is appointed. The terms and conditions determined by the Commissioner are valid despite any limitation in an Australian law or the governing rules of the public ancillary fund;

- the Commissioner may give directions to an acting trustee to do or not to do certain things. The acting trustee commits an offence if they contravene a direction;
- the Commissioner may terminate the appointment of an acting trustee at any time. If the Commissioner were to do so, he or she would be required to appoint a new acting trustee; and
- an acting trustee may resign as acting trustee. However, the acting trustee must do so in writing given to the Commissioner. The resignation is not effective until seven days after the Commissioner receives the written resignation;
- the Commissioner must make an order transferring the property of the public ancillary fund from the former or suspended trustee to the acting trustee:
 - the order has the legal effect of immediately transferring that property subject to certain limitations. The property covered by the order is both legal and equitable property;
- the Commissioner must also make a subsequent order transferring the property when the appointment of an acting trustee ends. The subsequent property transfer order may be to a new acting trustee, to the previously suspended trustee or to a newly appointed trustee as appropriate:
 - the Commissioner’s order to transfer property does not immediately transfer property if the property is of a kind whose transfer is registrable under an Australian law. Instead, the property is transferred only after the registration process has been completed; and
- a former trustee is required to comply with a number of obligations (for which they are strictly liable and which are an offence if not complied with). These obligations are:
 - providing the acting or new trustee with all books relating to the fund’s affairs that are in their custody, possession or control;
 - providing notice to the acting or new trustee identifying all the property of the fund (as much as they possibly can);

- providing notice to the acting or new trustee explaining how that property was accounted for; and
- assisting with the transfer of the property of the public ancillary fund.

8.53 In addition, these amendments ensure that former trustees of public ancillary funds are strictly liable for their actions relating to books, identification of property and transfer of property (that is, liable regardless of fault). This liability has been established to compel former trustees which have already been removed on the grounds of misconduct to deal fairly with the trust's property during the handover period.

8.54 As for private ancillary funds, it is expected that the Commissioner would only take action to remove or suspend a trustee in situations that involve serious non-compliance by a public ancillary fund. Whether the Commissioner decides to merely suspend a trustee or to remove them permanently will depend upon the nature of a breach, the circumstances of the trustee and the history of compliance.

Portability between funds

8.55 Portability of funds between ancillary fund types will be permitted in limited circumstances to provide additional flexibility in the management of funds. The circumstances and eligibility criteria will be set out in the guidelines.

8.56 For example, this rule will allow public ancillary funds to transfer sub-funds to private ancillary funds and for transfers of sub-funds between public ancillary funds. This rule allows donors the flexibility to choose an ancillary fund model which best suits their circumstances and which offers the lowest level of compliance and administrative costs.
[Schedule 8, item 35, section 426-170 in Schedule 1 to the TAA 1953]

Change to the Australian Business Register

8.57 For each public ancillary fund, the ABR must include a statement on the ABR indicating that the fund is a public ancillary fund.
[Schedule 8, items 1 and 16, paragraph 26(3)(ga) of the A New Tax System (Australian Business Number) Act 1999 and section 426-104 in Schedule 1 to the TAA 1953]

8.58 The ABR currently distinguishes between DGRs in items 1, 2 and 4 in the table in subsection 30-15(2) of the ITAA 1997. However, the ABR does not distinguish between public and private ancillary funds.

8.59 This additional requirement will clearly identify where a fund is a public ancillary fund. This will provide clarity to the ABR and assist

donors in determining which ancillary funds are public ancillary funds as opposed to private ancillary funds.

Application and transitional provisions

8.60 These amendments generally apply from 1 January 2012.
[Clause 2]

Transitional rules for existing public ancillary funds

8.61 Existing public ancillary funds will be taken to be endorsed by the Commissioner as DGRs under the reformed category on 1 January 2012. All existing public ancillary funds will also be taken to have agreed to comply with the guidelines as from 1 January 2012. This mechanism will ensure a smooth transition of existing public ancillary funds into the new regime. *[Schedule 8, items 38 and 40]*

Public ancillary funds with non-corporate trustees

8.62 Public ancillary funds (that were public ancillary funds before 1 January 2012) will not be required to replace their non-corporate trustees with corporate trustees. Mandating the replacement of trustees will create unnecessary compliance costs for existing trustees. *[Schedule 8, item 39]*

8.63 Those public ancillary funds that continue to have non-corporate trustees will not be subject to the Commissioner's new powers to suspend or remove trustees. It is for constitutional reasons that the new powers cannot be extended to these existing public ancillary funds.

8.64 In cases of serious non-compliance by public ancillary funds with non-corporate trustees, the Commissioner has the ability to refer the matter to the relevant state or territory Attorney-General for action.

8.65 If at any point after 1 January 2012, a public ancillary fund with non-corporate trustees replaces all its non-corporate trustees with corporate trustees, the public ancillary fund will become subject to the Commissioner's new powers.

8.66 Under the existing integrity arrangements, public ancillary funds and other ancillary funds are prevented from distributing to one another. However, in order to assist public ancillary funds move fully into the new regime, public ancillary funds with non-corporate trustees will be permitted to transfer all of their property to another public ancillary fund with trustees that have only corporate trustees. This transitional

arrangement will give public ancillary funds the option of restructuring their trustee arrangements by establishing a new public ancillary fund to hold the assets of the old fund. *[Schedule 8, item 41]*

8.67 Transitional public ancillary funds that wish to restructure (either by establishing a new public ancillary fund, or replacing their existing trustees) should make themselves familiar with the state and territory laws on replacing trustees or transferring assets between trusts.

Progressive changes to the ABR

8.68 The Australian Business Registrar will be given until 1 July 2012 to update the ABR with the additional public ancillary fund category. The changes are commencing at a later time to give the Registrar sufficient time to make the necessary systems changes in support of the new requirements. *[Schedule 8, item 36]*

Consequential amendments

8.69 An amendment is required to paragraph 31-10(1)(b) of the ITAA 1997 to update references from 'public fund' to 'public ancillary fund'. *[Schedule 8, item 6, paragraph 31-10(1)(b) of the ITAA 1997]*

Miscellaneous amendments

8.70 This Schedule repeals the definitions of private ancillary fund in subsection 6(1) of the ITAA 1936 and subsection 2(1) of the TAA 1953 as these definitions are now redundant. *[Schedule 8, items 42 and 43]*

8.71 This Schedule also replaces a reference to 'private ancillary fund' in subsection 355-65(8) in Schedule 1 to the TAA 1953 with 'ancillary fund'. This provision relates to the disclosure of information to the Attorney-General of a state or territory in relation to the non-compliance of a private or public ancillary fund. *[Schedule 8, item 10]*

Chapter 9

Film tax offsets

Outline of chapter

9.1 Schedule 9 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to make a number of changes to the film tax offsets, with the aim of delivering support more efficiently and effectively to companies benefiting from these offsets.

Context of amendments

9.2 In the 2011-12 Budget, the Government announced a package of measures to reform and strengthen the Australian screen production industry. The package is designed to support the industry at a time when it is striving to meet the challenges of a changing global environment.

9.3 These amendments are a result of the *Review of the Australian Independent Screen Production Sector* (Review), conducted by the Office for the Arts in 2010. An extensive range of domestic and international stakeholders were consulted as part of the Review.

9.4 Companies may be entitled to one of three refundable tax offsets in relation to ‘qualifying Australian production expenditure’ they incurred in making films.

9.5 The relevant provisions are contained in Division 376 of the ITAA 1997.

9.6 The three tax offsets are:

- the producer offset, which is available for Australian expenditure incurred in making an Australian film;
- the location offset, which is available for Australian expenditure incurred in making a film; and
- the post, digital and visual effects offset, which is available for Australian expenditure incurred on post, digital and visual effects production for a film.

9.7 The producer offset was established in 2007 by Division 376 to provide support for the domestic film and television industry. The producer offset delivers support for Australian film and television productions through the tax system.

9.8 This Schedule makes a number of amendments to the producer offset in order to more efficiently and effectively deliver government support to Australian screen producers.

9.9 The Government supports offshore production through two tax offsets.

- The location offset is designed to encourage large-scale film and television production to Australia and provide greater economic, employment and skill development opportunities.
- The post, digital and visual effects offset is intended to provide further incentive for offshore productions to contract Australia's post, digital and visual houses.

9.10 The amendments in this Schedule also provide some enhancements to the location and post, digital and visual effects offsets. This includes allowing some additional expenditure to be claimed as qualifying expenditure and an increase to the rate of the offsets.

9.11 Expenditure on a film is ***production expenditure*** where it satisfies the general test of being incurred in making the film or being attributable to the use of equipment or other facilities for, or activities undertaken in, making the film (section 376-125).

9.12 Production expenditure is a general concept with a list of specifically excluded expenditure items. However, some of these excluded items may be given production expenditure status if they are sufficiently connected to Australia to qualify as 'qualifying Australian production expenditure'.

9.13 The amount of each of the three film tax offsets is expressed as a percentage of a company's 'qualifying Australian production expenditure'. 'Qualifying Australian production expenditure' is a subset of a production company's overall 'production expenditure'. The amount of 'qualifying Australian production expenditure' is determined as part of the certification process for the film.

9.14 ***Qualifying Australian production expenditure*** is defined as production expenditure on a film that is linked to the provision of goods and services provided in Australia or the use of land or goods located in Australia in making the film. Qualifying Australian production

expenditure has certain statutory inclusions and exclusions in its meaning. Various inclusions and exclusions apply generally (that is, for all of the tax offsets) and individually (that is, differently for each tax offset) (sections 376-145 to 376-180).

9.15 Division 376 sets out the minimum expenditure thresholds which apply for the offsets and for different types of films. A company's 'qualifying Australian production expenditure' on a film must be at least as much as the relevant threshold for the film to be eligible for a tax offset.

9.16 In determining an amount of expenditure for the purpose of applying the film tax offsets, the expenditure is taken to include the goods and services tax (GST).

Producer offset

9.17 The rate of the producer offset is 40 per cent of 'qualifying Australian production expenditure' for feature films or 20 per cent of 'qualifying Australian production expenditure' if the film is not a feature film.

9.18 For the film authority to issue a company with a producer offset certificate, it must be satisfied that the minimum expenditure threshold for a feature film and single episode program, other than a documentary, is \$1 million (column 3 of items 1 and 2 in the table in subsection 376-65(6)). A 'per hour' expenditure threshold of \$800,000 also applies to single episode programs other than documentaries.

9.19 There is no minimum total 'qualifying Australian production expenditure' requirement for documentaries (column 3 of items 3, 6 and 8 in the table in subsection 376-65(6)).

9.20 Financing expenditure does not count as production expenditure (item 1 in the table in section 376-135).

9.21 A film which is a series or a season of series benefits from the producer offset for their first 65 episodes of content (paragraphs 376-55(2)(b) and (c)).

9.22 In calculating an amount for all film tax offsets, a company's 'qualifying Australian production expenditure' is to be translated to Australian currency at the average of the exchange rates applicable during the period that 'qualifying Australian production expenditure' is incurred on the film (item 9B in the table in subsection 960-50(6)).

9.23 For the purposes of the producer offset, a 20 per cent cap limits the amount that can be claimed as qualifying Australian production expenditure on development expenditure and expenditure on remuneration provided to the principal director, producers and principal cast associated with the film (paragraph 376-170(4)(b)). Expenditure incurred in relation to distributing the film is excluded from the general test of production expenditure (paragraph 376-125(4)(c)).

9.24 Publicity and promotion expenditure, that is, marketing costs, are generally excluded from production expenditure (item 5 in the table in section 376-135).

9.25 Short form animated dramas are eligible for the producer offset. If the film is a short form animated drama, it must be a drama program comprising one or more episodes which are produced wholly or principally for exhibition together, for a national market or national markets under a single title (subsection 376-65(4)).

Location offset

9.26 The rate of the location offset is 15 per cent of qualifying Australian production expenditure (section 376-15).

9.27 Financing expenditure does not count as production expenditure (item 1 in the table in section 376-135).

Post, digital and visual effects offset

9.28 The rate of the post, digital and visual effect offset is 15 per cent of qualifying Australian production expenditure (section 376-40).

9.29 Financing expenditure does not count as production expenditure (item 1 in the table in section 376-135).

Summary of new law

Producer offset

9.30 A company can be eligible for the producer offset for a feature film and single episode program, other than a documentary, if it incurs at least \$500,000 total qualifying Australian production expenditure. There is no longer a 'per hour' threshold for single episode programs other than documentaries.

9.31 A company can be eligible for the producer offset for a documentary if it incurs at least \$500,000 total qualifying Australian production expenditure and at least \$250,000 per hour.

9.32 A company in receipt of financial assistance from the film authority's Producer Equity Program for the making of a documentary film is ineligible for the producer offset for that film. If a company re-edits a film that has been granted such assistance, the re-edited version will be considered the same film and not be eligible for the producer offset.

9.33 For all film tax offsets, certain financing expenditure incurred in Australia can be claimed as qualifying Australian production expenditure in relation to the financing of the film. This includes any of the following:

- insurance related to making the film;
- fees for audit services and legal services provided in Australia in relation to raising and servicing the financing of the film; and/or
- fees for incorporation and liquidation of the company that makes or is responsible for making the film.

9.34 For the producer offset only, additional financing expenditure incurred in Australia can be claimed as qualifying Australian production expenditure in relation to the financing of the film. This includes:

- fees in obtaining an independent opinion of a film's qualifying Australian production expenditure.

9.35 For the producer offset only, expenditure incurred in Australia in relation to offsetting carbon emissions created during making the film can be claimed as qualifying Australian production expenditure.

9.36 A film which is a series or a season of a series will benefit from the producer offset for their first 65 commercial hours of content.

9.37 For the producer offset only, films with qualifying Australian production expenditure of less than \$15 million are able to translate expenditure incurred in a foreign currency at the exchange rate applicable at the time when expenditure is incurred on the film.

9.38 For the producer offset only, the 20 per cent cap which limits the amount that can be claimed as qualifying Australian production expenditure on development expenditure and expenditure on remuneration

provided to the principal director, producers and principal cast associated with a documentary is removed.

9.39 For the producer offset only, certain expenditure incurred in relation to distributing the film can be counted as qualifying Australian production expenditure. This will include any of the following expenditure in delivering or distributing the film:

- acquiring Australian classification certificates;
- sound mix mastering licenses;
- re-versioning the film in Australia;
- freight services provided by a company in Australia for delivery of contracted deliverables in relation to the film; and/or
- storing the film in a film vault in Australia.

9.40 For the producer offset only, certain publicity and promotion expenditure on publicist services provided in Australia, promotional stills, trailers and press kits (with Australian-owned copyright) that is incurred after the film's completion but prior to the end of the income year in which production is complete can be counted as qualifying Australian production expenditure.

9.41 Short-form animated documentaries will be eligible for the producer offset.

9.42 In determining an amount of expenditure for the purpose of applying the producer offset, the expenditure is taken to exclude the GST.

Location offset

9.43 A company benefits from an increase to the location offset from 15 per cent to 16.5 per cent.

9.44 For all film tax offsets, certain financing expenditure incurred in Australia prior to the end of the income year in which the film is complete can be claimed as qualifying Australian production expenditure in relation to the financing of the film. This will include any of the following:

- insurance related to making the film;

- fees for audit services and legal services provided in Australia in relation to raising and servicing the financing of the film; and/or
- fees for incorporation and liquidation of the company that makes or is responsible for making the film.

9.45 In determining an amount of expenditure for the purpose of applying the location offset, the expenditure is taken to exclude the GST.

Post, digital and visual effects offset

9.46 A company benefits from an increase to the post, digital and visual effects offset from 15 per cent to 30 per cent.

9.47 For all film tax offsets, certain financing expenditure incurred in Australia prior to the end of the income year in which the post, digital and visual effects work is complete can be claimed as qualifying Australian production expenditure in relation to the financing of the film. This will include any of the following:

- insurance related to making the film;
- fees for audit services and legal services provided in Australia in relation to raising and servicing the financing of the film; and/or
- fees for incorporation and liquidation of the company that makes or is responsible for making the film.

9.48 In determining an amount of expenditure for the purpose of applying the post, digital and visual offset, the expenditure is taken to include the GST. Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
A company is eligible for the producer offset for feature film and single episode programs, other than documentaries, if it incurs at least \$500,000 qualifying Australian production expenditure on that production.	A company is eligible for the producer offset for feature film and single episode programs, other than documentaries, if it incurs at least \$1 million of qualifying Australian production expenditure on that production.
The 'per hour' threshold for single episode programs, other than documentaries, no longer applies.	There is a 'per hour' threshold of \$800,000 for single episode programs other than documentaries.

<i>New law</i>	<i>Current law</i>
A company eligible for the producer offset for a documentary must meet minimum expenditure thresholds of \$500,000 and \$250,000 per hour.	There is no minimum expenditure threshold for documentaries other than the per hour threshold requirement of \$250,000.
Companies who are in receipt of funding from the Screen Australia's Producer Equity Program for a film are ineligible for the producer offset for that film.	No equivalent.
Certain financing expenditure counts as qualifying Australian production expenditure of a company on a film, including any of the following: <ul style="list-style-type: none"> • insurance related to making the film; • fees for audit services and legal services provided in Australia to the company in relation to raising and servicing the financing of the film; and/or • fees for incorporation and liquidation of the company that makes or is responsible for making the film. 	Financing expenditure did not count as production expenditure on a film.
For the producer offset only: <ul style="list-style-type: none"> • fees in obtaining an independent opinion of a film's qualifying Australian production expenditure; and/or • expenditure on offsetting carbon emissions. 	No equivalent.
A company is entitled to the producer offset for a series or season of a series which must be at least two episodes and no more than 65 commercial hours of content.	A company is only entitled to the producer offset for a series or season of a series which must be at least two episodes and no more than 65 episodes.
For calculating the amount of the producer offset, films with qualifying Australian production expenditure of less than \$15 million are to use actual exchange rates at the time when expenditure in a foreign currency is incurred on the film.	For calculating the amount of the offset, the exchange rate used is the average rate of exchange for the period during which qualifying Australian production expenditure is incurred.

<i>New law</i>	<i>Current law</i>
For documentaries, under the producer offset, the 20 per cent cap will be removed.	There is a 20 per cent cap which limits the amount that can be claimed as qualifying Australian production expenditure on development expenditure and/or remuneration provided to the principal director, producers and principal cast associated with the film.
For the purposes of the producer offset, any of the following expenditure incurred in distributing the film by a company will also be qualifying Australian production expenditure: <ul style="list-style-type: none"> • acquiring Australian classification certificates; • sound mix mastering licenses; • re-versioning the film in Australia; • freight services provided by a company in Australia for delivery of contracted deliverables in relation to the film; and/or • storing the film in a film vault in Australia. 	Distribution expenses are excluded from production expenditure on a film.
For the purposes of the producer offset, marketing costs on publicist services provided in Australia, promotional stills, trailers and press kits (with Australian-held copyright) that is incurred after the film's completion but prior to the end of the income year in which production is complete will be allowed.	Publicity and promotion expenditure are excluded from production expenditure on a film, other than expenditure on Australian copyrighted material incurred before completion of the film.
Short-form animated films are eligible for the producer offset.	Short-form animated dramas are eligible for the producer offset.
GST is now excluded in determining an amount of expenditure for the purposes of these offsets.	GST is not currently excluded in determining an amount of expenditure for the purpose of these offsets.
The amount of the location offset is 16.5 per cent of the company's qualifying Australian production expenditure.	The amount of the location offset is 15 per cent of the company's qualifying Australian production expenditure.

<i>New law</i>	<i>Current law</i>
The amount of the post, digital and visual effects offset is 30 per cent of the company's qualifying Australian production expenditure.	The amount of the post, digital and visual effects offset is 15 per cent of the company's qualifying Australian production expenditure.

Detailed explanation of new law

Changes to producer offset

Minimum expenditure threshold

9.49 For Screen Australia to issue a company with a producer offset certificate, it must be satisfied that the film meets certain minimum expenditure requirements. The minimum expenditure thresholds differ depending on the format of the project. The minimum expenditure threshold for the producer offset for a feature film and single episode program, other than a documentary, is reduced from \$1 million of qualifying Australian production expenditure to \$500,000. The 'per hour' threshold for single episode programs (other than documentaries) no longer applies. [Schedule 9, items 12 to 14, subsection 376-65(6)]

9.50 A new minimum expenditure threshold of \$500,000 for a documentary is introduced. The minimum qualifying Australian production expenditure to be spent per hour of the film will remain at \$250,000. [Schedule 9, items 15, 17 and 18, subsection 376-65(6)]

Example 9.1

Acme Film is a company based in Australia.

From December 2011 to June 2012, Acme Film incurs \$800,000 of qualifying Australian production expenditure in making a feature film.

Because Acme Film's qualifying Australian production expenditure on this film is at least \$500,000, Acme Film meets the expenditure threshold for the producer offset for its work in making the film.

If the minimum threshold had instead remained at \$1 million of qualifying Australian production expenditure, Acme Film would not have met the expenditure threshold for the producer offset.

Example 9.2

Marina Documentary is a company based in Australia.

In January 2012, Marina Documentary incurs \$300,000 of qualifying Australian production expenditure in making a single episode documentary about Australian cruise ships.

Because Marina Documentary's qualifying Australian production expenditure on this documentary is less than \$500,000, Marina Documentary is not eligible for the producer offset for its work.

If the threshold for a documentary had not been introduced, Marina Documentary would have met that eligibility criterion for the producer offset. This is because any amount of qualifying Australian production expenditure in making a documentary would have been eligible for the producer offset.

Ineligibility for the producer offset

9.51 Those documentaries that do not meet the new expenditure threshold of \$500,000 may be eligible for financial assistance under Screen Australia's Producer Equity Program. A company in receipt of this financial assistance is ineligible to apply for the producer offset for the same film. [*Schedule 9, item 7, paragraph 376-55(4)(g)*]

Example 9.3

Further to Example 9.2.

As noted in Example 9.2, Marina Documentary is not eligible for the producer offset because its qualifying Australian production expenditure on this documentary is less than \$500,000.

Marina Documentary instead receives financial assistance under Screen Australia's Producer Equity Program. This direct support from Screen Australia reduces the administrative burden on small production companies.

Because Marina Documentary is in receipt of this financial assistance, Marina Documentary will not be eligible to apply for the producer offset for this documentary. This is still the case even if Marina Documentary eventually incurs qualifying Australian production expenditure on this documentary of an amount equal to or greater than \$500,000.

Permitting certain financing expenditure

9.52 There is a general test for what constitutes production expenditure. Production expenditure of a film is so much of a company's expenditure as it incurs in, or in relation to, making the film; or as is

reasonably attributable to the use of equipment or other facilities for making the film or to activities undertaken in making the film. There are a number of specific exclusions that are not eligible to be included as production expenditure.

9.53 Production expenditure for a film also includes some specific expenditure that may not meet the general test of production expenditure.

9.54 Qualifying Australian production expenditure for a film is the production expenditure for the film to the extent to which it is incurred for, or is reasonably attributable to:

- goods and services that are provided in Australia;
- the use of land located in Australia; or
- the use of goods that are located in Australia at the time they are used in making the film.

This broad test connects particular items of production expenditure to Australia.

9.55 All qualifying Australian production expenditure is included in production expenditure, even if it would not otherwise come within the scope of production expenditure.

9.56 Expenditure incurred in relation to the financing of a film is not production expenditure. This specifically includes interest, or other returns, on amounts invested in the film and costs connected with raising and servicing finance for the film.

9.57 For the producer offset, certain financing expenditure incurred in Australia prior to the end of the income year in which the film is complete can be claimed as qualifying Australian production expenditure.
[Schedule 9, item 20, section 376-135]

9.58 This will include any of the following:

- insurance related to making the film *[Schedule 9, item 22, subsection 376-150(1)]*;
- fees for audit services and legal services provided in Australia in relation to raising and servicing the financing of the film *[Schedule 9, item 22, subsection 376-150(1)]*;

- fees for incorporation and liquidation of the company that makes or is responsible for making the film [*Schedule 9, item 22, subsection 376-150(1)*]; and/or
- fees in obtaining an independent opinion of a film's qualifying Australian production expenditure [*Schedule 9, item 23, subsection 376-170(2)*].

Example 9.4

Ting Films is a special purpose vehicle company established in Australia to carry out the making of a feature film.

In September 2011, costs are incurred in setting up the special purpose vehicle company specifically to produce the film that is applying for the film tax offset. The costs in establishing a special purpose vehicle company is a one-off claim for the making of the particular film and cannot be claimed as qualifying Australian production expenditure in context of another film.

In November 2011, Ting Films incurs insurance expenditure that is related to the making of a feature film. The types of insurance purchased by Ting Films include film producer's indemnity; extra expense insurance; negative film risk; and weather insurance. For these purposes insurance expenditure is deemed to include completion guarantor fees.

In December 2011, Ting Films also incurs fees for an audit of the whole production expenditure (not just qualifying Australian production expenditure) and legal fees in relation to a Production Investment Agreement and a distribution agreement. All audit and legal fees are incurred directly by Ting Films and are not in respect of fees that are paid to absorb a third party's legal or audit fees expenses.

In June 2012, Ting Films incurs expenditure in relation to liquidating the special purpose vehicle company established in September 2011.

The financing expenditure incurred by Ting Films in relation to these insurances, fees for audit and legal services, and fees for setting up and liquidating the special purpose vehicle company are able to be claimed as qualifying Australian production expenditure if it is incurred prior to the end of the income year in which the film is complete. This means that a film tax offset applies to these particular types of financing expenditure.

If these types of financing expenditure were not specifically included as qualifying Australian production expenditure, the expenditure incurred by Ting Films on insurances, fees for audit and legal services, and fees for setting up and liquidating the special purpose vehicle

company would be excluded from being claimed as qualifying Australian production expenditure.

Example 9.5

Vinnie Productions is a company based in Australia.

Vinnie Productions incurs expenditure in relation to a qualifying Australian production expenditure opinion fee. A qualifying Australian production expenditure opinion fee is a fee for obtaining an independent opinion of a film's qualifying Australian production expenditure to meet financing requirements. A qualifying Australian production expenditure opinion fee is a type of financing expenditure.

In paying the qualifying Australian production expenditure opinion fee, the producer of the film receives a letter of advice to demonstrate to cash flow providers and investors what the expected qualifying Australian production expenditure of a film is.

The qualifying Australian production expenditure opinion fee is incurred directly by Vinnie Productions, that is, it is not a fee incurred by a third party but absorbed by Vinnie Productions.

The qualifying Australian production expenditure opinion fee incurred by Vinnie Productions is able to be claimed as qualifying Australian production expenditure. This means that the producer offset applies to this particular type of financing expenditure.

If fees in obtaining an independent opinion of a film's qualifying Australian production expenditure were not specifically included as qualifying Australian production expenditure, the expenditure incurred by Vinnie Productions on a qualifying Australian production expenditure opinion fee would have been excluded from qualifying Australian production expenditure.

Offset carbon emissions

9.59 Expenditure incurred in Australia in relation to offsetting carbon emissions created during the making of the film can be claimed as qualifying Australian production expenditure. This expenditure can be incurred in paying an airline to offset carbon emissions or directly paying a recognised service supplier to offset carbon emissions created making the film. A recognised service supplier must be accredited at a national or state government level or comply with an industry standard. [*Schedule 9, item 23, subsection 376-170(2)*]

Sixty-five commercial hours of content

9.60 Currently a company is only entitled to the producer offset for a series or season of a series which must be at least two episodes and no

more than 65 episodes. The 65 episode limit is a cumulative cap on the support the producer offset will provide to a series. It recognises that once a series has been in production for such a number of episodes, it should be capable of being made without Australian Government support and effectively become self-sufficient.

9.61 The 65 episode limit is changed to allow a company to benefit from the producer offset for their first 65 commercial hours of content. When the 65 commercial hour limit has been reached, that series will be deemed completed and only qualifying Australian production expenditure on the episodes up to and including the 65th commercial hour are eligible for the producer offset. Further hours on episodes or seasons of the series are ineligible for the producer offset. *[Schedule 9, items 5, 6, 25 and 27]*

9.62 The concept of a commercial hour recognises that programs are made of varying length and they may be transmitted to the public in different ways. For instance, a program of 52 minutes duration may be shown without interruption by one broadcaster, but be shown over a 60 minute programming slot by another broadcaster if the broadcast slot includes advertisements. In each case, such a program would be regarded as 'one commercial hour' in length.

Example 9.6

Childs Play is a company based in Australia.

Childs Play produces a television program for young children. Each episode has duration of 20 minutes but fills a 30 minute programming slot by the broadcaster because the broadcast slot includes advertisements.

Each episode of the television program is regarded as half a commercial hour in length.

Example 9.7

This example sets out a number of scenarios to illustrate the transition between the 65 episode limit and the new 65 commercial hours limit.

Scenario 1

An applicant has made a series consisting of 70 × 26 minute (commercial half hour) episodes, all completed prior to 1 July 2011. The series has been completed and the applicant will not make any further seasons of this series. The producer offset can only be claimed for the first 65 episodes of the series.

Scenario 2

An applicant is making a season of a series where the season consists of episodes 52 to 70, each episode being 26 minutes (commercial half hour). Production commenced prior to 1 July 2011 and will be completed after this date. Because this season commenced production prior to 1 July 2011, the '65 episode limit' will be applied and the season can only claim qualifying Australian production expenditure up to the 65th episode. However, the applicant can make a further season of this series and be eligible for the producer offset. In this case, episodes 66 to 70 cannot form part of the applicant's qualifying Australian production expenditure claim for any season, and these episodes also will not be included in the commercial hour count. In other words, if the applicant starts a new season after 1 July 2011, the applicant will be deemed (at the outset) to have completed 32.5 commercial hours ($65 \div 2$) of the series, and will be eligible to receive the producer offset for another 32.5 commercial hours of the series produced after 1 July 2011.

Scenario 3

An applicant has made a series consisting of 70×26 minute (commercial half hour) episodes, all completed prior to 1 July 2011. The applicant will make another season of this series after 1 July 2011. Episodes 66 to 70 were completed prior to 1 July 2011 and so cannot receive the producer offset and will not be included in the commercial hour count for the new season. Therefore the applicant will have been deemed to have completed 32.5 commercial hours ($65 \div 2$) of the series to date and will be eligible to receive the producer offset for another 32.5 commercial hours of content produced for the series after 1 July 2011.

Scenario 4

An applicant will produce a new series with the first season being made after 1 July 2011. The producer offset will be capped at 65 commercial hours.

Exchange rate

9.63 In working out a company's production expenditure and qualifying Australian production expenditure, any expenditure incurred in a foreign currency must be converted into Australian dollars.

9.64 For the purposes of meeting a relevant minimum expenditure requirement for an offset, table item 9 of subsection 960-50(6) requires the amount that is relevant for the purposes of issuing a certificate for the producer offset to be translated to Australian currency at the time when principal photography commences or production of the animated image commences. For calculating the amount of the offset, the exchange rate

used is the average rate of exchange for the period during which qualifying Australian production expenditure is incurred.

9.65 Films with a qualifying Australian production expenditure of less than \$15 million are to use actual exchange rates at the time when expenditure is incurred on the film. [*Schedule 9, items 29 and 30, subsection 960-50(6)*]

Example 9.8

Williams Productions incurs qualifying Australian production expenditure in a foreign currency. This expenditure is incurred on two occasions. The first is on 1 February 2012 in the amount of US\$1 million. The second occasion is on 1 March 2012 in the amount of US\$2 million.

In making the film, Williams Productions incurs a total qualifying Australian production expenditure of \$14 million.

Any expenditure incurred in a foreign currency must be converted into Australian dollars in calculating Williams Productions production expenditure and qualifying Australian production expenditure.

Because Williams Productions has a total qualifying Australian production expenditure of less than \$15 million, Williams Productions are to use the actual exchange rates at the time when expenditure is incurred on the film, that is, on 1 February 2012 and 1 March 2012.

If the film incurred a total qualifying Australian production expenditure of greater than \$15 million, Williams Productions would be required to apply an average exchange rate for the whole period when qualifying Australian production expenditure was incurred.

Twenty per cent cap

9.66 The amount of expenditure that can be claimed as qualifying Australian production expenditure by a company in regard to development, remuneration for the principal director, the producers and producer's unit and principal cast, is limited. These expenditures are intended to represent the stated 'above the line' costs for a film.

9.67 The qualifying Australian production expenditure that can be claimed on these costs is only up to a maximum of 20 per cent of a film's total film expenditure (total budget). This does not mean that further expenditure on 'above the line' costs cannot be made, nor does it mean that expenditure that exceeds the cap will mean that the production cannot qualify for the producer offset. Rather, it means that any expenditure on 'above the line' costs that is greater than 20 per cent of the film's total film expenditure will not be considered as qualifying Australian

production expenditure and will therefore not be counted towards the expenditure threshold or the rebate amount for the production.

9.68 This 20 per cent cap is removed for documentaries. A company that makes a documentary can now claim as qualifying Australian production expenditure on development, remuneration for the principal director, the producers and producers' unit and principal cast without limit. [*Schedule 9, items 24 and 26, subsection 376-170(4)*]

Example 9.9

VIP Docs is a company based in Australia. VIP Docs makes a documentary about the history of Vietnamese cuisine.

VIP Docs incurs \$200,000 qualifying Australian production expenditure in remuneration costs for the principal director, the producers and principal cast. This equates to 35 per cent of their total film expenditure. These are examples of 'above the line' costs of a company. All of the expenditure incurred in relation to remuneration costs counts towards VIP Docs qualifying Australian production expenditure.

If the film was not a documentary, the amount that could be claimed as qualifying Australian production expenditure by a company in regard to development, remuneration for the principal director, the producers and producer's unit and principal cast would be limited to a maximum of 20 per cent of a film's total film expenditure.

Distribution expenditure

9.69 There is a general test for what constitutes production expenditure. Production expenditure of a film is so much of a company's expenditure as it incurs in, or in relation to, making the film; or as is reasonably attributable to the use of equipment or other facilities for making the film or to activities undertaken in making the film.

9.70 The making of a film means the doing of the things necessary for the production of the first copy of the film.

9.71 For the purposes of the producer offset, the distribution of the film and its promotion are not necessarily part of actually making the film. Some costs of promotional material are now included in both qualifying Australian production expenditure and production expenditure; as some promotional activities can be occurring while a film is being made.

9.72 Certain expenditure incurred, prior to the end of the income year in which the film is completed, in relation to the distribution of the film will now count as qualifying Australian production expenditure. [*Schedule 9, item 19, paragraph 376-125(4)(c)*]

9.73 This will include any of the following expenditure in delivering or distributing the film:

- acquiring Australian classification certificates;
- sound mix mastering licenses;
- re-versioning the film in Australia;
- freight services provided by a company in Australia for delivery of contracted deliverables in relation to the film; and/or
- storing the film in a film vault in Australia.

[Schedule 9, item 23, subsection 376-170(2)]

Example 9.10

DCR is a company based in Australia specialising in making films with significant Australian content.

DCR has just completed making a film and incurs certain expenditure in distributing the film prior to the end of the income year in which the film is complete.

DCR incurs qualifying Australian production expenditure in applying to the Classification Board for a censorship certificate for the purpose of distributing or broadcasting the film in Australia. Acquiring an Australian classification certificate is required prior to distributing or broadcasting a film.

DCR incurs qualifying Australian production expenditure in acquiring a Dolby™ license. A Dolby™ license is an example of a sound mix master license.

DCR incurs qualifying Australian production expenditure in re-versioning a film. Re-versioning a film includes activities such as creating audio descriptions of the film; creating a special version of a feature film so the film can be distributed on DVD (as opposed to in a cinema); or creating a different version so the film is suitable for overseas broadcasters, for example, language translation.

DCR incurs qualifying Australian production expenditure on freight services provided by a company in Australia for delivery of contracted deliverables in relation to the film, otherwise known as 'agreed deliverables'. 'Agreed deliverables' includes the physical items (specific formats of the film) that the producer and a distributor agree are necessary to be delivered to the distributor in order for the film to

be distributed. An example of a deliverable is an ‘interneg’ which is required to make a print of the film

DCR incurs qualifying Australian production expenditure on storing the film in a film vault in Australia. Storing the film in a vault is storing the original master versions of the film in safe and secure conditions so that the film can be preserved, copied and accessed as necessary.

All of the listed distribution costs in this example are specifically included types of qualifying Australian production expenditure allowed under the producer offset.

If these specific distribution costs were not included as qualifying Australian production expenditure, DCR would not be able to claim such distribution costs as they do not relate directly to making the film.

Marketing costs

9.74 Expenditure that relates to publicising or otherwise promoting the film (press expenses, still photography, promotion, video tapes, public relations and other similar expenses) is excluded from production expenditure, even if it is incurred during production, unless it is qualifying Australian production expenditure.

9.75 Certain publicity and promotion expenditure on publicist services provided in Australia, promotional stills, trailers and press kits (with Australian-owned copyright) that is incurred after the completion of the film but prior to the end of the income year in which production is complete can be counted as qualifying Australian production expenditure. *[Schedule 9, items 21 and 23, section 376-135 and subsection 376-170(2)]*

Example 9.11

Further to Example 9.9.

DCR completes the film on 24 May 2012.

DCR incurs qualifying Australian production expenditure on unit publicist fees and on a study guide on 15 June 2012, that is, after completion of the film. These marketing costs are incurred prior to the end of the income year in which the film is complete, that is, before 30 June 2012.

A unit publicist will often be on set throughout production and can remain working on publicity after a film is complete to prepare the film for release. A study guide is created to help teachers interpret films for school students and may be done after production is complete.

DCR will be eligible to claim the producer offset on the qualifying Australian production expenditure incurred on the unit publicist fees and on the study guide.

If the amendment had not been made to include marketing costs incurred after completion of the film but prior to the end of the income year in which production is complete, DCR would not be able to claim the marketing costs spent on unit publicist fees and on the study guide as qualifying Australian production expenditure.

Short-form animated documentaries

9.76 A short-form animated drama is eligible for the producer offset. A short-form animation is a program of one episode or a collection of episodes, predominantly utilising cell, stop motion, digital and/or other animation, of not less than one quarter commercial television hour in total duration. This means, for example, that a collection of six five-minute animated episodes (30 commercial minutes) would be regarded as a short-form animation, as the film will be at least one quarter of a commercial hour. A short-form animation is limited to a drama and therefore excludes a documentary.

9.77 A 'short-form animated drama' is replaced with 'short-form animated film' to include short-form animated dramas and documentaries. [*Schedule 9, items 8 to 11 and 16, subparagraph 376-65(2)(c)(v), subsection 376-65(4), paragraph 376-65(4)(a) and subsection 376-65(6)*]

GST exclusion

9.78 In calculating a company's total production expenditure and qualifying Australian production expenditure, the GST-inclusive cost has previously been used to calculate the offset payable for a certified production. This was irrespective of whether the company was able to claim input tax credits under Division 11 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

9.79 A company's production expenditure and qualifying Australian production expenditure on a film now excludes the GST. This is to address a situation of providing an offset (additional tax benefit) in respect of an amount not incurred but is reimbursed to the taxpayer. [*Schedule 9, item 28, section 376-185*]

Example 9.12

NLR Films is a film production company based in Australia.

In May 2012, NLR Films contracts a digital effects company to perform some effects work for a large budget feature film, and incurs

\$2.2 million of expenditure. This \$2.2 million in expenditure is inclusive of the GST.

NLR Films is responsible for making the arrangements for all the post, digital and visual effects work on the film that is carried out in Australia.

Because NLR Films' qualifying Australian production expenditure on the film is not less than \$500,000, NLR Films meets the expenditure threshold for the post, digital and visual effects offset.

In determining the amount of qualifying Australian production expenditure for the post, digital, and visual effects offset, NLR Films will only be able to claim the offset on the GST exclusive amount, that is, \$2 million. The amount of the offset would be calculated at 30 per cent of the \$2 million.

If the amendment had not been made to exclude the GST amount, NLR Films would have been able to claim the post, digital, and visual effects offset on the GST inclusive amount. The amount of the offset would have been calculated at 15 per cent (previous post, digital, and visual effects offset rate) of \$2.2 million.

Changes to the location offset

Amount of the offset

9.80 The rate of the location offset is increased from 15 per cent to 16.5 per cent of the total of the company's qualifying Australian production expenditure on a film. [*Schedule 9, items 1 and 3, paragraph 376-2(3)(b) and section 376-15*]

Example 9.13

Gomez Film is a company established in Australia to carry out the Australian component of a feature film, *The Three Chipotles*. This film is shot in 2012 in both Australia and Mexico, taking account of the requirements of the script.

In January 2012, Gomez Film incurs \$50 million of expenditure in making the film, comprising \$25 million of qualifying Australian production expenditure and \$25 million of other production expenditure.

Because the amount of qualifying Australian production expenditure is at least \$15 million, Gomez Film is eligible for the location offset for *The Three Chipotles*. The amount of the offset is calculated at 16.5 per cent of \$25 million.

If the rate of the location offset remained at 15 per cent, the amount of the offset would have been 15 per cent of \$25 million.

Financing expenditure

9.81 For the location offset, certain financing expenditure incurred in Australia prior to the end of the income year in which the film is complete can be claimed as qualifying Australian production expenditure.

[Schedule 9, item 20, section 376-135]

9.82 This includes any of the following:

- insurance related to making the film *[Schedule 9, item 22, subsection 376-150(1)]*;
- fees for audit services and legal services provided in Australia in relation to raising and servicing the financing of the film *[Schedule 9, item 22, subsection 376-150(1)]*; and/or
- fees for incorporation and liquidation of the company that makes or is responsible for making the film *[Schedule 9, item 22, subsection 376-150(1)]*.

GST exclusion

9.83 In calculating a company's total production expenditure and qualifying Australian production expenditure, the GST-inclusive cost has previously been used to calculate the offset payable for a certified production. This was irrespective of whether the company is able to claim input tax credits under Division 11 of the GST Act.

9.84 A company's production expenditure and qualifying Australian production expenditure on a film now excludes the GST. This is to address a situation of providing an offset (additional tax benefit) in respect of an amount not incurred but is reimbursed to the taxpayer. *[Schedule 9, item 28, section 376-185]*

Changes to post, digital and visual effects offset

Amount of the offset

9.85 The rate of the post, digital and visual effect offset is increased from 15 per cent to 30 per cent of the total of the company's qualifying Australian production expenditure on a film. *[Schedule 9, items 2 and 4, paragraph 376-2(3)(c) and section 376-40]*

Example 9.14

KevTech is a visual effects company based in Australia.

In June 2012, KevTech performs some visual effects work for a feature film, and incurs \$1 million of qualifying Australian production expenditure. KevTech is the company responsible for all the post, digital, and visual effects work in Australia for the film.

Because KevTech's qualifying Australian production expenditure on the film is at least \$500,000, KevTech is eligible for the post, digital and visual effects offset. The amount of the offset is 30 per cent of \$1 million.

If the rate of the post, digital and visual effects offset remained at 15 per cent, the amount of the offset would have been 15 per cent of \$1 million.

Financing expenditure

9.86 For the post, digital and visual effects offset, certain financing expenditure incurred in Australia prior to the end of the income year in which the post, digital, visual effects work is complete can be claimed as qualifying Australian production expenditure. This will include any of the following:

- insurance related to making the film [*Schedule 9, item 22, subsection 376-150(1)*];
- fees for audit services and legal services provided in Australia in relation to raising and servicing the financing of the film [*Schedule 9, item 22, subsection 376-150(1)*]; and/or
- fees for incorporation and liquidation of the company that makes or is responsible for making the film [*Schedule 9, item 22, subsection 376-150(1)*].

GST exclusion

9.87 In calculating a company's total production expenditure and qualifying Australian production expenditure, the GST-inclusive cost has previously been used to calculate the offset payable for a certified production. This was irrespective of whether the company is able to claim input tax credits under Division 11 of the GST Act.

9.88 A company's production expenditure and qualifying Australian production expenditure on a film now excludes GST. This is to address a situation of providing an offset (additional tax benefit) in respect of an

amount not incurred (reimbursed to) by the taxpayer. *[Schedule 9, item 28, section 376-185]*

Application and transitional provisions

9.89 The amendments as they relate to the producer offset apply to:

- films for which production assistance (other than development assistance) has been approved by the film authority on or after 1 July 2011; or
- in any other case, films for which production expenditure is first incurred in, or in relation to, pre-production of the film on or after 1 July 2011.

[Schedule 9, subitem 31(3)]

9.90 The amendments as they relate to the location offset apply to films commencing principal photography or production of the animated image on or after 10 May 2011. *[Schedule 9, subitem 31(1)]*

9.91 The amendments as they relate to the post, digital and visual effects offset apply to post, digital and visual effects production in Australia that commences on or after 1 July 2011. *[Schedule 9, subitem 31(2)]*

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<i>Bill reference</i>	<i>Paragraph number</i>
Not applicable	Not applicable

Schedule 3: TOFA and PAYG instalments

<i>Bill reference</i>	<i>Paragraph number</i>
Item 1, subsection 45-120(2C)	3.10
Item 1, subparagraphs 45-120(2C)(a)(ii) and 45-120(2C)(b)(ii)	3.15
Item 1, subsection 45-120(2D)	3.18
Item 1, subsection 45-120(2E)	3.20
Item 2	3.22, 3.23
Subitems 3(1) and (2)	3.24
Subitems 3(3) and (5)	3.30
Subitems 3(4) and (6)	3.31
Subsection 3(7)	3.33
Paragraph 3(7)(d)	3.34
Subitems 3(7) and (8)	3.36
Subitem 3(9)	3.37

Schedule 4: Notification of TOFA transitional elections

<i>Bill reference</i>	<i>Paragraph number</i>
Item 1	4.18
Item 2	4.10
Item 3	4.19
Item 4	4.17

Schedule 5: Farm management deposits

<i>Bill reference</i>	<i>Paragraph number</i>
Part 1, item 1, section 393-1, item 2, paragraph 393-15(2)(d), item 3, note 1 to subsection 393-40(1), item 4, note 1 to subsection 393-40(2), and item 7, paragraph (d) of note 1 to subsection 393-55(2)	5.32
Part 1, item 5, subsection 393-40(3A)	5.27
Part 1, item 6, subsection 393-40(4)	5.31
Part 1, item 8	5.47
Part 2, item 9, note to section 393-1, and item 10, heading to subsection 398-5(1) in Schedule 1 to the TAA 1953	5.37
Part 2, item 11, subsection 398-5(1) in Schedule 1 to the TAA 1953	5.33
Part 2, item 12, subsection 398-5(1) in Schedule 1 to the TAA 1953, items 13 to 15, paragraphs 398-5(3)(a) to (d) in Schedule 1 to the TAA 1953	5.35
Part 2, item 16	5.48
Part 3, item 17, item 5 in the table in section 393-35	5.38
Part 3, item 18, item 10 in the table in section 393-35, item 19, subsections 393-55(4) and (5)	5.40
Part 3, item 20	5.49
Part 4, item 21, subsection 69(1A) of the Banking Act 1959	5.43
Part 4, item 22, subsection 69(2) of the Banking Act 1959	5.46
Part 4, item 23	5.50

Schedule 6: Temporary loss relief for merging superannuation funds

<i>Bill reference</i>	<i>Paragraph number</i>
Item 1, section 310-1 (note 1) of the ITAA 1997	6.10
Items 2 to 4, item 11 of Schedule 2 to the <i>Tax Laws Amendment (2009 Measures No. 6) Act 2010</i>	6.11
Item 5, subitem 11(2) of Schedule 2 to the <i>Tax Laws Amendment (2009 Measures No. 6) Act 2010</i>	6.9
Item 6, Schedule 2 to the <i>Tax Laws Amendment (2009 Measures No. 6) Act 2010</i>	6.16

Schedule 7: Penalty notice validation

<i>Bill reference</i>	<i>Paragraph number</i>
Item 1	7.17

Schedule 8: Ancillary funds

<i>Bill reference</i>	<i>Paragraph number</i>
Clause 2	8.60
Items 1 and 16, paragraph 26(3)(ga) of the <i>A New Tax System (Australian Business Number) Act 1999</i> and section 426-104 in Schedule 1 to the TAA 1953	8.57
Items 2, 3, and 7, item 2 in the table in subsection 30-15(2) of the ITAA 1997; definition of 'ancillary fund' in subsection 995-1(1) of the ITAA 1997	8.23
Items 4 and 5, subsection 30-125(1) of the ITAA 1997	8.25, 8.35
Item 6, paragraph 31-10(1)(b) of the ITAA 1997	8.69
Items 8 and 16, definition of 'public ancillary fund' in subsection 995-1(1) of the ITAA 1997 and section 426-102 in Schedule 1 to the TAA 1953	8.24
Items 9 and 16, definition of 'public ancillary fund guidelines' in subsection 995-1(1) of the ITAA 1997 and section 426-103 in Schedule 1 to the TAA 1953	8.34
Item 10	8.71
Items 11 to 15	8.26
Item 16, section 426-102 in Schedule 1 to the TAA 1953	8.27, 8.32
Item 16, subparagraph 426-102(1)(a)(ii) in Schedule 1 to the TAA 1953	8.29
Item 16, subsection 426-102(3) in Schedule 1 to the TAA 1953	8.50
Items 18 to 22	8.45
Item 20, subparagraph 426-120(2)(b)(ii)	8.47
Items 23 to 34	8.49
Item 35, section 426-170 in Schedule 1 to the TAA 1953	8.56
Item 36	8.68
Items 38 and 40	8.61
Item 39	8.62
Item 41	8.66
Items 42 and 43	8.70

Schedule 9: Film tax offsets

<i>Bill reference</i>	<i>Paragraph number</i>
Items 2 and 4, paragraph 376-2(3)(c) and section 376-40	9.85
Items 5, 6, 25 and 27	9.61
Item 7, paragraph 376-55(4)(g)	9.51
Items 8 to 11 and 16, subparagraph 376-65(2)(c)(v), subsection 376-65(4), paragraph 376-65(4)(a) and subsection 376-65(6)	9.77
Items 12 to 14, subsection 376-65(6)	9.49
Items 15, 17 and 18, subsection 376-65(6)	9.50
Item 19, paragraph 376-125(4)(c)	9.72
Item 20, section 376-135	9.57, 9.81
Items 21 and 23, section 376-135 and subsection 376-170(2)	9.75
Item 22, subsection 376-150(1)	9.58, 9.82, 9.86
Item 23, subsection 376-170(2)	9.58, 9.59, 9.73
Items 24 and 26, subsection 376-170(4)	9.68
Item 28, section 376-185	9.79, 9.84, 9.88
Items 29 and 30, subsection 960-50(6)	9.65
Subitem 31(1)	9.90
Subitem 31(2)	9.91
Subitem 31(3)	9.89

