The declaration of an interim dividend by directors empowered under the company's articles of association to pay a dividend does not create a debt owing by the company to its shareholders. Consequently, the declaration of an interim dividend may be revoked before payment because it is subject to the will of the directors until it is paid, credited or distributed (*Brookton Co-operative Society*).

The posting of a dividend cheque is equivalent to payment and the dividend would be taxable in the year the cheque was posted by the company, even if it is not received or not banked until a later income year.

A dividend is "credited", so as to have been paid, provided a dividend has been declared, profits are appropriated to its payment and the shareholder's account with the company is credited in such a way that it may be drawn on as and when the shareholder desires. But mere book entries are not always sufficient. Offsetting the dividends against a debt owed to the company by a shareholder is payment, but crediting to a general "dividends payable account" is not crediting in the relevant sense. Where fully paid bonus shares are issued, a dividend need not be formally declared and the relevant amount is credited when the shares are issued, not when a book entry is made (IT 2603).

Dividends declared on shares owned by a deceased estate, but not paid over until after the production of probate, are not assessable until actually paid over.

A shareholder who, wishing to leave the amount of dividends on deposit with the company, tacitly or expressly authorises the company to retain the amounts payable as dividends remains assessable on the amount of the dividends.

[FTR ¶3-380, ¶20-310]

¶4-130 Dividends indirectly derived

Dividend income derived indirectly through a trust estate, trustee or nominee is not caught by ITAA36 s 44 because that section applies only to dividends derived by a shareholder, ie a person who is entered in the company's register of members as the holder of shares in it.

However, the beneficial owner of shares registered in the name of a nominee or trustee, or a beneficiary presently entitled to a share of trust income that consists directly or indirectly of dividends, would be assessable on such income either under ITAA97 s 6-5 or ITAA36 s 97 or, in the case of an infant beneficiary, the trustee might be assessable under ITAA36 s 98. The taxation of trust income is considered at ¶6-060; for the imputation provisions relating to trustees and beneficiaries, see ¶4-860.

Dividend income thus indirectly derived by a person (companies, partnerships, etc, as well as individuals) is deemed to be "income attributable to a dividend" (ITAA36 s 6B). The provision also applies to a "non-share dividend" (¶23-125). A foreign income tax offset may be available where an Australian resident taxpayer derives foreign income attributable to dividends (¶21-670).

[FITR ¶18-200; FTR ¶13-001, ¶50-600]

¶4-140 Profits and their source

Dividends paid to Australian resident shareholders out of *any* "profits" of the company are assessable under ITAA36 s 44. The profits need not be revenue profits or assessable profits; they may be capital profits or exempt profits. Indeed, any increase in the company's assets, including an increase resulting from a gift, is a profit (*Slater Holdings (No 2)*). In certain circumstances dividends may be *deemed* to have been paid out of profits (¶4-105, ¶4-110, ¶4-300).

Conceptually, dividends are paid out of after-tax profits, ie the dividends are not deductible in arriving at either accounting income or taxable income. There is an exception in the case of co-operative companies. Co-operatives have a choice — they can pay deductible (pre-tax) distributions, which are unfrankable, or they can make non-deductible (post-tax) distributions, which are frankable (¶3-430).

It has been suggested that, to come within s 44(1), the distribution must be made wholly out of profits and that it is not enough that there is a distribution of a mass of assets that contains profits (*Slater Holdings (No 2)*).

The assessability of dividends received by a shareholder is generally determined by whether the dividend was paid out of profits, irrespective of the Australian or foreign source of those profits. (The conduit foreign income regime (¶4-190, ¶21-100) is an exception to this general rule.)

A June 2000 distribution of shares in a foreign resident demerged entity was an assessable dividend paid wholly out of profits despite the market value of the shares being nearly seven times the amount debited to the parent company's retained earnings in relation to the distribution (*Condell*).

A foreign resident who indirectly receives dividend income through a trust or nominee (¶4-130), and not as a shareholder, will be assessable only if the source of the dividend income is in Australia.

[FTR ¶20-275 – ¶20-395]

¶4-160 Demerger dividends

Tax relief is available for demergers, ie the restructuring of corporate or trust entities or groups (other than discretionary trusts and superannuation funds) by splitting them into two or more entities or groups. The relief applies to spin-offs that happen on or after 1 July 2002, where underlying ownership is maintained and the demerging entity divests at least 80% of its ownership interests in the demerged entity. The two main elements of this relief are CGT relief (¶12-328) and tax relief on otherwise assessable dividends (discussed below). Actual examples of the application of demerger relief are discussed in a number of class rulings.

Central to the demerger dividend relief provisions are the concepts of "demerger dividend" and "demerger allocation". A *demerger dividend* is that part of a demerger allocation that is assessable as a dividend under ITAA36 s 44(1), or would be so assessable but for s 44(3) and (4). A demerger dividend is unfrankable (¶4-620). A *demerger allocation* is the total market value of the new interests in the demerged entity that each new owner of the head entity acquires under the demerger. Depending on how the demerger is effected, the demerger allocation may consist of an otherwise assessable dividend component, a return of capital or a combination of capital and profit.

Demerger relief applies to a demerger dividend if:

- just after the demerger at least 50% (by market value) of CGT assets owned by the demerged entity or its demerger subsidiaries is used in the carrying on of a business by those entities, and
- the head entity does not elect (for all shareholders) that the relief not apply.

Where demerger relief applies, a demerger dividend is taken not to be paid out of profits and is non-assessable non-exempt income (s 44(2) to (6): ¶10-890). A withholding tax exemption is provided for the assessable dividend component of the demerger dividend received by foreign resident shareholders (ITAA36 s 128B(3D)). The ITAA36 Pt III Div 7A deemed dividend provisions (¶4-200) do not apply to deem demerger dividends of a private company to have been paid out of profits (ITAA36 s 109RA).

- special rules apply to franked distributions paid to a partnership or to a trustee of a trust. These rules enable the streaming of franked distributions by the trustee of a trust but otherwise ensure that the attached franking credits flow through to each partner or beneficiary (or trustee if appropriate) in proportion to their share of the net income of the trust or partnership that is attributable to franked distributions (¶4-860)
- special rules apply to prevent abuse of the imputation system (¶4-900).

Debt/equity borderline

The debt and equity provisions (¶23-100) apply to the taxation of dividends (including imputation), thin capitalisation, characterisation of payments from foreign resident entities, and the boundary between dividend and interest withholding tax. Thus, the imputation system applies to a non-share equity interest in the same way as it applies to a membership interest. It also applies to a non-member equity holder in an entity in the same way as it applies to a member of the entity (ITAA97 s 215-1).

Public trading trusts, corporate limited partnerships

The imputation system applies not only to companies but also to distributions paid by public trading trusts, which are treated as companies for tax purposes (¶6-330). Corporate limited partnerships (¶3-475) are also taxed as companies and fall within the imputation system (¶4-440).

Special rules for franking by some entities

There are special franking rules for certain entities (ITAA97 s 200-45):

- venture capital franking by a PDF (¶3-555)
- franking by life insurance companies (¶4-760)
- franking by exempting entities and former exempting entities (¶4-970)
- franking by co-operative companies (¶3-430).

Proposed integrity measure

The government has announced that a specific measure will be introduced that will prevent the distribution of franking credits where a distribution to shareholders is funded by particular capital raising activities and will address the issues raised by the ATO in TA 2015/2.

The proposed measure will apply to distributions declared by a company to its shareholders outside or additional to the company's normal dividend cycle (a special dividend), to the extent it is funded directly or indirectly by capital raising activities which result in the issue of new equity interests. Examples of capital raising activities include an underwritten dividend reinvestment plan, a placement or an underwritten rights issue. Where such arrangements are entered into, the company will be prevented from attaching franking credits to shareholder distributions.

Amendments to implement this measure (which is proposed to apply to distributions made after 12.00 pm (AEDT) on 19 December 2016) have not yet been introduced into parliament.

[FITR ¶213-000]

¶4-405 Corporate tax rate changes for 2016/17 and onwards: imputation implications

The corporate tax rate was reduced from 30% to 28.5% for the 2015/16 income year and to 27.5% for the 2016/17 income year for corporate tax entities that were small business entities (¶7-050). The 27.5% corporate tax rate was extended to companies with an aggregated turnover of less than $25m (for 2017/18) and less than $50m (for 2018/19 and 2019/20) and which qualify as base rate entities (¶3-055).

The position for the 2015/16 income year was that, although the maximum franking credit that could be allocated to a frankable distribution was usually set by the applicable company tax rate, in the case of companies that were small business entities, the franking credit cap remained at the standard corporate tax rate of 30% for 2015/16. However, the normal franking credit distribution provisions applied.

It was officially explained that, given the rate reductions, it was not feasible to continue to operate the imputation system at the headline corporate tax rate of 30% for all corporate tax entities.

Consequently, from the 2016/17 income year, the operation of the imputation system for corporate tax entities has been based on the company's corporate tax rate for a particular income year, worked out (broadly) having regard to the entity's position for the previous income year. This was necessary because corporate tax entities usually pay distributions to members for an income year during that income year. However, a corporate tax entity will not know its aggregated turnover for a particular income year (and therefore its corporate tax rate for that income year) until after the end of the income year.

As a result of this change, for the purposes of applying the imputation system, corporate tax entities now use what is called the "corporate tax rate for imputation purposes". This generally means the entity's corporate tax rate for the income year (the current income year), worked out on the assumption that the entity's aggregated turnover, base rate entity passive income and assessable income for the current income year is equal to its aggregated turnover, etc, for the previous income year. For further discussion (including an example), see ¶4-640.

Because of the uncertainty that was created by the delay in the enactment of relevant legislation, the Commissioner issued PCG 2018/8 that explains the ATO's compliance and administrative approaches for corporate tax entities that have faced practical difficulties in determining their corporate tax rate in the 2015/16, 2016/17 and 2017/18 income years.

¶4-440 Corporate tax entity and franking entity

The simplified imputation system applies to distributions made by corporate tax entities to their members. An entity is a "corporate tax entity" at a particular time if the entity is (ITAA97 s 960-115):

- a company at that time
- a corporate limited partnership (¶3-475) in relation to the income year in which that time occurs, or
- a public trading trust (¶6-320) in relation to the income year in which that time occurs.

These entities are taxed separately from their members, at the corporate tax rate.

For the special provisions that apply to transfers of interests in trading stock associated with the formation, variation or dissolution of a partnership, see ¶9-290. Note also the application of the commercial debt forgiveness measures to partners (¶16-910).

[FTR ¶49-401, ¶49-409]

¶5-140 Life policies of partners

In accordance with general principles (¶16-550 – ¶16-570), premiums paid by a partnership for life insurance policies on the lives of the partners are not deductible for the purposes of calculating the net partnership income or partnership loss. A partner, however, may claim a deduction for insurance premiums where the proceeds of the policy would be assessable, ie where the purpose of the insurance is to fill the place of a revenue item (IT 155; IT 2503). This would presumably apply where a partner takes out a policy to insure against the sickness or disability of one or more co-partners.

The proceeds of an insurance policy will not be assessable and the premiums will not be deductible where the purpose of the insurance is to guard against a capital loss, eg where insurance is taken out to assist a partner to meet any liabilities on the death or retirement of another partner (*Wells*) or to buy out another partner's interest in the partnership. As regards CGT, no liability would arise if the proceeds are paid to the original beneficial owner of the policy or to a person who did not acquire the rights under the policy for money or other consideration (¶11-880).

Superannuation contributions

In calculating the net partnership income or loss, no account is taken of deductions allowable for personal superannuation contributions by a partner (¶13-730) (s 90). Nor will the net partnership income or loss take into account a deduction for contributions by an employer (¶13-710) on behalf of a partner because a partner is not an employee of the partnership.

¶5-150 Partnership with non-resident partner

The net income or loss of a partnership and the exempt income of a partnership are calculated by reference to income from all sources, whether Australian or ex-Australian. The calculations are made on the assumption that the partnership is a resident taxpayer (s 90: ¶5-070).

Where the partner is a resident for the whole of the year of income, no difficulty arises. The partner is assessable on their share of the net partnership income or is entitled to a deduction for their share of the partnership loss; and if there is exempt income of the partnership, the partner's exempt income includes their share of the partnership exempt income (¶5-130).

In the case of a partner who is a non-resident for the whole or a part of the year of income, special rules ensure that such a partner is not assessed on income derived from foreign sources while the partner was a non-resident (s 92).

- A partner who is a non-resident for the whole of the year is assessable only on so much of their interest in the net income of the partnership as is attributable to sources in Australia. If there is a partnership loss, the partner may claim a deduction only for their share of the loss that is attributable to Australian sources. If there is exempt income of the partnership, the exempt income includes only the partner's share of the partnership exempt income that is attributable to Australian sources.
- A partner who is a non-resident for part only of the year is assessable on: (a) so much of their share of the net income of the partnership as is attributable to Australian sources; and (b) so much of the net income as is attributable to foreign sources and to the period when the partner is a resident. Similar rules apply where there is a partnership loss or partnership exempt income.

Under the provisions of the tax law applicable to partnerships, an Australian source is attributed to certain royalties paid to non-residents and "natural resource income" respectively (¶21-070).

[FTR ¶49-401]

Assignment of Partnership Interests

¶5-160 Alteration of partner's profit entitlement: "Everett" assignments

By assigning an interest or part of an interest in a partnership, a partner could avoid income tax on the partnership profits attributable to the assigned interest, according to the High Court decision in *Everett's case*. The taxpayer, a partner in a firm of solicitors, assigned part of his interest in the partnership to his wife (also a qualified solicitor) in return for a payment of several thousand dollars. The deed of assignment specifically stated that she was not to become a member of the partnership by virtue of the assignment nor was she entitled to interfere with its business or affairs. The High Court held that the assignment was effective to make the wife taxable on the partnership profits attributable to the assigned interest and to relieve the taxpayer from liability to tax on that same amount.

The principle in *Everett* was taken a step further in *Galland's case* in which a solicitor in partnership with his father assigned 49% of his interest in the partnership to a discretionary family trust. The assignment was held to be effective, even though the solicitor controlled the corporate trustee of the trust and was himself a potential beneficiary under the trust. The High Court also held that, even though the assignment took place in the last few days of the income year, it was effective to assign the relevant share of partnership profits for the whole of that year, not just the profits arising after the date of the assignment. This is because a partner's assessable income can generally only be determined at the end of the income year when the net income of the partnership is ascertained.

Different considerations apply if an assignment brings about a dissolution of the partnership and its replacement by a new partnership. In *Kelly*, a retiring partner by a retirement deed was held to have assigned only a right to a share in the partnership profits that was attributable to his interest up to the date of retirement, rather than any interest in any new partnership that might form subsequently between the remaining partners.

Despite the above cases, the ATO previously said that it would consider applying Pt IVA to Everett assignments entered into on or after the 2015/16 year but before 14 December 2017, and also certain pre-1 July 2015 assignments. The ATO would rate a post-1 July 2015 assignment as "low risk" only if it met one of the benchmarks specified in the guidelines *Assessing the risk: allocation of profits within professional firms*. However, the ATO suspended the application of these guidelines from 14 December 2017 and said that it would be working towards providing certainty soon (¶30-170). In any event, as a general rule, the ATO would apply s 102 (¶6-240) where the deed of assignment contains a clause enabling the bare trust created by the assignment to be revoked either at the instance of the assignor or one of the other partners (IT 2501). Note the Commissioner would also treat Everett assignments as disposals (or part disposals) for CGT purposes (¶11-200).

Attempts by partners, towards the end of the year of income, to retrospectively adjust the ratios in which they share profits or losses (as distinct from altering partnership interests) were held to be ineffectual in *Case P73* and *Case Q53*. In *Nandan*, however, the Federal Court held that a dissolution agreement drawn up on the last day of an income year adjusted the partners' share of the net partnership income for that year. The court noted that the partners were aware that there would be profits for the year, but until the year ended it was not possible to say with certainty what the profits would be.

period is based on its income for the period from 1 July in one year to the last day of the SAP in the following year, even though this exceeds 12 months. PS LA 2007/21 provides a table that sets out the length of transitional accounting periods. Where a newly registered entity is granted a SAP, its first year will be the period starting on its date of incorporation (or commencement of trading) and ending on the next succeeding balance date of their requested SAP, ie it will not exceed 12 months.

Consolidated groups

When a consolidated group is formed, the head company continues to use its existing tax accounting period. Its payment, reporting and lodgment obligations (as head company of the group) will be based on this period. A subsidiary member retains its own balance date when entering the group. On exit from the group the subsidiary will continue with the balance date it had on entry unless it has applied for and had a different balance date approved. See further ¶9-020.

[FTR ¶6-585]

¶9-020 Short period returns

Ordinarily, no return is allowed for a period of more than 12 months, except in certain cases where there is a change to or from a substituted accounting period (¶9-010). Returns for a period of less than 12 months are more frequently required, for example:

- a return for a deceased taxpayer is lodged for the period from the first day of the income year to the date of death (¶6-030).
- the estate (of a deceased person) lodges a separate return in respect of the income from the date of death to the close of the estate's income year.
- new taxpayers lodge a return for the period from the date on which income commenced to be derived to the last day of the income year.
- a dissolved company lodges a return from the first day of the income year to the date of dissolution.
- where there is any variation in the membership of a partnership, a return may need to be lodged for the partnership as originally constituted from the first day of the income year to the date of the variation, with a separate return being lodged for the reconstituted partnership from that date to the end of the income year (¶5-060).
- where a trust is created or terminated, a return must be lodged for the period from its creation to the end of the income year, or from the first day of the income year to the trust's dissolution.

A subsidiary that joins or leaves a consolidated group during the subsidiary's income year *does not* lodge a part-year return, but rather lodges a return for the whole income year, at the normal lodgment time, including only income and deductions properly attributable to the non-membership period(s) (¶8-000).

[FTR ¶79-300]

Accounting Method

¶9-030 Cash versus accruals basis

Taxable income must be calculated not only on the basis of a fixed accounting period, but also in accordance with the *method* of accounting that correctly reflects the true income (*CT v Executor & Trustee Agency Co of South Australia* (*Carden's case*)). There are currently two methods of determining income for tax purposes:

Cash or receipts basis. This method is used by most individuals. Income is returned in the year when it is actually or constructively received, either in the form of cash or its equivalent, or other property.

Accruals or earnings basis. Generally used by business taxpayers. Income is brought to account when the right to receive it comes into being, ie when all the events that determine the right have occurred. It is not actual receipt but the *right to receive* that is critical.

Deductions under both bases of income recognition are claimed in accordance with the rules allowing the deduction. For deductions claimed under ITAA97 s 8-1, this is in the year the expenses are *incurred* (TR 97/7; ¶16-040); deductions allowable under special provisions (eg film investments) are deductible in accordance with that provision.

The method that truly reflects the income of the particular taxpayer in accordance with the taxation law is a question the final adjudication of which, lies with the courts (*Henderson*, see below) not a choice of the taxpayer from year to year. Accordingly, the method first applied by the taxpayer to determine taxable income is generally adhered to strictly. Notwithstanding, certain circumstances (see ¶31-120) may support a change of method. Changes of method in bringing income to account for tax purposes are rare, as it results in double taxation of income when moving from accrual to cash, and an amount not subject to tax when moving from cash to accrual (see below).

Generally, the mere act of consolidation will not affect the choice of income recognition method for business activities carried out by a consolidated group (TD 2005/3). See below.

Guidelines for choice of tax accounting method

Guidelines for choosing which method of tax accounting is likely to provide a substantially correct reflex of income in a given income year are set out in TR 98/1. A cash basis is likely to be appropriate for income derived as an employee, for *non-business* income derived from providing knowledge or skill, and for income derived from investments. The ruling includes exceptions to the general rule in respect of interest income (¶9-050).

The cash basis may also be appropriate for *business* income derived from providing knowledge or skill. However, the presence of the following factors, to a significant extent, may result in the accruals basis being more appropriate:

- the taxpayer's activities involve the sale of trading stock
- the taxpayer's outgoings in the day-to-day conduct of the business relate directly to income derived
- the taxpayer relies on circulating capital or consumables to produce income, or
- the taxpayer relies on staff or equipment to produce income.

The accruals basis is usually appropriate for trading or manufacturing businesses. Although, a separate determination should be made of the appropriate method for accounting for the income from each different business activity, however, unless the differences between the various business activities are significant different methods need not be adopted. In most cases the same method is likely to be appropriate for income from all business activities.

Professional practices

It is not always clear which accounting basis (ie accruals or cash) a professional practice should use to return income. In *Henderson*, it was held, for a large firm of accountants, the accruals basis was appropriate to reflect its income and the Commissioner could not insist the firm continue with the cash basis. Moreover, in the

- when the employee ceases the employment for which they acquired the share(s) (¶10-096)
- 15 years after the employee acquired the share(s). For ESS interests acquired before 1 July 2015 the time period was seven years (s 83A-115).

Subject to the 30-day rule, the deferred taxing point for *rights* is the earliest of:

- when the employee ceases the employment for which they acquired the right(s) (¶10-096)
- 15 years after the employee acquired the right(s). For ESS interests acquired before 1 July 2015 the time period was seven years
- when there is no real risk of forfeiture of the rights and any restrictions on the sale of the rights are lifted, or
- when the employee exercises the right, and after exercising the right there is no real risk of forfeiture of the underlying share and the restrictions on sale of the share are lifted. For ESS interests acquired before 1 July 2015, the requirement was when there was no real risk of forfeiture of the benefits and any restrictions on the sale or exercise were lifted (s 83A-120).

Roll-over relief for corporate restructures

Where employees have a deferred tax liability on a discount on an ESS interest and a takeover or corporate restructure of their employer occurs triggering a disposal or breaking the employment relationship, roll-over relief may be available.

In particular, where:

- an arrangement is entered into that results in the original company becoming the subsidiary of another company, or
- there is a change in the ownership of the existing company that results in any ESS interests in the old company being replaced, whole or partly, by ESS interests in one or more other companies,

the new interests are treated as continuations of the old interests (s 83A-130).

However, the new interests must be ordinary shares or rights over ordinary shares and must reasonably be regarded as matching the old interests (s 83A-130(4), (5)).

Further, the roll-over relief is only available to employees who, at the time of acquisition of the new interests, do not hold a beneficial interest in more than 10% of the shares in the new company, and are not in a position to cast more than 10% of the maximum number of votes at a general meeting. For ESS interests acquired before 1 July 2015, the relevant percentage for ownership and voting rights was 5%.

Any consideration paid by the employee for the ESS interests is spread among the matching ESS interests in proportion to their market values immediately after the corporate restructure. This allows the apportionment of the cost base and the calculation of the discount for tax purposes for those ESS interests that are not subject to the roll-over and those that will.

Assessable amount

Under deferred taxation, the amount to be included in assessable income for the income year in which the deferred taxation point occurs is the market value of the ESS interest (at the deferred taxing point) reduced by the cost base of the ESS interest (s 83A-110(1)).

As noted above, "market value" takes it ordinary meaning but the Commissioner can, by legislative instrument, approve optional safe harbour valuation methodologies which will be binding on the Commissioner (s 960-412; see *Income Tax Assessment (Methods for Valuing Unlisted Shares) Approval 2015*). The "cost base" takes into

account consideration paid, expenses such as interest and brokerage fees, or events such as value shifting, a return of capital or other expenses incurred in holding the asset in the same way as for CGT purposes (¶11-550). However, the cost base does not include a payment made by the employee to the ESS trustee to retain the shares in the ESS beyond a three-year restriction period (*Munnery*).

The market value substitution rules in ITAA97 s 112-20 (¶11-570) and s 116-30 (¶11-510) are ignored for these purposes.

▶ Example

Jake acquires ESS interests in his employer, Beanstalk Co, through an employee share scheme, which meets the conditions for deferred taxation. He purchases the ESS interests at a 50% discount to their market value of $2,000, ie for $1,000. Beanstalk Co passes on brokerage fees of $50 to Jake. The cost base of Jake's ESS interests is $1,050.

Further, for these purposes, a discount on an ESS interest relating to foreign service is taken to be from a foreign source (s 83A-110(1)).

[FITR ¶131-050 – ¶131-095]

¶10-090 Start-up companies and ESS

A specific concession applies to employees of certain small start-up companies when acquiring shares or rights in their employer or a holding company of their employer on or after 1 July 2015 (s 83A-33). Broadly, the concession provides an income tax exemption for the discount received on certain shares and the deferral of the income tax on the discount received on certain rights which are instead taxed under the capital gains tax rules (s 83A-33(1); 115-30(1)).

In relation to shares, the discount is not subject to income tax and the share, once acquired, is then subject to the capital gains tax system with a cost base reset at market value. In relation to rights, the discount is not subject to upfront taxation and the right is then subject to capital gains tax with a cost base equal to the employee's cost of acquiring the right (s 83A-30(2); 130-80(4)).

To access the concession, no equity interests in the company in which the ESS interest is in can be listed on an approved stock or securities exchange. Further, the ESS interests need to be in a company that had been incorporated less than 10 years at the end of the most recent income year before the ESS interest was acquired. In relation to this requirement, it is the company's income year that is the relevant income year (s 83A-33(2), (3)). In addition, the ESS interests need to be in a company that has an aggregated turnover not exceeding $50m for the income year prior to the income year in which the ESS was acquired (s 83A-33(4)). Also, the employing company (which may or may not be the company issuing the ESS interest) must be an Australian resident taxpayer. If the ESS interests are not in the employing company, only the employing company needs to be an Australian resident taxpayer (s 83A-33(6)). Moreover, the ESS interest must:

- in the case of a share — be acquired with a discount of not more than 15% of the market value of the share when acquired, and
- in the case of a right — have an exercise price (or strike price) that is greater than or equal to the market value of an ordinary share in the issuing company at the time the right is acquired (s 83A-33(5)).

In addition to satisfying the above specific conditions in s 83A-33(2) to (6), the ESS interest must also satisfy the general conditions in s 83A-45 and, in relation to shares, the broad availability rule in s 83A-105(2) (s 83A-33(1)).

Assets of joint tenants

Individuals who own a CGT asset as joint tenants are treated as if they each owned a separate CGT asset constituted by an equal interest in the asset and as if each of them held that interest as a tenant in common (s 108-7). This applies even if the party was on the title deed solely to protect the property from being sold on a whim, where there was no evidence of a trust relationship (*Gerbic*). The conversion of a joint tenancy to a tenancy in common (or vice versa) has no CGT consequences. However, the transfer of a 50% interest in jointly-owned shares by two brothers to each other was subject to CGT as the restructuring constituted a disposal (*Johnson*). Further, the transfer of the registration of a share from a single name to be owned jointly with a spouse results in a disposal of 50% of the interest (*Murphy*).

Joint trustees of one trust estate who own property are treated as a single person.

Assets subject to special rules

Particular CGT provisions govern the treatment of some kinds of assets, eg collectables (¶11-390), personal use assets (¶11-400), certain investments (¶12-600 – ¶12-650), leases (¶12-680) and options (¶12-700).

[FITR ¶152-810 – ¶152-870]

¶11-390 Collectables

A collectable is an artwork, an item of jewellery, an antique, a coin, a medallion, a rare folio, a rare manuscript, a rare book, a postage stamp or a first day cover that is used or kept mainly for personal use or enjoyment (s 108-10). Collectables also include an interest in any of the above items, a debt that arises from those items, or an option or right to acquire any of those items. An artwork held as a long-term investment in the expectation of capital appreciation is a collectable. However, collectables acquired for $500 or less are CGT exempt (¶11-640).

An antique is considered to be an object of artistic and historical significance that is over 100 years old. For this purpose, the age of an item is worked out as at the time of the relevant CGT event, eg an item which is not an antique because it is acquired when it is 95 years old is an antique if it is over 100 years old when disposed of (TD 1999/40).

If collectables that comprise a set and would ordinarily be disposed of as a set are disposed of in one or more transactions for the purpose of trying to obtain the exemption for collectables under $500, the set of collectables is itself taken to be a single collectable and each disposal is taken to be a disposal of part of that collectable (s 108-15). This rule does not apply to collectables acquired before 16 December 1995.

The third element of the cost base (which involves the non-capital costs of ownership: ¶11-550) is not counted for collectables (s 108-17).

Capital gains and losses from collectables

In working out a net capital gain or loss, capital losses from collectables can only be used to offset capital gains from collectables (s 108-10). A capital gain from a collectable can qualify as a discount capital gain. The taxpayer can choose the order in which the capital gain from collectables is reduced by capital losses from collectables. If some or all of a capital loss from a collectable cannot be applied in an income year, the unapplied amount (a net capital loss from collectables) can be applied in the next income year for which the taxpayer has capital gains from collectables that exceed capital losses from collectables. A net listed personal-use asset loss for 1997/98 (which includes such losses for earlier years) is taken to be a net capital loss from collectables for that income year (collectables were referred to as listed personal-use assets under ITAA36).

An ordinary capital loss cannot generally be made from the disposal of shares in a company or an interest in a trust that owns a personal use asset which has declined in value (¶11-520).

▶ Example

A taxpayer sells five collectables over a two-year period as follows:

Collectable	Income year of disposal	Cost base and reduced cost base	Cost base (indexed)	Capital proceeds	Collectable gain (loss)
A	Year 1	$1,500	$1,520	$1,800	$280
B	Year 1	$1,000	$1,020	$680	($320)
C	Year 2	$2,020	$2,070	$3,000	$930
D	Year 2	$4,000	$4,080	$3,860	($140)
E	Year 2	$600	$650	$475	($125)

For the first income year, the taxpayer has a net collectable loss of $40, ie $320 (Asset B) – $280 (Asset A). For the second income year, the taxpayer (using the indexation method) makes a capital gain of $625, calculated as follows:

$930 (Asset C) – $140 (Asset D) – $125 (Asset E) – $40 (Year 1 collectable loss) = $625

Note: In the second year, this taxpayer would be better off using the discount method. On this basis, the net capital gain would be:

50% × ($980 (Asset C) – $140 (Asset D) – $125 (Asset E) – $40 (Year 1 collectable loss)) = $337.50

[FITR ¶152-875 – ¶152-915]

¶11-400 Personal use assets

A personal use asset is a CGT asset, other than a collectable, that is used or kept mainly for the personal use or enjoyment of the taxpayer (or associate: ¶10-390). It includes an option or right to acquire such an asset, a debt arising from a CGT event relating to such an asset, and a debt arising other than from income-producing activities or carrying on a business, eg where a parent lends money to a child to help buy a house (s 108-20). A capital gain from a personal use asset is CGT exempt if it is acquired for $10,000 or less (¶11-640).

Land, strata title units, and buildings and structures that are taken to be separate CGT assets (¶11-410) are not personal use assets. The exclusion of land and buildings means that, while houseboats and caravans that are not fixed to land can be personal use assets, holiday houses erected on land cannot. Other examples of personal use assets include clothing, white goods, furniture, sporting equipment, cameras and boats.

Where a director/shareholder is required to make a payment under a guarantee of a company's debt, the resulting debt owing to the shareholder by the company is not a personal use asset if the objectively determined primary purpose of the guarantee payment was assisting the business so as to promote the future flow of dividends to the shareholder, provided the amount of expected dividends is not completely disproportionate to the amount of the liability under the guarantee (TR 96/23).

A horse acquired by a taxpayer who races horses as a hobby (ie who is not carrying on a business of racing horses) is a personal use asset (TR 93/26).

If personal use assets that comprise a set and would ordinarily be disposed of as a set are disposed of in one or more transactions in order to meet the $10,000 exemption threshold, the set is treated as a single personal use asset (s 108-25).

The third element of the cost base (which involves the non-capital costs of ownership: ¶11-550) is not counted for personal use assets (s 108-30).

- Subdiv 815-C: special rules for permanent establishments: (¶22-620), and
- Subdiv 815-D: special rules for trusts and partnerships (¶22-610, ¶22-630).

These replace the previous provisions, including the Div 13 rules and the interim rules in Subdiv 815-A. The main purpose of the current rules is to align the application of the arm's length principle in Australia's domestic law with international transfer pricing standards (currently set out in *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*).

The new rules apply the arm's length principle:

- to relevant dealings between both associated and non-associated entities, and
- to attribute an entity's actual income and expenses between its parts.

The aim is that, regardless of whether the entities are related, the amount brought to tax in Australia from non-arm's length dealings should reflect the economic contribution made by the Australian operations. Thus independent parties engaging in, for example, collusive behaviour or other practices where they are not dealing exclusively in their own economic interests, will not circumvent the rules by reason of their non-association.

Unlike the former transfer pricing rules in Div 13 and in Subdiv 815-A, which both rely on the Commissioner making a determination, the new provisions are "self-executing" in their operation. Entities are required to determine their overall tax position that arises from their arrangements with offshore parties on the basis of independent commercial and financial relations or (in the case of the permanent establishment of an entity, on the basis of arm's length profits) occurring between the entities or parts of the entity.

"De minimis" thresholds also apply to scheme shortfall amounts that arise as a result of a transfer pricing adjustment; below the threshold, scheme administrative penalties will not apply (¶22-630).

For further details of the measures in former Div 13 and Subdiv 815-A, see the 61st edition of the *Australian Master Tax Guide* and earlier editions.

[FITP ¶620-040]

¶22-610 "Transfer pricing benefit" in cross-border transactions

Subdivision 815-B, effective from 2013/14, applies where an entity would otherwise get a tax advantage in Australia from cross-border conditions that are inconsistent with internationally accepted arm's length principles. In this situation, the entity's Australian tax position should instead be determined as if the arm's length conditions in fact existed.

The tax advantage is called a "transfer pricing benefit". An entity gets a transfer pricing benefit where:

(1) the entity and another entity have "commercial or financial relations"

(2) the benefit is from conditions that operate between the entities in connection with those relations (the "actual conditions")

(3) the actual conditions differ from the "arm's length" conditions

(4) the actual conditions satisfy the "cross-border" test, and

(5) if the arm's length conditions had operated:

- the entity's taxable income for an income year would have been greater, or
- its losses of a particular sort — whether a tax loss, film loss or net capital loss — for an income year would have been less, or
- its tax offsets for an income year would have been less, or

- the withholding tax payable by the entity in respect of interest or royalties would have been greater (s 815-120).

If this applies, the arm's length conditions are substituted for the actual conditions in working out the amount of the taxable income, loss, offset or withholding tax, as the case may be (s 815-115). This applies regardless of whether the entity had any purpose or motive of avoiding tax, and regardless of whether the entities are associated.

In the case of a trust or a partnership, references to the "taxable income" are treated as references to the net income. In the case of partnerships, references to tax losses are read as references to partnership losses (Subdiv 815-D: s 815-305; 815-310). These are purely terminological changes, and do not affect the practical operation of the provisions.

Amendments to assessments to give effect to this provision may be made within seven years of the date on which the Commissioner gives notice of the assessment to the entity concerned (s 815-150).

Commercial or financial relations

The term "commercial or financial relations" referred to in (1) is not defined in the legislation, but is intended to cover the totality of arrangements relating to the interaction of two entities. It could therefore include a single transaction, a series of transactions, a practice, understanding or arrangement, available options, unilateral actions, strategies, or overall profit outcomes achieved by the parties.

Actual conditions

The "actual conditions" referred to in (2) are those that in fact operate in connection with the commercial and financial relations between the parties, and that ultimately affect each of the entities' economic or financial positions. They are not limited to contractual terms. According to TR 2014/6, they may also include the price paid for the sale or purchase of goods or services, the terms of an agreement that have an economic impact on the margin of profits earned by one or both the entities, or a division of profits between the entities.

Arm's length conditions

The "arm's length" conditions referred to in (3) are those that might notionally be expected to operate between independent entities dealing wholly independently with one another in comparable circumstances (s 815-125).

In identifying the arm's length conditions, the method(s) used should be those that are the most appropriate and reliable in the circumstances. The internationally accepted arm's length methodologies are based on the concept of comparability — comparing the prices/margins achieved by associated enterprises in their dealings with each other to those achieved by independent enterprises for the same or similar dealings. The accepted methodologies are:

- the comparable uncontrolled price (CUP) method
- the resale price method
- the cost plus method
- the profit split method, and
- the transactional net margin method.

For the ATO's position on a number of issues relevant to using these pricing methodologies, see TR 97/20.

Relevant factors to take into account in choosing the method(s) include:

- the relative strengths and weaknesses of the methods available in the particular circumstances

Guidance); (d) *Country-by-Country reporting guidance*; and (e) *Local file — Part B: Guidance on providing International Related Party agreements, Local file instructions* and *Local file high level design*.

Australia is a signatory to the Multilateral Competent Authority Agreement on the Exchange of CbC reports (the CbC MCAA). The OECD website contains a useful table detailing the jurisdictions that have committed to CbC reporting, the status of domestic legislation to implement CbC, first reporting periods and whether local filing is required. Australia and the United States signed a bilateral Competent Authority Arrangement in August 2017 to exchange CbC reports.

A significant global entity that is a company must also give the Commissioner a general purpose financial statement if it does not lodge one with the Australian Securities and Investments Commission.

International Dealings Schedule

Taxpayers with international dealings that exceed certain thresholds must lodge additional documentation with their annual returns. This must be in the form of an *International Dealings Schedule* ("IDS"). The IDS is available on the ATO website (see "International Dealings Schedule" and instructions for the relevant year).

[FITR ¶620-070, ¶620-550, ¶762-733]

¶22-640 International cooperation on transfer pricing

The Australian Government is actively involved in dialogue and cooperation with governments and revenue authorities to target fraud, money laundering and tax evasion. For other developments in relation to international cooperation, information sharing and profit shifting countermeasures, see ¶22-165.

BEPS project

In October 2015, the OECD released a final package of tax reform measures under the Base Erosion and Profit Shifting (BEPS) Project. The OECD and G20 countries started the BEPS project in 2013 to address what is thought to be very significant losses in global corporate income tax revenues caused by aggressive tax planning by some multinational enterprises (MNEs), the interaction of domestic tax rules, lack of transparency and coordination between tax administrations, limited enforcement resources and harmful tax practices (eg special tax deals and concessions offered by countries). The final package of measures is the result of work on 15 Actions — problem areas identified by the OECD and G20 countries for action by participating states domestically and through treaty provisions.

The Australian Government has implemented BEPS reform measures in domestic law and it has made a number of announcements that it will adopt other measures.

Hybrid mismatch rules

ITAA 1997 Div 832 implements part of the OECD hybrid mismatch rules by preventing entities that are liable to income tax in Australia from being able to avoid income tax, or obtain a double non-taxation benefit, by exploiting differences between the tax treatment of entities and instruments across different countries. The hybrid mismatch rules apply to income years starting on or after 1 January 2019.

Broadly, a hybrid mismatch arises if an entity enters into a scheme that gives rise to a payment, and the payment gives rise to a "deduction/non-inclusion mismatch" or a "deduction/deduction mismatch".

Division 832 defines a set of factual scenarios to which the hybrid mismatch rules apply. If a relevant mismatch arises, it is neutralised by disallowing a deduction or including an amount in assessable income. An integrity rule targets the misuse of the rules by multinational groups using interposed country conduit type vehicles to invest into Australia, as an alternative to investing using hybrid instruments or entities.

The rules also limit the scope of the exemption for foreign branch income and prevent a deduction from arising for payments made by an Australian branch of a foreign bank to its head office in some circumstances.

Imputation benefits and foreign equity distributions

The rules deny imputation benefits on franked distributions made by an Australian corporate tax entity if all or part of the distribution gives rise to a foreign income tax deduction. In addition, certain foreign equity distributions received, directly or indirectly, by an Australian corporate tax entity are prevented from being non-assessable non-exempt income if all or part of the distribution gives rise to a foreign income tax deduction.

PCG 2018/7 sets out the ATO's compliance approach under Pt IVA of the ITAA 1936 in relation to restructures that preserve Australian tax benefits that would otherwise be disallowed under the hybrid mismatch rules. See also *Draft* LCR 2018/D9 (the meaning of a "structured arrangement" and related terms), *Draft* PCG 2018/D9 (guidance for taxpayers assessing the risk of the rules applying) and *Draft* LCR 2019/D1 (the targeted integrity rule).

Exchanging financial information

Australia has committed to participating in an OECD scheme for the automatic exchange of financial information between tax authorities (¶22-165). The international information exchange scheme is not formally part of the BEPS process but has been undertaken in parallel with it.

Tax havens

A tax haven is a country, region or state with a secretive tax or financial system that has minimal or low taxes for non-residents. Tax havens are used for tax evasion or tax avoidance, for example, by diverting income to an entity in a haven that is not taxable in Australia.

Tax havens may also be exploited for other reasons, including money laundering, the concealment of assets and breaches of Australian financial laws and regulations. The phrase "secrecy haven" has been coined to reflect the potential use of such places for a range of activities that is wider than tax avoidance or evasion.

Some tax provisions dealing with international transactions specifically recognise the existence of tax havens. For example, under the controlled foreign companies (CFC) rules, Australian shareholders are taxed on an accruals basis in respect of the income of some controlled foreign companies. The rules are tougher for companies located in tax havens (¶21-110). Other anti-avoidance provisions apply generally to international transactions but may reach dealings involving tax havens, such as the transfer pricing measures, thin capitalisation and value shifting that deal with arrangements to shift profits or value out of Australia. Part IVA may also apply to international arrangements.

The ATO uses a range of methods to detect and deal with tax haven arrangements and combat tax avoidance and evasion, including:

- tax return information-gathering tools like the *International Dealings Schedule* (IDS) and the *Reportable Tax Position Schedule* for company taxpayers (¶3-045)
- the Serious Financial Crime Taskforce, a multi-agency taskforce that conducts investigations and prosecutions addressing superannuation and investment fraud, identity crime and tax evasion
- the Financial account information obtained under the Common Reporting Standard (¶22-165) and the FATCA agreement with the US (¶22-075), and country-by-country (CbC) information about large multinational companies (¶22-630)

- long service leave.

A variation applies to payments made to individuals engaged in foreign service whose foreign earnings from that service are not exempt under s 23AG (¶10-860). The amount to be withheld is the amount which would normally be withheld in Australia from the Australian dollar equivalent of those earnings, under the relevant withholding tax table as if the earnings were not foreign earnings *less* the Australian dollar equivalent of the amount of tax to be withheld and paid to the foreign country in relation to the individual's foreign income tax liability for the provision of the service for the relevant period in that country. If the resulting withholding amount is nil or negative, there is no amount to withhold (*Legislative Instrument* F2009L02794).

Variations to nil

The Commissioner has varied the withholding rate to nil for the following payments:

- amounts paid by an entity to an individual who is under 18 years of age and who has not provided the entity with a TFN declaration, where the amount paid by the paying entity does not exceed $350 weekly, $700 fortnightly or $1,517 monthly (*Legislative Instrument* F2012L00884)
- certain allowances (*Legislative Instrument* F2013L00521):
  - car expense payments up to amounts calculated using the approved cents per kilometre rate, to a maximum of 5,000 business kilometres (*Legislative Instrument* F2015L01047)
  - award transport payments for deductible transport expenses
  - laundry (not dry cleaning) allowance for deductible clothing up to the threshold amount (currently $150: ¶16-210)
  - award overtime meal allowances up to the reasonable allowances amount (published in an annual ATO ruling: ¶16-210), and
  - domestic or overseas travel allowance (excluding overseas accommodation allowance) involving an overnight absence from the payee's ordinary place of residence up to reasonable allowances amount (published in the annual ATO ruling: ¶16-210)

  where the payee is expected to incur expenses that may be able to be claimed as tax deduction at least equal to the amount of the allowance, and the allowance is shown separately in the accounting records of the payer
- payments made to an individual partner as a director of a company because of its connection with the partnership where the partner agrees to remit the director's fees to the partnership
- payments made by an entity that is not a religious institution to a religious practitioner (*Legislative Instrument* F2016L00107):
  - for work or services except for the performance of chaplaincy and/or counselling services, and
  - for chaplaincy and/or counselling services, where the payment does not exceed $100 (if paid weekly), $200 (if paid fortnightly), or $433 (if paid monthly)
- payments made by a religious institution to a religious practitioner for locum services performed for a period of not greater than two days in a quarter (*Legislative Instrument* F2016L00107)
- a payment for reimbursement of actual expenses incurred by a payee for work performed under a labour hire arrangement where the expenses may be deductible and can be substantiated (*Legislative Instrument* F2016L01580)

- remuneration to a company director, committee member or office holder where the recipient is required to remit those payments to another entity (*Legislative Instrument* F2016L00222), and
- allowance payments to Green Army Programme participants made by Green Army service providers.

[FTR ¶976-550 – ¶976-570]

¶26-180 PAYG: retirement payments

An entity that makes a payment to an individual must withhold an amount if the payment is:

- a superannuation income stream or annuity (TAA Sch 1 s 12-80) (¶14-120)
- a superannuation lump sum or employment termination payment (TAA Sch 1 s 12-85) (¶14-120, ¶14-600), or
- an unused leave payment (TAA Sch 1 s 12-90) (¶14-720, ¶14-730).

In *Bennett v Higgins*, an amount was held to be required to be withheld from an award of compensation for unfair dismissal made to a former employee as the award constituted an ETP.

In *Flack*, the AAT did not have jurisdiction to review the imposition of PAYG withholding on an ETP because the taxpayer could not validly object against the imposition of PAYG.

Withholding variations

Reduced rates of withholding apply for payments made from a taxed element of a superannuation income stream benefit to a payee who is 59 years of age and will turn 60 in the financial year in which the payment is made (*Legislative Instrument* F2018L00775). This is to ensure that superannuation beneficiaries are not subject to excessive withholding in the financial year in which they turn 60.

The Commissioner has also varied the amount to be withheld from payments made by trustees of bankrupt estates and external administrators covered by TAA Sch 1 s 12-85 and 12-90 to an amount equal to 34.5% of the total payment (*Legislative Instrument* F2015L01528). The payments subject to the variation include amounts paid as:

- a back payment of wages, including unpaid amounts of leave already taken, that were accrued prior to the date on which the administrator was appointed
- unused annual leave
- payment in lieu of notice
- redundancy pay
- long service leave.

The withholding obligations arise as a consequence of the *Applied Designs case* (¶26-150).

Variations to nil

The Commissioner has varied the withholding rate to nil for payments made to recipients with a terminal medical condition of lump sum superannuation member benefits in circumstances where the payment will not be subject to income tax (*Legislative Instrument* F2008L01854).

Investment bodies are not required to give an annual report but continue to give TFN reports and annual investment income reports under TAA Sch 1 Div 393. An entity's ABN must be reported if this has been quoted in place of a TFN. Managed investment trusts, custodians and other investment bodies must also include in their annual investment income report information about amounts withheld under Subdiv 12-H from payments to foreign residents.

Single touch payroll (STP) reporting

Employers utilising STP reporting (¶26-630) are not required to provide an annual report. This exclusion covers reportable employer superannuation contributions and reportable fringe benefit amounts voluntarily notified to the Commissioner using STP reporting by 14 July after the end of the financial year.

However, an employer must give a declaration to the Commissioner that he/she/it has given all the information that he/she/it would otherwise be required to give under s 16-153 (annual reports), 16-155 (annual payment summaries) and 16-165 (payment summaries for superannuation lump sums and employment termination payments) for payments made in the financial year by 14 July to be exempt from the annual reporting obligations (TAA s 389-20(2)). As this declaration is to be given in the approved form, the Commissioner could, for example, specify that the last STP report for the financial year could be one of the approved forms.

Information about payment recipient

A payer that commences a relationship with another person under which that person is entitled to receive a payment for work or services, a retirement payment, an annuity or pension, or a benefit or compensation payment must give notice to the Commissioner about the payment recipient (ITAA36 s 202CF). This notice must be given within 14 days of entering into the relationship, unless a TFN declaration is in force at the end of that period (¶26-350).

No deduction if Commissioner not notified

Similar to the denied deduction where a payer fails to withhold (¶26-450), a deduction is denied for payments made from 1 July 2019 where the payer did not notify the Commissioner when required under s 16-150 (s 26-105). This will apply to a payment: of salary, wages, commissions, bonuses or allowances to an employee; of directors' fees; to a religious practitioner; under a labour hire arrangement; or for a supply of services where the payee has not quoted its ABN (excluding supplies of goods and supplies of real property). A deduction will also be denied in relation to a non-cash benefit provided in lieu of a cash payment where an amount must be paid and reported to the Commissioner but no notification is made.

[FTR ¶976-880]

¶26-630 Single touch payroll reporting

Single touch payroll (STP) is a reporting framework for employers to provide payroll information to the Commissioner in line with their payroll cycle, which is usually at a time earlier than that which applies under other reporting provisions. It applied from 1 July 2018 to "substantial employers" (ie, an entity with 20 or more employees) but it applies to all employers from 1 July 2019. Entities that report to the Commissioner using STP do not have to comply with some other reporting obligations. The main STP reporting provisions are contained in TAA Sch 1 Div 389.

Exemptions

The Commissioner can exempt entities of a particular class or individual entities from STP reporting by written notice, as a result of an application by the entity or on the Commissioner's own volition (TAA Sch 1 s 389-10). Where the entity has applied for an exemption, the Commissioner must notify the entity if the application is refused and there is a deemed refusal if the Commissioner does not notify the entity within 60 days of the application being made. The entity can object in the usual way against a refused application or the Commissioner's decision to limit the exemption. The following exemptions currently apply:

- *Legislative Instrument* F2019L00121 exempts an entity from reporting contribution amounts paid to a superannuation fund from 1 July 2018
- *Legislative Instrument* F2019L00457 exempts entities that administer a Portable Long Service Leave scheme or a Portable Redundancy scheme from reporting in respect of payments made to members of the scheme from 1 July 2018
- *Legislative Instrument* F2019L00437 exempts employers who do not have an Australian Business Number (ABN) but instead have a Withholding Payer Number (WPN), limited to the 2018/19 and 2019/20 financial years, and
- *Legislative Instrument* F2019L00440 exempts insolvency practitioners for the 2018/19 financial year in respect of the entities they administer; it also exempts employers subject to the appointment of an insolvency practitioner, in relation to payments they make after the commencement of the appointment.

Withholding payments covered

The withholding payments (including nil amounts) covered by STP are (s 389-5):

- A payment that constitutes an employee's ordinary time earnings or salary or wages (within the meaning of the SGAA) — this excludes contractors, and
- The following payments:
  - under the Seasonal Labour Mobility Program (¶26-275)
  - for work and services (¶26-150), with the exception of payments under voluntary agreements, labour hire arrangements, and those prescribed by regulations
  - for termination of employment (¶26-180)
  - for unused leave (¶26-180)
  - for parental leave pay (¶26-190), and
  - for dad and partner pay (¶26-190).

Reportable employer superannuation contribution (RESC) and reportable fringe benefit (RFB) amounts are not required to be reported using STP reporting. However, an entity may nonetheless choose to report these amounts to the Commissioner using STP reporting by 14 July (s 389-15(3)).

Timing and method of reporting

Although STP reporting applies to all employers from 1 July 2019, small employers (ie, those with less than 20 employees) can start reporting any time from 1 July to 30 September 2019 and the ATO will grant deferrals to any small employer who requests additional time to start.

Payments that constitute an employee's ordinary time earnings or salary or wages must be notified to the Commissioner on or before the day on which the amount is paid. All other amounts must be notified to the Commissioner on or before the day by which the PAYG withholding amount is required to be withheld from the payment (regardless of whether the withholding has been made by that time).

Under STP reporting, employers must report information to the Commissioner in the approved form (s 389-5(2)). The approved form can only cover the withholding payments covered by STP reporting. Failure to use the approved form would render the employer liable to a failure to lodge penalty under TAA Div 286.

Criminal sanctions for tax fraud or evasion

The *Crimes (Taxation Offences) Act 1980* (Taxation Offences Act) creates a number of criminal offences relating to the fraudulent evasion of various federal taxes — specifically income tax, GST-related taxes, FBT, petroleum resource rent tax and the superannuation guarantee charge. The Act is directed against stripping arrangements which are designed to render a company or trust incapable of paying tax.

In relation to income tax, the Act makes it an offence to enter into an arrangement with a purpose of securing that a company or trust will be, or will be likely to be, unable to pay income tax that is then payable (Taxation Offences Act s 5), or that will or may reasonably be expected to become payable in the future. It is also an offence to aid, abet, counsel or procure another person to enter such an arrangement (Taxation Offences Act s 6; 7). The maximum penalty is 10 years' gaol, a fine of $210,000 (1,000 penalty units: ¶29-000) or both. The person convicted may also be ordered to pay some or all of the tax involved (Taxation Offences Act s 9; 12). The Act operates in a similar way in relation to the other taxes within its scope.

Note that the directors of a company may be personally liable to pay compensation for tax liabilities arising from participation in tax avoidance schemes or tax evasion. In *BCI Finances Pty Ltd (in liq) v Binetter (No 4)*, the Federal Court found that directors of companies involved in tax evasion schemes had sufficient knowledge of and involvement in the schemes to support a finding that they had breached their statutory and common law duties as directors of the companies. The liquidators of the companies succeeded in claims against directors, based on rights to equitable compensation.

[FTR ¶81-150, ¶942-005]

¶30-120 Scope of Pt IVA

ITAA36 Pt IVA (s 177A to 177F) applies to schemes entered into with the sole or dominant purpose of obtaining a tax benefit. The operation of Pt IVA is not limited by any other provision of ITAA36, ITAA97 or by any provision of the *International Tax Agreements Act 1953*.

When Pt IVA was enacted, the then Treasurer said that:

- "arrangements of a normal business or family kind, including those of a tax planning nature", would be beyond its scope
- Pt IVA is designed to operate against "blatant, artificial, or contrived arrangements, but not cast unnecessary inhibitions on normal commercial transactions by which taxpayers legitimately take advantage of opportunities available for the arrangement of their affairs".

Despite these statements, the language used in the provisions is extremely wide. However, since the practical application of Pt IVA depends on the Commissioner making a determination in accordance with the powers conferred under s 177F, it is reasonable to expect that the ATO will only exercise these powers where it considers that a scheme is blatant, artificial or contrived, although it is somewhat uncertain which schemes would be treated as falling within that description. It is also worth noting that in recent years the original function of Pt IVA as a general anti-avoidance regime has been significantly expanded by the enactment of provisions designed to combat more specific arrangements, such as those involving withholding tax (¶30-160) and franking credit trading (¶30-195).

Part IVA specifically does *not* affect tax benefits under the income equalisation deposit or farm management deposit schemes.

Part IVA is intended to apply to trusts and trustees even though in certain circumstances they may not technically be "taxpayers" (*Grollo Nominees*). It may also apply to some schemes involving the group consolidation provisions (¶8-950).

Part IVA may also apply to treaty shopping schemes (TD 2010/20). Treaty shopping refers to the structuring of an arrangement in a manner that attracts the operation of a tax treaty between Australia and another country to obtain a particular benefit or advantage.

Guidelines for ATO staff in dealing with the application of Pt IVA are contained in PS LA 2005/24. In addition, PS LA 2008/6 provides guidelines for dealing with taxpayers who have committed fraud or evasion. See also ¶30-170.

The ATO has published a practical guide outlining the basic principles of how and when Pt IVA applies to tax schemes. The guide, *Part IVA: the general anti-avoidance rule for income tax — basic principles about how and when it applies* (2005), is available on the ATO website. A fact sheet entitled *Recognising, rejecting and reporting tax avoidance schemes* (2013) is also available on the ATO website.

Effect of applying Pt IVA

Where Pt IVA applies, the Commissioner may cancel the relevant tax benefit (¶30-180) and, in addition, impose penalty tax (¶29-180).

[FTR ¶81-190]

¶30-130 Does Pt IVA apply?

Section 177D determines when Pt IVA applies to a scheme. Separate rules apply to some other specific schemes or benefits (eg franking credit schemes: ¶30-195). The conditions for the application of s 177D are as follows:

- there is a scheme (¶30-140)
- there is a tax benefit (¶30-160)
- it must be possible to conclude that a participant in the scheme did so for the purpose (determined objectively) of enabling one or more taxpayers to obtain a tax benefit in connection with the scheme (¶30-170).

Part IVA applies if the conditions of s 177D are met. However, consequences flow from the application of Pt IVA only if and when the Commissioner makes a determination under s 177F to cancel tax benefits (¶30-180).

[FTR ¶81-195]

¶30-140 Is there a scheme?

To work out if Pt IVA applies, it is necessary to identify a "scheme" as defined in ITAA36 s 177A. A "scheme" means any agreement, arrangement, understanding, promise or undertaking — whether express or implied and whether legally enforceable or not — and any scheme, plan, proposal, course of action or course of conduct (ITAA36 s 177A). Anything done either alone or in association with another or others may constitute a scheme.

Schemes involving franking credit trading and dividend streaming, or franking credits and consolidation, are separately defined in s 177EA (¶30-195) and 177EB, respectively. The Pt IVA consequences of those kinds of schemes are set out in those sections.

The role of artificial entities and their controllers may call for particular consideration. Where a company is concerned, the company itself will probably be a party, its purpose being determined by the collective purpose of its directors (or sometimes the shareholders). However, the directors individually may also be parties, if not otherwise than as a result of their involvement as directors. The role played by directors in discussions of the arrangement should be carefully considered.

A similar question may arise in relation to advisers, particularly when the client of the adviser is relatively unsophisticated and relies heavily on the skill and comprehension of the adviser. In such circumstances, the adviser may well be a party to the scheme.

Where it applies, the PSI regime has the following main effects:

- PSI is included in the assessable income of the individual whose personal efforts or skills generated the income, notwithstanding that it may have been alienated to another interposed entity (¶30-610)
- there are restrictions on the deductions that may be claimed by the individual or interposed entity, so that they broadly correspond to the deductions available to employees, eg expenses relating to the individual's private residence, certain travel expenses and payments made to spouses or other associates (¶30-620, ¶30-630)
- interposed entities may have additional PAYG withholding obligations (¶26-280).

The PSI regime does not apply if:

- the income is not PSI
- the income is derived as an employee or office holder, or
- the income is derived as part of a personal services business (¶30-660).

Although the PSI regime is intended to level the playing field between an employee and a contractor who has PSI, it does not deem contractors to be employees and does not alter the legal relationship between the parties (ITAA97 s 84-10).

Relationship to general anti-avoidance rules

The PSI regime does not overrule the operation of the general anti-avoidance rules of ITAA36 Pt IVA (¶30-690).

[FITR ¶133-000]

¶30-610 Assessment of personal services income

Income which is **mainly** a reward for an individual's personal efforts or skills is the individual's *personal services income* (PSI), regardless of whether it is income of another entity (eg a company, trust, partnership or other individual), whether it is for doing work or producing a result or whether it is payable under a contract (ITAA97 s 84-5). Only individuals can have PSI.

Examples of PSI include salary or wages, income payable under a contract which is wholly or principally for the labour or services of a person, and income derived by consultants (eg computer consultants) from the exercise of personal expertise (*Fowler*). Payments made to an individual's personal service entity when he/she is not actually providing services can still be PSI (TD 2015/1). That could include annual or personal leave payments or gardening leave and retainer payments.

Personal services income does not include income that is mainly generated by the use of assets, the sale of goods, or a business structure.

The characterisation of income as PSI is a question of fact depending on the circumstances of each case, including the substance of the agreement under which services are provided. "Mainly" means more than half of the relevant amount of ordinary or statutory income. This requires the exercise of practical judgment as to whether the value contributed by the efforts or skills of the individual exceeds the value of all other inputs, such as the efforts of other workers, and the use of plant and equipment or machinery, or intellectual or other property (TR 2001/7).

A company, partnership or trust whose ordinary income or statutory income includes the PSI of one or more individuals is referred to as a *personal services entity* (PSE).

Subject to the following exceptions, an individual's PSI that is income of a PSE is included in the assessable income of the individual (ITAA97 s 86-15). This is called "attribution" (see further TR 2003/6). The exceptions are:

- the part of the PSE's income that is income from conducting a personal services business (¶30-660)
- amounts that are paid to the individual as employee salary or wages before the end of the 14th day after the PAYG payment period during which the amount became income of the entity
- exempt income of the PSE
- deductions of the PSE that are permitted to be offset against PSI.

If a personal services entity that is an Australian resident earns income that is the PSI of an individual who is a resident of a foreign country, the income is not assessable to the individual under ITAA97 s 6-10(5) (ID 2010/214). However, the Australian personal services entity is assessable on the foreign-sourced PSI.

The income of a *non-resident company* may be attributed to an Australian resident taxpayer under the PSI rules (*Russell*, Full Federal Court). The Australia–New Zealand DTA did not prevent the income being taxed both to the New Zealand company in New Zealand and to the taxpayer as PSI in Australia.

Offsetting the personal services entity's deductions against PSI

The amount of PSI included in the individual's assessable income may be reduced (but not below nil) by the amount of certain deductions to which the PSE is entitled (ITAA97 s 86-20). The reduction consists of two elements:

(1) deductions to which the PSE is entitled that are deductions relating to the PSI (this excludes entity maintenance deductions (¶30-630) and deductions for wages paid to the individual)

(2) the part (if any) of the PSE's entity maintenance deductions that exceeds the entity's *assessable* income from sources other than PSI. If the PSI is identified with more than one individual, any reduction for this element is apportioned to the individuals on a pro rata basis.

▶ Example

Interco has $200,000 of income that is the PSI of Louisa ($80,000) and Bruce ($120,000), as well as $10,000 of assessable income that is not PSI. Interco is entitled to deductions of $11,000 that relate directly to Louisa's PSI and $15,000 that relate to Bruce's PSI. Interco is entitled to entity maintenance deductions of $16,000.

$10,000 of the entity maintenance deductions must be allocated to Interco's other assessable income, leaving only $6,000 to be offset against the PSI which is assessable to Louisa and Bruce.

The entity maintenance offset apportionable to Bruce's PSI is:

$$\frac{\$120{,}000}{\$200{,}000} \times \$6{,}000 = \$3{,}600$$

The net PSI which is to be included in Bruce's assessable income is therefore:

Bruce's gross PSI	$120,000
Less Interco's deductions relating to Bruce's PSI	15,000
Less pro rata entity maintenance deductions	3,600
Amount to be included in Bruce's assessable income	$101,400

Similar calculations would be made for Louisa.

An individual is entitled to deduct a net PSI loss from other income. An individual can deduct an amount equal to the excess of the individual's "personal services deduction amount" over the individual's "unreduced personal services income". This

If the employer paid less than market price for the property (such as where a manufacturer provides a "free" item with a large order), the taxable value is the notional market price less the amount, if any, paid by the employee.

In the case of a remote area housing scheme, where the employer sells a house at a discount to an employee or pays an option fee to the employee for the right to purchase the house, the value of the benefit is spread over the period it is enjoyed, rather than being taxed "up-front" as a lump sum. In most cases, the value of the benefit is spread over a seven-year period, but in limited cases a 15-year amortisation period may apply (s 65CA).

Where an employer made contributions to a redundancy fund (*Caelli Constructions*) and to a superannuation fund (*Walstern*), the taxable value of the benefit was the amount of the employer's contributions. The value of the property benefit (shares) provided by a company to two key employees was the amount of the premium allocated to each employee (*Experienced Tours*).

[FTR ¶815-325, ¶815-450, ¶815-460, ¶821-280]

Residual Benefits

¶35-570 Residual fringe benefits

Any fringe benefit not covered by any other valuation rules is treated as a residual fringe benefit.

The only criteria are that there must be something that can be identified as a benefit and the necessary employment relationship must exist to make the benefit a fringe benefit (¶35-060). The benefit may be provided by the employer, an associate of the employer, or by a third party under an arrangement with the employer. The benefit may be provided to an employee, an associate of an employee, or to some other person at the request of an employee or an associate of an employee.

Examples of residual benefits are free or discounted services, such as travel or the performance of work, the use of property, the provision of insurance coverage (eg CR 2004/113 and CR 2005/103), the provision of vehicles that are not cars (eg vehicles designed to carry more than one tonne or nine or more passengers, hire cars, and e-bikes: CR 2015/80) and use of a travel smartcard provided by the employer (CR 2016/58). Specifically, the provision of reticulated gas or electricity is a residual benefit (s 156), as is the provision of a hired taxi, rental car or motor cycle (¶35-150). Where the provision of a taxi by an employer gives rise to a taxable benefit, the value of the benefit is the amount paid to the taxi operator and does not include any additional service charges (eg Cabcharge) referable to the taxi fare (*National Australia Bank*). A free loan establishment service provided by a bank to an employee, being a service for which the bank charges customers, gives rise to a residual benefit (*Westpac Banking Corporation*), as does the provision of investment services, chauffeur services (ID 2003/498) and the use of the employer's electronic road toll tag. In *Kumagai Gumi Co*, the payment by a foreign company of the Australian income tax liabilities of Japanese executives transferred to Australia gave rise to a residual fringe benefit.

In cases where property is provided at the same time as a residual benefit (eg spare parts are provided when a television set is repaired), the two benefits are treated as one residual benefit if the provider is in the business of supplying such goods and services (s 153). If the goods are supplied by one provider and the services by another, the two types of benefit are valued separately.

A residual benefit generally arises at the time when the benefit is provided. If the benefit is provided over a period, such as where an employee has the use of property for a period of time, the benefit arises during that period (s 149(1)). If the period straddles more than one FBT year, the benefit is taxable on a proportional basis in each year (s 46(1)).

In some cases, the benefit arises when the time for payment for the benefit is due (s 46(2)). This is where:

- the benefit is a continuing one which would normally be billed on a regular basis, and
- the same services are provided to members of the public in the ordinary course of the employer's business.

For example, where electricity or gas is supplied at a discounted rate with quarterly billing periods, a benefit will arise at each quarterly payment due date rather than over the period of the quarter. This can affect the year into which the benefit will fall — where the period of supply spans the end of one tax year and the beginning of the next, the benefit falls into the year in which the payment due date occurs, rather than being spread over the two. This does not apply where the benefit arises from a lease or licence of property. In that case the benefit is provided over the whole of the relevant period (s 149(2)).

[FTR ¶816-550]

¶35-580 Exempt residual benefits

A number of residual benefits are specifically exempted from tax (s 47). These can be summarised as:

- free or discounted transport (not air transport) provided to current employees in the course of the employer's business of providing such transport to the public (s 47(1))
- certain recreational or child care facilities for the benefit of employees (such facilities being located on the "business premises of the employer") (s 47(2)) and certain contributions to secure priority of access to child care facilities (eg ID 2012/58) (s 47(8)). "Recreational facility" includes general attendance or reserved seating at a sporting event organised by the employer on its business premises. The exemption may apply to the provision of gym facilities (CR 2015/9) but not fitness classes (ID 2015/25)
- the use by an employee of an employer's equipment that is ordinarily located on the business premises (other than a motor vehicle) (s 47(3))
- "work-related" use, and other minor, infrequent and irregular private use, of vehicles not being "cars" (the same as the exemption applying to work-related and other minor private use of commercial vehicles: ¶35-160, particularly PCG 2018/3) (s 47(6), eg use of a bus is exempt (ID 2001/313; CR 2017/35) but not a tram (ID 2010/163))
- private use of an unregistered motor vehicle (one which cannot be legally driven on a public road) which is used principally for business purposes (s 47(6A))
- transport provided under certain "fly-in fly-out" travel arrangements for employees in designated remote areas or working on oil rigs and other off-shore installations (TD 95/49) (s 47(7))
- living-away-from-home accommodation provided to employees who are required for work purposes to live away from their usual place of residence and who satisfy the requirements in ¶35-470 (*Draft* TR 2017/D6) (s 47(5)). For the meaning of "usual place of residence", see CR 2003/19 and Ch 11 of the ATO's "Fringe benefits tax — a guide for employers".

¶36-100 Payroll tax on payments to contractors

Generally, payroll tax is a tax on ''wages'' paid or payable to an employee by an employer. While a contractor is not ordinarily considered to be an ''employee'', persons/contractors may be deemed to be employees where a ''relevant'' contract exists between the person supplying the services (the contractor) and the end-user (the employer).

Broadly, the contractor provisions deem payments to certain contractors to be ''wages'' for payroll tax purposes.

The basic situations that will give rise to a ''relevant'' contract are:

(1) where a person, in the course of carrying on a business, supplies to another person services for or in relation to the performance of work

(2) where a person, in the course of carrying on a business, is supplied with the services of another person for or in relation to the performance of work, and

(3) where a person, in the course of carrying on a business, provides goods to persons who perform work and resupply the goods. This is intended to deal with the practice of a person in business providing goods to ''outworkers'' or ''home workers'' who perform specified work and return the goods.

Under the contractor provisions, the term ''contract'' includes an agreement, arrangement or undertaking, whether formal or informal and whether express or implied. Although the provisions relate to the supply of services, the term ''services'' is defined to include ''results (whether goods or services) of work performed''. However, only the amount of the payment that relates to labour is liable to tax and not the cost of materials and equipment incurred by the contractor. Some states have issued guidelines on the deductions available for materials and equipment for particular types of contractors.

Although the situations covered are very broad, at least one party to the contract must enter into the agreement while in the course of carrying on a business.

The legislation also provides for specific exclusions from the contractor provisions, supplemented by rulings from the various state revenue offices. Where any exclusions apply, the contract payments by the person engaging the contractor will be exempt from payroll tax. Contracts may be exempted if any of the following apply.

- The labour component of the contract is ancillary to the supply of materials or equipment.
- The services provided are not normally required by the business receiving the services and the person supplying those services provides them to the general public.
- The services provided are not required by the business for more than 180 days per financial year regardless of how many different contractors provide the same service.
- Any one contractor is not engaged for more than 90 days in total per financial year or provides one person or the same people for no more than 90 days in total to carry out the contract.
- Services provided under contract are ordinarily rendered to the general public.
- The services under the contract are provided by two or more persons supplied by the contractor.
- The services are those of an owner/driver, an insurance agent or a direct selling agent. Note that the exemptions that apply in relation to insurance agents and direct selling agents are not available in New South Wales, Tasmania, the Northern Territory and the ACT.

Where the contractor provisions do not apply the liability for payroll tax will generally depend on whether an employer/employee relationship exists. Accordingly, payroll tax does not fall on payments made to independent contractors provided the intention of the contract is not to reduce or avoid the liability to payroll tax.

In all states, provisions apply to make employment agents liable for payroll tax on payments made to persons engaged to provide services to the agents' clients (see (12) at ¶36-140).

¶36-110 Payroll tax grouping provisions

The legislation in all states provides for the ''grouping'' of related or associated businesses so that, where two or more businesses are grouped, their wages are aggregated in order to determine whether a liability exists. However, each employer in the group remains primarily responsible for the payment of payroll tax on its own wages. The principal circumstances in which businesses will be grouped by the various state tax authorities are as follows:

- where companies are ''related'' under *Corporations Act 2001* (ie in a holding/subsidiary relationship)
- where employees of one business perform duties solely or mainly for the benefit of another business
- where there is an agreement between two businesses relating to the performance of duties by employees of one, for the benefit of the other
- where the same person (or persons) has a controlling interest in two or more businesses. Different rules apply to companies, trusts, partnerships or businesses owned by one person, and
- where an employer has controlling interest in another employer (being a corporation) under tracing provisions.

Determining whether a group exists largely hinges on the opinion of the Commissioner in each state, having regard to the circumstances of each particular case. Generally, the legislation provides that, other than in respect of companies related under the corporations law, the Commissioner has a discretion to exclude an employer from the operation of the grouping provisions. The discretion may be exercised where it can be demonstrated that the grouped businesses are substantially independent and unconnected, and that the relationship is not designed to reduce or avoid payroll tax. Each state has separate guidelines as to the circumstances in which a person may seek to gain exclusion from the respective grouping provisions.

Generally, where employers are grouped, one group member claims the exemption threshold and the remaining members must pay a flat rate of tax (¶36-040).

¶36-120 Payroll tax jurisdiction issues

The legislation in each state prescribes the circumstances in which wages are liable to payroll tax to ensure that tax in respect of services rendered by a particular employee is payable in only one state for any given month.

Under the nexus provisions common to all states, wages are taxable in a state if they relate to services performed wholly in that jurisdiction. For wages relating to services performed in two or more Australian jurisdictions, or partly in one or more Australian jurisdictions and partly outside all Australian jurisdictions, they are taxable in a particular state if:

- the employee is based in that state
- where the employee is not based in an Australian jurisdiction, the employer is based in that state