- where the individual is a small business entity — the individual's net small business income for the income year, and
- the individual's share of a small business entity's net small business income for the income year that is included in assessable income (excluding that of a corporate tax entity) less relevant attributable deductions to that share (s 328-360(1)).

The calculation of the total net small business income for an income year is modified if the individual is a ''prescribed person'' (¶2-170) (s 328-375).

The amount of the offset is limited to $1,000 per individual, per income year (s 328-360(2)).

An entity's ''net small business income'' is the result of:

- the entity's assessable income for the income year that relates to the entity carrying on a business disregarding any net capital gain and any personal services income not produced from conducting a personal services business
- LESS: the entity's relevant attributable deductions attributable to that share of assessable income (s 328-365).

If the result is less than zero, the net small business income is nil.

Relevant attributable deductions are deductions attributable to the assessable income other than tax-related expenses under s 25-5, gifts and contributions under Div 30 or personal superannuation contributions under Subdiv 290-C (s 328-370).

▶ Example

Pat Train was carrying on a restaurant business as a sole trader. For the 2019–20 income year, the business was a small business entity with less than $5 million aggregated annual turnover. The business had assessable income of $300,000 and deductions of $230,000 including a personal superannuation contribution of $30,000. Pat had other taxable income of $40,000.

Pat's net small business income for the year is $100,000. Pat's taxable income for the year is $110,000.

The percentage of Pat's taxable income that was ''total net small business income'' was 90.9% (being $100,000 ÷ $110,000). The basic income tax liability is $28,197. The result of the tax offset formula is $2,050 (being 8% × 90.9% × $28,197). As this result exceeds $1,000, the small business income tax offset is $1,000.

The effect of the offset is to reduce the income tax payable to $27,197 (excluding Medicare levy and low and middle income tax offset).

¶7-250 Simplified depreciation for small business

Small business entities can choose to deduct amounts for most of their depreciating assets under a special depreciation regime (''small business depreciation'').

Small business depreciation

The simplified regime for calculating capital allowances on depreciating assets is contained in ITAA97 Subdiv 328-D. Small business entities that choose to use this regime are not subject to the provisions of ITAA97 Div 40 (ITAA97 s 328-175). Under the simplified regime, small business entities have access to an immediate write-off for low-cost depreciating assets and a simple pooling facility for other depreciating assets (ITAA97 s 328-180). Simplified methods are also provided for balancing adjustments relating to the disposal of assets and for dealing with assets that are only partly used for business purposes. Depreciating assets that are not deductible under Div 40, including those excluded by ITAA97 s 40-45 (capital works, pre-21 September 1999 IRUs and Australian films) and 40-27 (second-hand assets in residential premises), are also excluded from small business depreciation (¶17-030, ¶17-012), as are assets for which a deduction was available under the R&D provisions.

The small business provisions are subject to the operation of the limited recourse finance provisions (¶23-260). See also the special provisions for hire purchase agreements (¶23-250).

Small business entities that are subject to the personal services income rules in ss 85-10 and 86-60 (¶30-620, ¶30-630) can deduct amounts for depreciating assets under the small business depreciation regime (s 328-235). However, the restrictions on car deductions imposed by ss 86-60 and 86-70 apply (¶30-630).

Immediate write-off/instant asset write-off

An immediate deduction is available to small business entities that use simplified depreciation for a low-cost asset in the income year in which it was first used, or installed ready for use, for a taxable purpose. This is also referred to as the instant asset write-off.

Assets costing less than the relevant instant asset write-off threshold are written off in the year they are first used, or installed ready for use. The applicable threshold depends upon the date the asset is acquired and first used, or installed ready for use. The relevant dates and thresholds are:

Date range	Asset threshold
Prior to 7.30 pm (AEST) 12 May 2015	$1,000
7.30pm (AEST) 12 May 2015 to 28 January 2019	$20,000
29 January 2019 to before 7.30 pm (AEDT) 2 April 2019	$25,000
7.30 pm (AEDT) 2 April 2019 to 11 March 2020	$30,000
12 March 2020 to 31 December 2020 purchased (with extension for first use or installed ready for use to 30 June 2021)	$150,000
7.30 pm (AEDT) 6 October 2020 to 30 June 2022 (full expensing — see below)	Unlimited

The above rules are subject to the temporary full expensing of depreciating assets provisions (ITTPA s 328-181). For small business entities choosing to apply the simplified depreciation rules the provisions allow for full expensing of the cost of an asset where the taxpayer both (i) started to hold the asset and (ii) started to use, or have the asset installed ready for use, for a taxable purpose, during the period from 7.30 pm (AEDT) 6 October 2020 until 30 June 2022. This is available for the purchase of new or second-hand assets.

For the acquisition of a car, the deduction under the instant asset write-off or the temporary full expensing provision is subject to the car cost depreciation limit, being $57,581 for 2019–20 and $59,136 for 2020–21.

From 1 July 2022 the threshold will reduce back to $1,000 (s 328-180(1)).

The instant asset write-off (¶17-330) and the temporary full expensing provisions (¶17-430) are also available to other businesses.

The deduction is limited to the taxable purpose proportion (see below) of the asset's cost. For example, if an asset that is newly acquired for $800 is to be used 60% for business purposes, the deduction will be $480. However, if it is to be used only for business purposes, the deduction will be $800. Unpooled low-cost assets that were held before the taxpayer chose to apply small business depreciation do not qualify for the immediate deduction but may be pooled.

Where a taxpayer claimed an immediate deduction for a low-cost asset in an income year and in a subsequent income year while still a small business entity first incurs a second element cost on the asset, the taxpayer can claim an immediate deduction for the second element cost where the cost was incurred at the time when it is less than the relevant threshold detailed above.

An entity held through a non-fixed trust may also be treated as a wholly-owned subsidiary in certain circumstances (ITAA97 s 703-40).

Excluded entities

The following entities cannot be members of a consolidatable or consolidated group (ITAA97 s 703-20):

- an entity whose total ordinary income and statutory income is exempt under ITAA97 Div 50 (exempt entities: ¶10-604)
- a recognised medium credit union (¶3-435)
- an approved credit union under ITAA36 s 23G that is not a recognised large credit union
- a pooled development fund (¶3-555)
- a complying superannuation entity, non-complying ADF or non-complying superannuation fund
- certain subsidiaries of life insurance companies (¶3-527)
- a corporate collective investment vehicle (¶6-410).

Forming a consolidated group

A consolidated group is established by the head company making a choice that a consolidatable group is consolidated on and after a specified day, provided it was also the head company on that day. The choice takes effect from the earliest point in time that a consolidatable group exists on that day (TD 2006/74; ID 2005/63). There must be at least one subsidiary member in existence at the time that the choice is made. Once made, the choice is irrevocable and the specified date cannot be changed (ITAA97 s 703-50(2)).

The choice must be made in writing no later than the day the head company lodges the first consolidated tax return or, if a return is not required, the day it would otherwise have been due. The head company must notify the Commissioner of the choice made in the approved form within the same time frame (ITAA97 s 703-58). No extension of time can be sought under TAA Sch 1 s 388-55 to make the choice (*MW McIntosh*). However, an extension of time for notifying the Commissioner of the choice may be sought. A technical defect in the notice to the Commissioner does not invalidate the choice made.

▶ Example: Forming a consolidated group

Assume that all members of a consolidatable group have the standard 30 June tax year and that the head company wishing to consolidate with effect from 1 October 2018, lodges its consolidated return for the income year ended 30 June 2019 on 2 December 2019. In that case, the head company must make its choice to consolidate from 1 October 2018 in writing, and also notify the Commissioner of this choice in the approved form no later than 2 December 2019.

Under the ''one in, all in'' principle, all members of the consolidatable group (other than a transitional foreign loss maker: ¶8-600) are consolidated (TD 2005/40). Every newly acquired eligible subsidiary of the head company automatically becomes a subsidiary member of the consolidated group. Any subsidiary member that ceases to be a wholly-owned Australian resident subsidiary of the head company automatically leaves the consolidated group.

The same consolidated group will continue to exist when subsidiary members leave the group, or new subsidiary members join the group, so long as the head company remains a head company. This will be the case even if all subsidiary members become ineligible, leaving only the head company. However, if a head company ceases to be eligible to be a head company, a consolidated group will cease to exist. In limited circumstances, a new head company can be interposed between the original head company and its shareholders without disbanding the consolidated group (¶8-500).

▶ Planning points: forming a consolidated group

- There may be scope for including/excluding certain entities from the group by acquiring minority interests or selling part-interests before the consolidation date. However, this should be examined in the context of the ITAA36 Pt IVA general anti-avoidance provisions (¶8-950).
- Consolidating on the first day of the tax year is not essential, but if a group consolidates part-way through the year, each member will need to file a return for the non-membership period (see below). If the head company is a public trading trust, the consolidation must take place on the first day of the trust's income year (¶8-550).

Tax liability in transitional income years

Where an entity becomes (or ceases to be) a member of a consolidated group during an income year, or ceases to be the head company of one consolidated group and simultaneously becomes a subsidiary member of another consolidated group, each part of the income year in which a different consolidation status applied will be treated separately.

Income and deductions attributable to the period where the entity was a member of a consolidated group are included in the head company's consolidated return. However, the entity will be responsible for self-assessing its tax liability for periods during which it was not part of a consolidated group, ie before joining a group and/or after leaving a group (ITAA97 s 701-30). It lodges a full-year return but includes only the income and deductions attributable to the period(s) when it was not a member of a consolidated group. The due date for the subsidiary member's return is the same as it would have been if it had not joined a group.

Where, just before the joining time, there is an arrangement in force for the supply of goods or services between a joining entity and the head company or another joining entity, ITAA97 s 701-70 may adjust the assessable income or deductions of the parties to the arrangement (the ''combining entities''). The purpose of the adjustment is to align the tax positions of the combining entities before they lose their separate identities. (See PS LA 2006/15 for the application of penalties and remission of interest charges in this context.)

Tax debts and tax sharing agreements

Subject to provisions concerning tax sharing agreements, the head company will be liable for the income tax debts of the consolidated group that are applicable to the period of consolidation. However, income tax debts may be recovered from subsidiary members in certain circumstances (ITAA97 Div 721; see also PS LA 2013/5). An exclusion applies to a subsidiary member that is legally prohibited from subjecting itself to such a liability (ITAA97 s 721-15(2); TR 2004/12).

The head company can enter into a tax sharing agreement (TSA) with one or more subsidiary members (TSA contributing members). Providing the TSA meets the requirements of ITAA97 s 721-25 (eg each TSA contributing member's contribution amount can be determined and represents a reasonable allocation, and the arrangement was not entered into to prejudice recovery by the Commissioner), each TSA contributing member is liable to pay the Commonwealth an amount equal to its contribution amount under the agreement (ITAA97 s 721-30). A TSA contributing member generally can leave the group clear of its liability by paying the head company the actual or estimated amount of its liability before the leaving time (ITAA97 s 721-35; PS LA 2013/5).

Entities with substituted accounting periods

When a consolidated group is formed, the head company will continue to use its existing tax accounting period. Thus, if the head company has a substituted accounting period (SAP), the consolidated group will use the same SAP.

In the case of a MEC group (¶8-610), if there is a change in head company, the new head company of the MEC group must use the same accounting period as the former head company.

¶8-230 Consolidated group acquired by another

Special rules apply where an existing consolidated group is acquired by another consolidated group (ITAA97 Subdiv 705-C, comprising s 705-175 to 705-200; modified by s 719-170 for MEC groups). The core rules and cost setting rules will apply in this circumstance as if the joining group were a single entity. See, for example, ID 2007/127. Modifications to the cost setting rules are made where certain non-membership equity interests have been issued by subsidiary members of the acquired group to members of the acquiring group or to third parties, or there are employee shares or certain ADI restructure preference share interests in a subsidiary member of the acquired group.

Where a single entity that is not a member of a consolidated group or MEC group acquires all the membership interests in, respectively, a consolidated group or the eligible tier-1 companies of a MEC group and then makes the choice to form a consolidated group, the tax cost setting modifications will not apply (ID 2009/160; ID 2010/40). In such a scenario, the consolidated group or MEC group will deconsolidate and the exit cost setting rules will apply (¶8-400) and entry cost setting rules apply upon formation of the new consolidated group or MEC group. ITAA97 s 705-175(1) applies only where an *existing consolidated group* acquires all the membership interests in the acquired group. The words ''become members of another consolidated group'' indicate that there must be an existing consolidated group as the acquiring group. (Where a MEC group is acquired by another MEC group or a consolidated group, the MEC cost setting rules in ITAA97 Subdiv 719-C are modified to align with Subdiv 705-C.)

[FITR ¶541-400 – ¶541-440]

¶8-240 Multiple joining entities linked by membership interests

Special rules apply where the combined membership interests of an existing consolidated group and an acquired entity result in additional entities becoming subsidiary members of the group (ITAA97 Subdiv 705-D, comprising s 705-215 to 705-240). This includes the situation where an acquired entity has a wholly-owned subsidiary (linked entities).

The cost setting rules applicable to a single joining entity are applied, subject to certain modifications. The modifications are made for:

- specifying the order in which tax cost setting amounts are worked out
- working out the step 3A amount of the allocated cost amount to take into account membership interests held by linked entities in other linked entities
- working out step 4 of the allocated cost amount for successive distributions of certain profits
- taking into account owned profits or losses of certain linked entities
- making adjustments to the tax cost setting amount for certain assets where there has been a loss of pre-CGT status of membership interests in the linked entity.

[FITR ¶541-450 – ¶541-490]

¶8-250 Adjustments of cost-setting errors

Under ITAA97 Subdiv 705-E (ss 705-305 to 705-320), a head company may be able to reverse unintentional errors affecting tax costs of reset cost base assets by realising an immediate capital gain or capital loss (CGT event L6: ¶11-360). Subject to certain conditions being satisfied, the tax costs that are affected by the errors are taken to be correct for most purposes. This approach is intended to avoid the time and expense involved in correcting the errors. It is available where it would be unreasonable to require a recalculation of the amounts involved, having regard to the relative size of the errors, the number and difficulty of the calculations required, the number of adjustments in assessments and tax returns and the difficulty in obtaining any necessary information.

The Commissioner must be notified of the amount by which the tax cost setting amount was overstated or understated as soon as practical after the error is discovered. The notification must be in the approved form. The rules for adjusting unintentional errors are explained in TR 2007/7.

[FITR ¶541-550 – ¶541-575]

¶8-280 Market valuation for tax consolidation

One of the most challenging aspects of consolidating a group will be the need to develop and document defendable market valuation data in the following circumstances:

- to establish the basis for revaluing the reset cost base assets brought into the group by a joining entity where the allocable cost amount (ACA) method is used (¶8-210)
- to ensure that revenue assets are not valued higher than their market value where the ACA method is used (¶8-210)
- to calculate the pre-CGT proportion arising from pre-CGT membership interests in a joining entity (¶8-210)
- to calculate an adjustment to the result of step 3 in the ACA calculation for an entity where the joining entity holds a CGT asset with a deferred roll-over gain or loss
- to calculate the ACA for subsidiary members that have not been chosen to have the transitional method of valuing assets apply
- to establish the available fraction attached to losses transferred to the consolidated group, other than concessional losses (¶8-120).

In calculating market values for the above purposes, taxpayers will need to balance the costs of determining and documenting market values of particular assets or asset groups against the risks of incurring additional tax, penalties and compliance costs if the taxpayer assigns values that cannot be defended or prove to be substantially wrong.

▶ Planning points: market valuation

- Determining market values, as required under the ACA method (and also required to establish pre-CGT proportions relevant to pre-CGT membership interests and available fractions relevant to transferred losses), can be costly and complex and can introduce substantial tax risks. The costs and risks may be mitigated by concentrating valuation resources on the most significant and sensitive asset areas.
- Costs incurred in obtaining market valuations required under the consolidation regime are deductible under ITAA97 s 25-5 as a tax-related expense. If the valuation is obtained for multiple purposes, the deduction may need to be apportioned (TD 2003/10; TD 2003/11). The costs are not deductible under ITAA97 s 8-1 (TR 2004/2).

The Commissioner has released general guidelines on *Market valuation for tax purposes* (¶17-050). Selected issues covered in the guidelines are discussed below.

The tax cost setting process involves allocating the ACA to underlying assets on the basis of proportionate market value. The values should be allocated on a reasonable basis, which includes the residual value method to allocate any remaining value to goodwill. The guidelines detail the allocation process and also provide 5 valuation shortcut options that may be used to value certain assets:

personal injury component of an undissected lump sum termination settlement could not be separately identified, no part of the payment was exempt as personal injury compensation (TR 95/35; *Dibb*).

Compensation payments that provide the victim with an income stream are generally assessable. Deferred lump sums may also be assessable under ITAA36 Div 16E if they fall within the definition of a qualifying security (¶23-320).

Normally, if an annuity is purchased out of a lump sum tax-free payment, it may be assessable to the extent that the annuity payments include a component related to the investment earnings on the underlying lump sum (ITAA36 s 27H).

In *Brackenreg*, a lump sum settlement, which had been commuted from a weekly compensation payment, was assessable income. In *Maher*, weekly compensation payments under the *Safety, Rehabilitation and Compensation Act 1988* were assessable income. In *Case 9/2006*, weekly workers compensation paid in arrears as part of a clearly dissected lump sum was assessable income.

Division 54 exemption for structured settlements and orders

ITAA97 Div 54 provides an exemption for certain annuities and lump sums provided to personal injury victims under structured settlements or structured orders.

A *structured settlement* is one that meets all of the following 5 conditions:

(1) The claim must be for compensation or damages for personal injury suffered by a person and the claim must be made by the injured person or by his/her legal personal representative.

(2) The claim must be based on the commission of a wrong or on a right created by statute.

(3) The claim cannot be an action against a defendant in his/her capacity as an employer, or an associate of an employer, or a claim made under workers compensation law, or a claim that could instead be made under workers compensation law.

(4) The settlement must be in a written agreement between the parties to the claim. This applies whether or not the agreement is approved by an order of a court or is in a consent order made by a court.

(5) The terms of the settlement must provide for some or all of a lump sum award of compensation or damages to be used by the defendant or the defendant's insurer to purchase from one or more life insurance companies or state insurers:

- an annuity or group of annuities to be paid to the injured person (or his/her trustee), or
- an annuity or group of annuities combined with one or more deferred lump sums to be paid to the injured person (or his/her trustee).

A *structured order* is essentially an order of a court that satisfies conditions (1), (2), (3) and (5) above but is not an order approving or endorsing an agreement as mentioned in (4) above.

Exempt personal injury annuities

A personal injury annuity is an annuity purchased under the terms of a structured settlement or structured order. A personal injury annuity will be eligible for exemption (ITAA97 s 54-15) if (broadly) the following conditions are met:

- The compensation payment or damages, if paid in the form of a lump sum at the date of settlement or order, would not have to be included in the assessable income of the injured person (eg it is not compensation for lost earnings) (ITAA97 s 54-20).

- The annuity instrument only allows for payments of the annuity to be made to the injured person, his/her trustee, a reversionary beneficiary or the injured person's estate and contains a statement to the effect that the annuity cannot be assigned and cannot be commuted except by a reversionary beneficiary (ITAA97 s 54-25).

- The annuity instrument provides that the payments of the annuity are to be made at least annually over a period of at least 10 years during the life of the injured person or for the life of the injured person. Annuity payments may be guaranteed up to 10 years after the date of settlement. In the event the injured person dies during the guarantee period, the remaining payments may be made to either the injured person's estate or a reversionary beneficiary (ITAA97 ss 54-30; 54-35).

- The annuity or annuities in total provide a minimum monthly level of support over the annuitant's life (ITAA97 s 54-40).

Exempt personal annuity lump sums

Structured settlements and structured orders may include non-annual lump sum payments that are made to claimants at regular intervals to fund expected purchases, eg a payment every 5 years to replace a wheelchair. A personal injury lump sum is a lump sum that is purchased under the terms of a structured settlement or structured order. Personal injury lump sums will be exempt from income tax if all of the following conditions are met (ITAA97 ss 54-45 to 54-60):

- There is at least one personal injury annuity provided under the same structured settlement or structured order that satisfies the eligibility conditions described above.

- The lump sum would not have been taxable if it had been paid as a lump sum at the time of settlement.

- The annuity instrument identifies the structured settlement or structured order under which the personal injury lump sum is provided and only allows for payments of the annuity to be made to the injured person or his/her trustee, or contains a statement to the effect that the right to receive the lump sum cannot be assigned or commuted/cashed out.

- The contract specifies the date and amount of the payment of the lump sum. The lump sum can only be increased through appropriate indexation or by a specified percentage.

Payments to reversionary beneficiaries

A reversionary beneficiary will be exempt from income tax on the periodic payments or the lump sum payment if the payment(s) would have been exempt from income tax in the hands of the injured person (ITAA97 s 54-65).

Payments to/from trustee

Broadly, structured payments that would have been exempt if paid directly to the injured person or reversionary beneficiary will be exempt when received by a trustee for the injured person or reversionary beneficiary, and when paid out by the trust (ITAA97 s 54-70). The exemption does not extend to investment earnings of the trust.

A payment of a lump sum to an injured person's estate or testamentary trust will also be exempt (s 54-70(3)).

[FITR ¶102-620, ¶104-000]

Approved overseas project income is taken into account in calculating Australian tax payable on other income derived by the taxpayer. Tax on the non-exempt income is calculated by applying a notional average rate of tax payable on the sum of the exempt income and non-exempt income using the same formula as in ¶10-865.

The income tax exemptions for Australian individuals engaged by the International Monetary Fund and the 3 institutions of the World Bank Group will be clarified (2020–21 Budget Paper No 2, p 22).

[FTR ¶9-890]

¶10-875 Continuous period of qualifying service

The approved overseas project exemption applies where the qualifying service is for a continuous period of at least 91 days. Broadly, this comprises days performing personal services abroad on the project and reasonable time spent travelling between Australia and the project site. It also includes: weekends and equivalent time off; and periods of absence from work due to illness or accident and holidays taken — during or at the end of the assignment to the project and whether in Australia or overseas — that accrued during the relevant period. Note that a person is deemed to have taken leave in the most advantageous order.

Provision is made for cases where, during assignment to a project, the taxpayer returns to Australia on non-qualifying service for short periods of time, in effect breaking the continuity on the project into 2 or more periods. Provided that the number of intervening days spent in Australia does not exceed one-sixth of the number of days engaged on qualifying service on the approved project, the service period will not be regarded as broken. However, the number of the intervening days spent in Australia will not count as days of qualifying service on the project.

Where, because of unforeseen circumstances (such as ill-health or death in the family), a person does not complete the period of service, the proportion of eligible income exempted will be based on the number of days in the planned period of the assignment. The qualifying period for a person engaged to complete the original person's assignment will be based on the combined periods spent on the project by that person and the person originally assigned.

A safeguarding provision is designed to counter arrangements that seek to take advantage of the exemption by inflating the amount of income that is attributable to qualifying service. Income will not be exempt to the extent that it exceeds an amount that the Commissioner considers would be reasonable remuneration for the services.

[FTR ¶9-890]

¶10-880 Approved overseas projects

The taxpayer must perform personal services overseas in connection with an ''approved project''. Applications for approved project status should be made to AUSTRADE (the Australian Trade Commission).

In *Wilson*, the AAT held that income received by a taxpayer from working as a contractor for the US Army overseas was not exempt from tax in Australia under ITAA36 s 23AF because the taxpayer did not work on an ''approved project''. It said there was no evidence that the Trade Minister or his delegate either determined that the projects were in the national interest, or exercised their discretion to approve them in a written and signed document. See also IT 2064.

[FTR ¶9-907]

Shipping

¶10-883 Exemption for shipping income

Ordinary and statutory income from qualifying shipping activities using an eligible vessel is exempt from income tax (ITAA97 s 51-100). An eligible vessel is one which has a shipping exempt income certificate issued by the Minister for Infrastructure and Transport for it.

The exemption applies to all the income from core shipping activities relating to the vessel, ie activities directly involved in operating a qualifying vessel to carry shipping cargo or shipping passengers such as demurrage or cleaning charges. Core shipping activities include:

- carrying the shipping cargo or shipping passengers on the vessel
- crewing the vessel
- carrying goods on board for the operation of the vessel (including for the enjoyment of shipping passengers)
- providing the containers that carry shipping cargo on the vessel
- loading shipping cargo onto, and unloading it from, the vessel.

The exemption also applies to income from incidental shipping activities to the extent that the total incidental shipping income does not exceed 0.25% of the total core shipping income in the income year; if the total incidental shipping income exceeds 0.25% of the total core shipping income in the year then none of the income from incidental shipping activities will be exempt.

Miscellaneous Exemptions

¶10-885 Miscellaneous tax exemptions

In addition to items discussed above, the following are exempt from tax:

- remuneration of **certain visitors to Australia**, subject to limitations (¶22-080 – ¶22-100)
- certain **mining-related income** including the income of the British Phosphate Commissioners Banaba Contingency Fund (ITAA97 s 50-35)
- **foreign source income of foreign residents** (¶22-000)
- income exempted under **double taxation agreements**, eg *Ardia* (¶22-140 – ¶22-160). This includes salaries paid to certain foreign residents (French, German, Italian and Japanese) employed as assistant teachers in Australian schools, where the relevant **visiting teacher** criteria (¶22-150) are met (TD 2001/21 to TD 2001/24)
- interest derived by **''small'' credit unions** from loans to members (¶3-435)
- most income of **copyright collecting societies** (¶3-450, ¶10-510)
- **exempt fringe benefits** (ITAA36 s 23L(1A)) and **non-cash business benefits** less than $300 (¶10-030). Most fringe benefits are non-assessable non-exempt (¶10-895)
- **reversionary bonuses on a life assurance policy** in limited circumstances (¶10-240)
- income from a trust estate where the trustee is an **offshore banking unit** and the beneficiaries are foreign residents (¶21-090).

Debt deductions arising from debt used to finance the Australian operations of certain multinational investors may be limited under the "thin capitalisation" rules (¶22-700) and the transfer pricing rules (¶22-580). For the interaction of those rules, see TR 2010/7. The interaction of the apportionment provisions of s 8-1 and the thin capitalisation provisions in the context of branch funding for multinational banks is discussed in TR 2005/11.

Consolidated entities

The head company of a multiple entry consolidated group can claim a deduction for interest paid on funds borrowed from outside the group by it or a subsidiary member to buy shares in an existing eligible tier-1 company of the group (TD 2006/47) and in another subsidiary member of the group (TD 2006/48).

[FITR ¶31-480 – ¶31-500, ¶31-630 – ¶31-700, ¶33-350 – ¶33-590, ¶68-200]

¶16-742 Interest on borrowings to acquire investments

As a general rule, interest on moneys borrowed to acquire shares will be deductible where it is reasonably expected that assessable dividends will be derived from the investment (ITAA97 s 8-1; ID 2005/42). Interest will not be deductible where the shares are acquired solely for the purpose of making a capital profit on their resale and the proceeds on sale are not assessable as ordinary income (IT 2606), but may be included in the cost base of the asset for CGT purposes.

For the consequences of negative gearing arrangements, see TR 95/33 (¶16-740). For the method of calculating deductions for interest on fixed-term loans or hire purchase agreements, see TR 93/16 and ITAA97 Div 240 (¶23-250).

Capital protected loans

Under ITAA97 Div 247 (introduced to reverse the effect of *Firth*), where the expense on a capital protected borrowing (CPB) exceeds a benchmark rate, part of the expense is attributed to the cost of the capital protection feature. The amount of the excess is treated as being: (a) not interest (rather as the cost of the capital protection feature); and (b) not deductible, if this cost is capital in nature. The capital protection feature is treated in the same way irrespective of whether it is provided explicitly (eg by an actual put option) or implicitly through the term of the arrangement.

A CPB is an arrangement under which there is a borrowing or a provision of credit where the borrower is, wholly or partly, protected against a fall in the market value of a thing to the extent that the borrower uses the amount borrowed or credit provided to acquire the protected thing or uses the protected thing as security for the borrowing or provision of credit, eg instalment warrants and capital protected equity loans (s 247-10).

Division 247 applies to CPBs entered into from 1 July 2007, where the "protected thing" is: a share, or a unit in a unit trust, that is listed on an approved stock exchange; or a stapled security where the issuer is listed. It also applies to shares, units and stapled securities that are not listed on an approved stock exchange, but where the issuer is widely-held. In addition, Div 247 applies to CPBs entered into in the interim period (16 April 2003 to 30 June 2007), where the protected thing is a listed share, unit in a unit trust, or a stapled security. Such CPBs entered into in either time period are also covered where the protected thing is held by the borrower through an interposed entity (eg a trust). However, the provisions do not apply to CPBs relating to interests under employee share schemes (s 247-15). For recent examples of the application of Div 247, see PR 2014/9, PR 2015/3, PR 2016/2 and PR 2016/7.

From 1 July 2013, the benchmark rate is the RBA indicator lending rate for standard variable housing loans (investor), plus 100 basis points (ITAA97 s 247-20(5); ITTPA s 247-80(4); TD 2016/10).

Interest on a full recourse loan will not be denied deductibility by Div 247 where that loan is used to prepay interest on another loan which is a CPB (TD 2013/1).

Linked bonds

For the deductibility of interest and other expenditure incurred in respect of linked bonds and notes paying fixed interest on maturity and a bonus return linked to the performance of a preselected equity, interest rate or exchange rate, see *ATO media releases* NAT 99/21, 99/84, 02/14 and *Young*. Generally, the ATO will allow a deduction for the cash outlay on interest charged on the notes. Money borrowed from the note issuer to "prepay" the balance of interest charged would not be allowed as a deduction.

Investing in trusts

No deduction for interest on borrowings is available to beneficiaries against distributions from discretionary trusts because the beneficiary has a mere expectancy of receiving income from the trust and is not presently entitled to the income of the trust when the expenditure was incurred (*Antonopoulos*; *Lambert*; *Chadbourne*). Even with present entitlement, the interest expense must also have a nexus with that income. Being presently entitled to income in future years is insufficient nexus to warrant a deduction for a current year's interest expense in the ATO's view (TD 2018/9). On the other hand, interest payments on loans taken to purchase units in a hybrid trust under which income was to be held on a fixed trust and capital gains on a discretionary trust were deductible (*Forrest*; ATO *Decision Impact Statement*). In PR 2014/15, interest incurred on borrowings used to invest in a unit trust, which only conferred benefits on unit holders, qualified as general deductions (s 8-1).

Interest on money borrowed to acquire units in a split property unit trust is generally deductible, even where the trust distribution consists of both assessable and non-assessable amounts. The interest deduction may be limited where the expected return from the units, both income and capital growth, does not provide an obvious commercial explanation for incurring the interest, especially if the expected amount of assessable income is disproportionately less than the interest. Interest on borrowings to acquire growth units in a split property trust that are expected to produce only negligible income is deductible only to the extent of the assessable income actually received (IT 2684). See also ID 2004/175.

For the Commissioner's views on certain home loan unit trust arrangements involving claims for interest deductions, see TR 2002/18 (¶30-170).

Interest is not deductible to the extent that the borrowed moneys are settled by the borrower on trust to benefit persons other than the taxpayer (TD 2009/17; TA 2008/3; TA 2008/4), eg other general beneficiaries or remainder beneficiaries (PR 2011/15).

Investment and related parties

A family trust was able to deduct the whole of the interest on borrowings to purchase a residence leased to a beneficiary of the trust at a commercial rent, even though the interest substantially exceeded the rental income (*Janmor Nominees*; distinguished in *Tabone*).

[FITR ¶33-350 – ¶33-600; ¶235-000]

¶16-744 Apportionment of interest deductions

Where a loan is taken out for 2 purposes, one business and one non-business, only a proportion of the interest will generally be deductible under ITAA97 s 8-1 (TR 95/33).

However, in *Carberry's case*, a married couple were allowed a deduction for the full amount of interest on a loan used to purchase a combined dwelling/child-minding business, where it was shown that the whole of the loan related to the purchase of the business and the dwelling was purchased with the proceeds from the sale of their previous home. The Commissioner accepts this approach where an asset can be notionally divided into a part acquired for business purposes and a part acquired for non-business purposes, and the loan can be attributed to the notional business part. If an asset

In the case of a trust, only the trustee may claim a deduction for expenditure incurred in relation to the management or administration of the trust. However, any taxpayer (including a beneficiary or director of a corporate trustee) who incurs expenditure on complying with an obligation imposed on the taxpayer in relation to the affairs of the trust will be allowed a deduction for such expenditure (TD 94/91).

In some circumstances, payments made to a ''fighting fund'' for the purpose of funding litigation, negotiating a settlement outcome or otherwise managing an income tax dispute arising from an investment or scheme are deductible under s 25-5 (TD 2002/1).

Judgment debt interest imposed on a judgment debt for outstanding income tax liabilities is not deductible.

Although GIC and SIC are deductible under s 25-5, the tax shortfall and other administrative penalties are not deductible. A taxpayer does not ''incur'' a GIC liability on unpaid income tax debts until they are served with a notice of assessment triggering the liability to pay the income tax to which the GIC relates (*Nash*; see also ATO *Decision Impact Statement*). GIC accruing after the issue date of an income tax assessment is deductible on a daily basis. SIC is incurred in the income year in which the Commissioner gives a taxpayer a notice of amended assessment. This is the case even if the SIC liability is notified separately from the notice of amended assessment, or if the SIC is unpaid at the end of that year of income (eg because the due date for payment of the SIC falls in the next year of income) (TD 2012/2).

The use of a capital asset for managing a taxpayer's income tax affairs, or for complying with an obligation imposed by a Commonwealth law regarding the income tax affairs of an entity, is treated as being for the purpose of producing assessable income, unless a provision provides otherwise. This means, for example, that a taxpayer may be able to claim depreciation on their computer to the extent that it is used to prepare their income tax return (¶17-005).

Exclusions

The deduction under s 25-5 is *not* available in relation to:

- expenditure of a capital nature (¶16-854; *Healy*)
- payments of the tax itself (including payments under the PAYG system) or interest payments or borrowing costs incurred to finance such payments (¶16-856)
- penalties payable under a local or foreign law or amounts payable on conviction for an offence against such a law
- expenditure relating to the commission of an offence against a local or foreign law, eg costs incurred in the investigation of, or in defending a prosecution for, a tax-related offence, or
- expenditure which, by virtue of a provision of the tax law other than s 8-1, is not deductible under s 8-1 (eg entertainment expenditure).

Tax affairs of a deceased taxpayer

Expenditure incurred by a trustee in relation to the income tax affairs of a deceased taxpayer is deductible against the deceased's income in the return to the date of death (s 25-5(8)).

[FITR ¶34-050, ¶65-080ff]

¶16-854 Treatment of tax-related capital expenditure

Tax-related expenditure that is capital in nature (eg the cost of a computer to be used in complying with the taxpayer's tax obligations; cost of establishing a superannuation fund: *Drummond*) is not deductible (ITAA97 s 25-5). Such capital expenditure may be included in the cost base of an asset for CGT purposes (¶11-550).

Expenditure will not be taken to be expenditure of a capital nature merely because the income tax affairs to which the expenditure relates are of a capital nature (s 25-5(4)). Examples of the kind of expenditure to which this exclusion might apply are: expenditure incurred in applying for a private ruling on whether an item of property is depreciable; the costs of disputing whether expenditure associated with the establishment of a business are deductible; and fees paid for professional tax advice relating to the application of CGT to an asset.

Expenditure on acquiring property for use in the management of the taxpayer's income tax affairs is not deductible under s 25-5. However, any use made of property by a taxpayer for an income tax-related matter will be taken to be for the purpose of producing assessable income. This will enable depreciation to be claimed on property such as a computer used by a taxpayer in ascertaining or meeting his/her income tax obligations or, for example, a deduction to be claimed for the borrowing costs associated with the acquisition of an item of property used for a tax-related matter.

[FITR ¶65-080ff]

¶16-856 Deductions for payments of income tax

Payments of income tax are not deductible under ITAA97 s 25-5, nor are interest or borrowing costs incurred to finance such payments (ID 2010/160).

It has generally been accepted that interest on a loan taken out to pay personal income tax is not deductible under ITAA97 s 8-1 (eg *Case V48*). However, where a business taxpayer uses an overdraft to pay income tax or pays the tax out of a larger loan taken out to meet general business expenses, the ATO will not disallow that part of the interest on the overdraft or loan that is attributable to the payment of tax. Further, the Commissioner accepts that, where a business taxpayer borrows money to pay income tax, the interest incurred on those borrowings is deductible provided the borrowings are connected with the carrying on of the business (IT 2582; *Case 14/98*). Partners are not entitled to a deduction for interest on borrowings to pay personal income tax (TD 2000/24).

The shortfall interest charge and the GIC (¶29-510) payable in respect of late lodgments, late payments and underpayments, as well as for failure to make deductions under the PAYG system, are deductible under s 25-5. No deduction is available under either s 25-5 or s 8-1 for judgment debt interest levied in respect of the taxpayer's outstanding income tax liability under legislation governing the local court.

Where GIC that applies to an RBA deficit debt (¶24-300) is deductible, no deduction is also available for the corresponding GIC on tax debts that have been allocated to the RBA.

[FITR ¶65-080]

¶16-858 Deductibility of other taxes and related costs

Where a taxpayer is carrying on a business, the cost of preparing a payroll tax or land tax return is deductible under ITAA97 s 8-1. The cost of objecting or appealing against any resulting assessment is also deductible. The cost of obtaining professional advice on matters relating to these taxes would generally also be deductible. For example, in one case, a retail motor trader was allowed a deduction of nearly $500,000 in fees paid for advice and administrative work in connection with a sales tax minimisation scheme (*Jezareed*).

Payroll tax and other business taxes are allowable as business deductions where the requirements of s 8-1 are satisfied (¶16-010). For the deductibility of GST payments, see ¶16-860. Where, under the Western Australian payroll tax legislation, the tax became payable when the wages were paid, payroll tax was incurred as a deduction in that year, despite the fact that no payroll tax return was lodged or payroll tax paid until a default assessment was issued some years later (*Layala Enterprises*).

determined by the Commissioner. Requests for valuation must be made in writing on a form approved by the Commissioner and lodged with the Australian Valuation Office. The valuation fee is tax-deductible (s 25-5).

Spreading of deductions

In general, deductions for gifts cannot give rise to a tax loss (s 26-55; ¶16-880). However, deductions for certain gifts can be spread, in instalments chosen by the taxpayer, over a period of up to 5 years. This applies to gifts to cultural organisations (¶16-965), gifts to environmental organisations (¶16-960), gifts to heritage organisations (¶16-967), gifts of property valued by the Commissioner at over $5,000 (see above), grants of conservation covenants (¶16-972) and gifts of cash to deductible gift recipients.

Registration of recipients

A taxpayer cannot obtain a tax deduction for a gift to a fund, authority or institution covered by item 1, 2 or 4 of the table in s 30-15, unless the recipient is: (i) registered by the Australian Charities and Not-for-profit Commission (ACNC) (¶10-610) and endorsed by the Commissioner under Subdiv 30-BA (s 30-120); or (ii) is specifically listed by name in the ITAA97 or its regulations as eligible to receive deductible gifts (s 30-17). The ACNC Register is available on the ACNC website (www.acnc.gov.au), and the procedural rules relating to endorsement (including the Commissioner's power to revoke an endorsement) commence at TAA 1953 Sch 1 s 426-15.

To be endorsed under Subdiv 30-BA, the recipient must have an Australian Business Number (¶33-100) and meet certain conditions set out in s 30-125. For example, in *Cancer and Bowel Research Association Inc*, the AAT held that a deductible gift recipient's endorsement should be retrospectively revoked because its trust deed did not comply with the s 30-125(6) condition requiring surplus assets to be transferred to another eligible recipient if it were wound up or disendorsed. The Full Federal Court held that the Commissioner's power to retrospectively revoke an entity's endorsement (in TAA 1953 Sch 1 s 426-55) was dependent on the entity not being entitled to endorsement on the date the revocation decision was made (*Cancer and Bowel Research Association Inc* (Full Fed Ct)).

Substantiation

Gifts are not subject to the formal substantiation requirements (¶16-210), but donors must be able to produce supporting evidence, if required. Typically, this will consist of a receipt. If a deductible gift recipient (DGR) issues a receipt, its name, ABN, and the fact that the contribution was a gift or related to certain fund-raising events, must be specified (s 30-228). The Commissioner may revoke a DGR's endorsement if receipts are issued that do not comply with these requirements (TAA 1953 Sch 1 s 426-55).

Where there is a workplace-giving program, the employee-donors will need to receive confirmation from the employer of the details of the gift. This may be a written or electronic communication or, where the gift deduction has been reflected in PAYG deductions, in the PAYG Payment Summary (PS LA 2002/15).

The Commissioner may accept itemised mobile phone invoices to substantiate deduction claims for certain gifts via SMS to the United Nation's Children Fund (CR 2014/5), the World Wide Fund for Nature (CR 2014/13), and Vision Australia Ltd (CR 2014/15); evidence on a bank or credit card statement of gifts made using a Donation Point Tap EFTPOS terminal is also acceptable to substantiate a deduction (CR 2017/14).

[FITR ¶74-000]

¶16-945 What constitutes a "gift"?

A transfer of property will constitute a ''gift'' if the property was transferred voluntarily and no advantage of a material character was received by the taxpayer in return (TR 2005/13). Thus, a payment by a parent to a school building fund, pursuant to an arrangement whereby the parent received a reduction in the amount of fees to be paid

in respect of the child attending the school, was not a gift (*McPhail*). A contribution to an overseas aid fund that enabled the taxpayer to participate in an aid project and which funded his airfare and accommodation was also not a gift (*Hodges*). The cost of attending a fundraising function is not deductible if a material benefit, such as a meal, is received (but see also ¶16-977). However, it will be deductible if only something of insubstantial value, such as a plastic lapel badge or a sticker, is received. In the *Individual tax return instructions*, the Commissioner states that a deduction cannot be claimed for a donation if something was received for it, such as a pen, raffle ticket, dinner or reduction in your child's school fees.

A gift must also be voluntary. In *Cyprus Mines Corporation*, a mining company, under the terms of an agreement with a state government, was permitted to make a donation to a prescribed authority within the gift provisions instead of paying mining royalties to that state. It was held that the donation was not deductible as a gift since it could not be said that the payment was voluntary or that no advantage of a material character had been received by the company in return for it. It was also held that the donation was not allowable as a business deduction. Similarly, in *Case 3/2000* a payment to a charity by an associate of the purchaser of land was not a gift as: (i) the payment was made pursuant to a contractual obligation; and (ii) the purchaser obtained the benefit of being relieved of the obligation to make the payment itself.

Donations to a football club or any other third party will not be made tax-deductible simply by channelling them through the Australian Sports Foundation (ASF) (a specified recipient). Where the donor insists, or the ASF guarantees, that a donation will necessarily be applied to a particular beneficiary, then the donation will not be tax-deductible (*Klopper*).

A gift of services is not deductible under Div 30. Expenditure incurred by a taxpayer in undertaking unpaid work for a charitable organisation is not deductible as a gift. Thus, no deduction was allowed for the cost of travel and postage incurred by a taxpayer while engaged in fundraising and associated activities for a charitable association (*Case S43*).

A motive of benefaction on the part of the donor is also an essential element of a gift (*Leary*). This does not have to be the sole motive — the fact that the donor is also motivated by the desire to obtain a tax deduction cannot, of itself, disentitle the donor to the deduction (*Coppleson*).

[FITR ¶74-002]

¶16-950 General categories of gift recipients

Gifts of $2 or more to the organisations, institutions, funds, etc, listed below are deductible, subject to the qualifications mentioned at ¶16-942 and, particularly, the requirement that the recipient of the gift be a charity, fund, organisation or authority in Australia. This normally requires that the institution be established and operated in Australia (TR 2019/6; ¶10-604).

A gift may be used by the recipient for any purpose within the scope of the objects for which it is established, except where there is an express requirement or limitation as to the use to which a gift may be put (TR 95/27). The meaning of ''charity'' has been extended by legislation (¶10-605).

Eligible recipients

(1) Public or non-profit **hospitals** (s 30-20).

(2) **Public benevolent institutions** (PBIs) (s 30-45), ie a charitable institution with a main purpose of providing benevolent relief targeted to people in need, and not to the broader general community. Detailed guidelines are in the ACNC Commissioner's Interpretation Statement on the meaning of a PBI (CIS 2016/03).

- cost may be reduced if a commercial debt is forgiven (¶17-510)
- cost of an asset may be reduced if the asset it replaces has been disposed of involuntarily (¶17-720), or
- cost of an asset does not include an amount that is denied deductibility (under ITAA97 s 26-97) because it is funded by certain amounts derived by participants of the National Disability Insurance Scheme (ITAA97 s 40-235).

The foreign currency denominated cost of a depreciating asset is converted at the exchange rate applicable when the taxpayer began to hold the asset or when satisfying the liability to pay for it, whichever occurs first (¶23-070). See also the foreign exchange gains and losses rules (¶23-075).

The TOFA rules (¶23-020) may affect the calculation of the cost of a depreciating asset where a financial arrangement is used as consideration for acquiring the asset.

GST and depreciating assets

The cost of a depreciating asset (and, in a year after the first year of use, the opening adjustable value) is reduced by any input tax credits relating to the acquisition of the asset or to second element costs of the asset, and by certain decreasing adjustments relating to the asset. If the decreasing adjustment is due to a change in planned use, it is included in assessable income (ITAA97 Subdiv 27-B). If the cost is taken to be market value, that is also a GST-exclusive value.

The cost of the asset (and, in a year later than the first year of use, the opening adjustable value) may be increased by certain increasing adjustments relating directly or indirectly to the asset. If the increasing adjustment is due to a change in planned use, it is deducted. For detailed explanation of increasing and decreasing adjustments, see the *Australian Master GST Guide*.

▶ Example

George, who is registered for GST, buys a ladder for $550 that will be used 80% of the time in his plumbing business. The remaining 20% usage is for non-taxable purposes. The cost of the asset is taken to be the purchase price reduced by $40, ie $510 (calculated as $550 – [(1/11 × $550) × 80%]). If the decline in value is $110 over 2 years, the opening adjustable value at the start of Year 3 is $400.

If the usage changes at the commencement of Year 3 to a 100% taxable purpose, there will be an assessable decreasing adjustment of $10 (ie [1/11 × $550] – $40).

If, instead, the usage changed to a 50% taxable purpose, there would be a deductible increasing adjustment of $15 (calculated as $40 – [1/11 × $550] × 50%).

[FITR ¶69-150 – ¶69-240, ¶87-400, ¶87-420, ¶87-425]

¶17-100 First element of cost of depreciating asset

The first element of cost of a depreciating asset generally represents the amount the taxpayer has paid or is taken to have paid in order to hold the asset, and is worked out when the taxpayer begins to hold the asset (ITAA97 s 40-180).

The first element of cost is subject to certain exclusions and modifications and is GST-exclusive (¶17-090).

If an amount is paid for 2 or more things including one depreciating asset, the amount is apportioned on a reasonable basis between those things, generally based on relative market values (ITAA97 s 40-195). That is not necessarily the adjustable value of the asset (ID 2002/818).

The first element of cost includes an amount paid or taken to be paid in relation to starting to hold the asset, if that amount is directly connected with holding the asset. It does not include an amount that forms part of the second element of cost of another depreciating asset.

The first element of the cost of a mining, quarrying or prospecting right may be reduced by the market value of exploration benefits received under farm-in farm-out arrangements (s 40-1130; ¶19-010).

A lessor's deduction for decline in value of an asset subject to a sale and leaseback arrangement is based on the cost of the asset to the lessor, not the cost to the lessee (TR 2006/13).

The amount the taxpayer is taken to have paid

The cost rules specify the amount that the taxpayer is taken to have paid to hold a depreciating asset (ie first element of cost) or to bring it to its current location and condition (ie the second element of cost). The taxpayer is taken to have paid the greater of the following 2 amounts (ITAA97 s 40-185):

(1) the consideration given, ie the sum of the following:

(a) any amount paid to buy or create the asset (eg labour and materials) or to bring the asset to its current location and condition. This would cover incidental costs (eg stamp duty) and if the taxpayer makes a prepayment, it is the amount of the prepayment. It includes amounts that the taxpayer *is taken to have paid*, such as the price of the notional purchase made when trading stock is converted to a depreciating asset (¶9-245), the cost of an asset held under a hire purchase arrangement under ITAA97 s 240-25 (¶23-250), and a lessor's deemed purchase price when a luxury car lease ends (ITAA97 s 242-90: ¶17-220; ID 2005/197). If the asset is a Div 230 financial arrangement or a Div 230 financial arrangement is involved in the consideration, ITAA97 s 230-505 applies (¶23-020)

(b) the amount of a liability to pay money. Only the part of the liability that has not been satisfied is taken into account

(c) where there is a reduction in a right to receive money (eg a debt is waived), the amount of the liability when it is terminated

(d) the market value of a non-cash benefit provided by the taxpayer. A non-cash benefit is any property or services that are not money (ITAA97 s 995-1(1)). Where a company issues shares for depreciating assets, TR 2008/5 applies (¶3-260).

(e) the market value of a non-cash benefit that the taxpayer becomes liable to provide. Only the part of the liability that has not been satisfied is taken into account, and

(f) where the liability to provide a non-cash benefit to the taxpayer is terminated, the market value of the benefit when the liability is terminated, and

(2) amounts included in assessable income because a taxpayer started to hold the asset (ie where an amount is assessable under ITAA36 s 21A (¶10-030) for receiving the depreciating asset as a non-cash benefit) or gave something to start holding it (this would be the case where the taxpayer exchanges a depreciating asset for another and as a result a balancing adjustment amount is assessable). In the case of second element costs, the relevant amount is the amount included in assessable income because the taxpayer received the benefit or gave something to receive the benefit (ie the benefit that brought the asset to its current condition and location, eg the modification to a truck). In determining the amount included in assessable income, the value of anything provided by the taxpayer that reduced the amount actually included in assessable income must be ignored.

For examples of the application of the above cost rules, see ID 2003/1085, ID 2004/116 and ID 2008/93.

No choice of method is made in the following circumstances:

- where a depreciating asset is acquired by the taxpayer from an associate, the taxpayer must use the same method that the associate was using in calculating its deductions for the decline in value of the asset. The taxpayer may request the associate to give information about the method it was using
- if the taxpayer acquires a depreciating asset from the former holder and the user of the asset while the taxpayer holds the asset is the same as, or is an associate of, the user of the asset while the asset was held by the former holder, the taxpayer must use the same method as that used by the former holder. Examples of cases where this might apply are sale and leaseback arrangements. If the former holder did not use a method, or if the taxpayer cannot readily find out the method used by the former holder, the taxpayer must use the *diminishing value method*
- if the depreciating asset is in a low-value pool, the decline in value is calculated in accordance with the rules outlined at ¶17-810
- if the depreciating asset was used for certain exploration or prospecting purposes (¶17-350) or if an asset costing $300 or less is used for non-business income-producing purposes (¶17-330), the decline in value is the cost of the asset
- if the cost of the depreciating asset is the decline in value (¶17-330), or
- the decline in value of an asset that was used for R&D and which is subject to the R&D offset provisions (¶17-420), must be calculated using the same method that was used to calculate the R&D notional deduction, and vice versa (s 40-65).

Regardless of which method is used, the decline in value of an asset cannot exceed its adjustable value (¶17-485). This ensures that the total amount allowed for the decline in value of a depreciating asset cannot exceed its original cost in the taxpayer's hands. Special rules apply to assets held by tax-exempt entities that became taxable (¶10-030, ¶17-130).

[FITR ¶87-050]

¶17-485 Adjustable value of depreciating asset

The concepts of ''adjustable value'' and ''opening adjustable value'' (ITAA97 s 40-85) are relevant to the calculation of the decline in value of a depreciating asset (¶17-490, ¶17-500) and balancing adjustments for the asset (¶17-630).

The opening adjustable value for an income year is the adjustable value of the asset at the end of the previous income year, ie the closing adjustable value from the previous income year.

The adjustable value of an asset at a particular time is the opening adjustable value for that year plus any second elements of cost for the year, less its decline in value for the year up to that time. Generally, this includes capital expenditure relating to the asset which is not deductible, such as improvements or enhancements. If the asset has not yet been used or installed ready for use, the adjustable value of the asset is its cost. In the income year in which the asset is first used or installed ready for use for any purpose, the adjustable value of an asset at a particular time is its cost less its decline in value up to that time.

If an understatement in the first element of cost of an asset is discovered, the opening adjustable value of the asset is recalculated for each income year from that time, using the correct cost of the asset.

After a balancing adjustment event occurs, the adjustable value of the asset is zero. However, if: (a) the event happens because the taxpayer expects never to use the asset again; (b) either the taxpayer stops using the asset for any purpose or never used the

asset; and (c) the taxpayer continues to hold the asset, the opening adjustable value for the year after the event is the termination value at the time of the event, plus any second element costs incurred in the event year, after the event (s 40-285(3), (4)).

Generally, the opening adjustable value of an asset is reduced by any input tax credits and decreasing adjustments relating to the acquisition of the asset or to second element costs of the asset (¶17-090). It may also be reduced if a commercial debt has been forgiven (¶17-510), if there has been an involuntary disposal of an asset (¶17-720) or if the short-term forex realisation rules have applied (ITAA97 ss 775-70; 775-75).

If the tax-preferred leasing provisions (¶23-210) have applied in respect of an asset and the arrangement period for the asset ends, the adjustable value of the asset at the end of the period is the ''end value'' (s 250-180) of the asset. If only some of the capital allowances were disallowed during the period of the arrangement (ie s 250-150 has applied to apportion the deductions), the adjustable value is modified under s 250-285.

Where the initial owner of a mining, quarrying or prospecting right transfers part of the right under a farm-in farm-out arrangement, the right is taken to be split into 2 depreciating assets immediately before the disposal (s 40-115). The entire adjustable value is allocated to the retained part (s 40-1110; ¶19-010).

[FITR ¶87-090]

¶17-490 Prime cost method

Under the prime cost method, the annual decline in value of a depreciating asset is calculated by allocating the cost of the asset over its effective life in accordance with the formula (ITAA97 s 40-75):

$$\frac{\text{cost}}{\text{effective life}} \times \frac{\text{days held}}{365}$$

Cost includes the first element and the second element of cost of the asset (¶17-080). This method assumes that an asset declines in value uniformly throughout its life. The use of this method is not relevant where the special temporary rules apply to fully deduct the cost of the asset (¶17-330; ¶17-430), unless the asset's opening adjustable value needs to be determined (see below).

If the taxpayer holds the asset for the entire year in a leap year, the ''days held'' will be 366. The denominator in the formula remains at 365.

The decline in value of the asset cannot exceed its opening adjustable value plus second element costs for the year (or its cost, in the year in which it is first used or installed ready for use).

▶ Example

Paul purchases a depreciating asset on 1 July 20X1 for $60,750 and commences to use it in his business on that day. The effective life of the asset is 4.5 years. Using the prime cost method, Paul is entitled to a deduction for the decline in value of the asset of $13,500 [($60,750/4.5) × (365/365)] in 20X1–X2, 20X3–X4 and 20X4–X5. In the 20X2–X3 year, he is entitled to a deduction of $13,537 [assuming 20X3 is a leap year ($60,750/4.5) × (366/365)]. In the 20X5–X6 year, he is entitled to deduct the balance of $6,713 (ie $60,750 – $13,537 – ($13,500 × 3)).

Apportionment

Where a depreciating asset is used (or is installed ready for use) for only part of the year, the decline in value of the asset is calculated on a pro rata basis (¶17-560). The deduction for the decline in value is reduced to reflect the extent of any use for non-taxable purposes (¶17-010, ¶17-570).

A balancing adjustment roll-over may be chosen where mining, quarrying or prospecting rights are disposed of under an interest realignment arrangement entered into after 7.30 pm EST on 14 May 2013 (s 40-363). Such arrangements arise where joint venture parties exchange post-30 June 2001 rights to pursue a single development project. Their goal is to align the ownership of individual rights with that of the overall venture. However, any non-realignment amounts received under the arrangement are assessable income, with the payer including an equivalent amount in the cost of the rights they acquire. After an interest realignment arrangement takes effect, new information may make it apparent that one of the parties originally made an inadequate contribution. The arrangement may provide for adjustments and a party receiving an adjustment includes the amount in their assessable income. The party paying the adjustment includes the amount in the second element of the cost of the rights they acquired under the realignment (s 40-364). Roll-over relief is also available for taxpayers entering into eligible farm-in farm-out arrangements after 7.30 pm EST on 14 May 2013 (¶19-010).

Automatic roll-over

Balancing adjustment roll-over relief is automatic (ie mandatory) in some situations. It is assumed that Div 118 (CGT exemptions), and also ss 122-25(3) and 124-870(5) (which exclude certain assets from some CGT roll-overs) do not apply. Based on these assumptions, CGT roll-over relief would be obtained for:

- transfer of an asset as a result of marriage breakdown (¶12-460, ¶12-470)
- disposal of an asset to a wholly-owned company (¶12-040)
- transfer of an asset of a fixed trust to a company under a trust restructure (¶12-395) or of an asset between fixed trusts (¶12-552)
- disposal of partnership property to a company that is wholly owned by the partners (¶12-090)
- disposal of an asset within a wholly-owned group (¶12-490). As a consequence of the consolidation regime (¶8-000), such roll-over relief is limited
- disposal of an asset as part of a superannuation fund merger (if the transferor chooses Subdiv 310-D roll-over), or as part of a transfer to a MySuper product (if the transferor chooses Subdiv 311-B roll-over), or
- depreciating asset transfers from 1 July 2016 under the small business restructure roll-over (¶12-380).

Roll-over is not available in respect of other disposals, eg a disposal from a discretionary trust to a unit trust.

Balancing adjustment roll-over relief is specifically extended to motor vehicles and other exempt assets as if they were assets to which the CGT roll-over provisions applied. Roll-over relief may also apply to a succession of transfers of a single depreciating asset.

The transferor must provide sufficient information to enable the transferee to calculate the transferee's deductions (ITAA97 s 40-360).

Optional roll-over

Optional balancing adjustment roll-over relief is available if a *joint election* for roll-over relief is made by the transferor *and* the transferee in relation to a partial change in ownership interests in a partnership asset, eg where there is a variation in the constitution of the partnership or in interests of the partners (s 40-340; ¶17-780). Where the change in interests occurs due to the death of a partner, the trustee of the deceased partner's estate may be a party to a joint election. The election must be in writing and must contain such information as the transferee requires in order to work out how the capital allowance provisions apply to the transferee's holding of the depreciating asset.

[FITR ¶87-685 – ¶87-720]

¶17-720 Offsetting balancing charge for involuntary disposals

A balancing adjustment offset is available for certain involuntary disposals. An involuntary disposal arises where plant is lost or destroyed (including stolen: ID 2002/782), or an Australian government agency acquires it compulsorily or by forced negotiation (ITAA97 former ss 42-293(2); 40-365).

In addition, the offset is available: (a) where a private acquirer compulsorily acquires an asset through recourse to a statutory power other than a compulsory acquisition of minority interests under company law; or (b) where a landowner whose land is compulsorily subject to a mining lease (or is subject to a mining lease in the shadow of compulsion) sells the land to the lessee and acquires a replacement asset, if the lease would significantly affect the landowner's use of the land. This concession does not extend to initial exploration licences or retention licences.

Under the offset rules, the balancing adjustment amount is not included in assessable income and is instead applied to reduce the cost (¶17-080) and the opening adjustable value (¶17-485) of the replacement asset (in years later than the year in which the replacement asset is first used or installed ready for use for any purpose).

The expenditure on the replacement asset must be incurred no earlier than one year before the time of the disposal of the asset and no later than one year after the end of the income year in which the disposal occurred. The Commissioner can agree to extend the time limit. At the end of the year in which the taxpayer starts holding the replacement asset or incurs the expenditure, the replacement asset must be used wholly for taxable purposes (¶17-010). Where there are 2 or more replacement assets, the offset amount must be apportioned between those items on the basis of their cost for capital allowance purposes.

The balancing adjustment offset for replacement plant for disposals that are not involuntary no longer applies (ITAA97 former s 42-290; ITTPA s 40-295).

[FITR ¶87-730]

Partial Change of Ownership

¶17-780 Disposal taken to occur on partial change of ownership

If there is a partial change in the holding of, or in interests of entities in, a partnership asset or in an asset that becomes a partnership asset (eg where a partnership is created, varied or dissolved), an adjustment may be required under the balancing adjustment rules (ITAA97 ss 40-285; 40-295(2)). This applies where at least one entity that had an interest in the asset before the change, has an interest in it after the change.

Unless a joint election for roll-over relief (¶17-710) is made by both the transferor(s) and the transferee(s), the termination value (¶17-640) of the asset for balancing adjustment purposes and the cost (¶17-100) to the transferee is the market value of the asset at the time of the change (ITAA97 ss 40-180; 40-300).

▶ Example

Mel and Liz, who have carried on a partnership together, admit John as a third partner, selling John 50% each of their interests in the partnership assets including depreciating assets. The partnership agreement indicates that the value attributed to the depreciating assets is $1,800 which is also the market value. If the cost of those assets to Mel and Liz was $2,000 and the decline in value of the assets up to the date of the new agreement was $1,600, there is an assessable balancing adjustment of $1,400 (ie the termination value of $1,800 less the adjustable value of $400) for the partnership of Mel and Liz, and further deductions for the decline in value of the assets of the partnership of Mel, Liz and John are based on a cost of $1,800 (assuming a joint election for roll-over relief is not made).

[FITR ¶87-540]

It is not necessary to demonstrate that a taxpayer is ''carrying on a business'' in order to access the deduction or that the amount paid is of a revenue nature. Failing to plant all of the trees under a forestry MIS means no Div 394 deduction is allowable for the investor's initial contribution. However, a deduction may be available under s 8-1. The initial investor's sale and harvest proceeds are treated as assessable income on revenue account.

Payments under the scheme exclude payments for financing (borrowing costs and interest and payments in the nature of interest), stamp duty, GST and processing forestry produce, for example in-field wood chipping or milling of logs, whether in-field or at a static facility.

Where an initial investor disposes of interests within 4 years, any deductions will be denied in the income years claimed. However, an investor does not fail the 4-year holding period rule if interests are disposed of within 4 years for reasons genuinely outside their control. Examples include: insolvency or accidental death; compulsory transfer of the scheme interest on marriage breakdown; compulsory government acquisition; the insolvency of the scheme manager causing the winding up of the scheme. The investor must not reasonably have been able to anticipate the circumstances when the investment was made.

Where a business is or was being carried on, the amount paid may be allowable under s 8-1. A market value pricing rule applies for disposals of forestry schemes interests by initial investors. Amounts received by initial and secondary investors for thinnings are assessable income on revenue account.

A secondary investor (ie an investor who acquires an interest in the scheme from another investor, eg by purchasing the interest from the initial investor on the secondary market) cannot claim a deduction under Div 394 for the cost of their interest but can claim a deduction for ongoing contributions under the scheme. The secondary investor's proceeds from sale and harvest are deemed to be held on revenue account to the extent that they ''recoup'' prior forestry deductions and the balance is deemed to be held on capital account (with the cost base increased to reflect the income deemed to be held on revenue account), provided that the secondary investor does not hold the forestry scheme interest as an item of trading stock. The measures allowing trading in forestry interests apply to interests in a pre-existing forestry MIS as well as future investment in newly established schemes. Therefore taxpayers who invested in a forestry MIS before 1 July 2003 may trade their interest from 1 July 2007.

If a scheme manager receives an amount from an investor and all of the requirements of s 394-10 are satisfied, the amount must be included in the scheme manager's assessable income in the year in which the investor is first able to claim the corresponding deduction (ITAA97 s 15-46).

If a taxpayer would be eligible for deductions under both s 8-1 and Div 394, the taxpayer may claim a deduction only under Div 394. If a forestry scheme does not qualify under Div 394, s 8-1 may continue to apply. If the new forestry provisions apply, the prepayment provisions (¶16-045) do not apply. The new arrangements do not apply for investments in non-forestry agribusiness MISs (¶18-020).

There are notification requirements for scheme managers (TAA 1953 s 394-5) and record keeping requirements for investors and scheme managers (ITAA36 s 262A). PS LA 2008/2 guides tax officers dealing with product ruling applications in relation to Div 394 and considering the 70% direct forestry expenditure rule, the arm's length pricing rule, net present value calculations and the 18-month establishment rule.

[FITR ¶363-000]

Abnormal Receipts

¶18-135 Primary production abnormal receipts

Special provisions apply to abnormal receipts relating to double wool clips (¶18-140), insurance recoveries for live stock and timber (¶18-150), and the forced disposal or death of live stock (¶18-160). Various elections apply in relation to the abnormal receipt provisions (see below).

Where an entity joins or leaves a consolidated group under the consolidation regime (¶8-000), amounts of assessable income spread over 2 or more years are split between the entity and the head of the group based on the period spent by the entity in the group (ITAA97 s 716-15: ¶8-580).

Elections

The elections available to a primary producer relating to abnormal receipts must be made on or before the date for lodging the first return where the effect of the election will be relevant or within any extended period allowed by the Commissioner (ITAA97 s 385-150). Where a partnership or trustee carries on a primary production business, only the partnership or trustee can make the election. Where a new partnership carries on the primary production business of a partnership that has ceased to exist, the new partnership can elect to be treated as a continuation of the old partnership and obtain the benefit of elections made by the old partnership, if the new partners together are entitled to 25% of the income and were partners in the old partnership (ITAA97 s 385-165; ID 2005/275). As to elections generally, see ¶24-040.

If a ''disentitling event'' happens, that is, if a taxpayer becomes bankrupt, leaves Australia permanently or ceases to carry on the primary production business, the assessable income in the year of bankruptcy, etc, includes the balance of the proceeds of disposal or death of livestock (¶18-160), of the insurance recovery for loss of live stock or trees (¶18-150), or of the proceeds of sale of 2 wool clips (¶18-140). If an election was made under ITAA97 s 385-110 (¶18-160), the unused tax profit on the disposal or death of the live stock is included in assessable income (ITAA97 s 385-160). The Commissioner has a discretion to ignore a disentitling event that happens to the beneficiary of a primary production trust (ITAA97 s 385-163).

[FITR ¶355-595]

¶18-140 Double wool clips

A measure of tax relief from the consequences of an advanced shearing caused by drought, fire or flood is available to primary producers carrying on a sheep grazing business in Australia (ITAA97 s 385-135).

A woolgrower may elect to have the assessment of the profit from the advanced shearing deferred to the succeeding income year where the effect of such an advanced shearing is that the grower's assessable income in the year of income would otherwise include:

- the proceeds of sale of 2 wool clips from shearings in that year, or
- the proceeds of sale of the advanced shearing in that year, plus the proceeds of the previous year's clip if its opening value taken in at the beginning of the year was at *cost price*.

The profit is the gross proceeds of the advanced shearing less the expenses directly attributable to the advanced shearing *and* sale that were incurred in the year in which the gross proceeds of the advanced shearing were receivable. These expenses include wages paid to shearers, classers and shed hands, payments to shearing contractors, and the costs

Under Australia's double taxation agreements, certain classes of income are deemed to be sourced in one or other country (¶22-150). In other cases, the source is undefined and falls to be determined under the laws of each country, which may or may not be the same.

[FITR ¶28-500]

¶21-070 Source of particular classes of income

Except where there is a specific statutory provision, determining the dominant source of an item of income is a practical, hard matter of fact to be determined separately in each case — the general comments below are intended merely as a guide.

Wages or salary, professional fees

The source of remuneration under a normal contract of employment or contract for services is generally the place where the duties or services are performed (*French*). If, however, creative powers or special knowledge is involved to such a high degree that the place where those powers or knowledge are utilised is relatively unimportant, the dominant source may be the place where the contract was made (*Mitchum*). In *Efstathakis' case*, salary paid by the Greek Government to a Greek national working in Sydney at the Greek Press and Information Service was taken to have an Australian source. Although the circumstances under which the taxpayer's employment was obtained, and the remuneration paid, included some factors occurring outside Australia, they were not significant enough to outweigh the importance of other factors relating to the employment which took place in Australia. In *Case X78*, a US resident was assessed on a payment made by his US employer of the tax payable on the salary he had received while working in Australia on secondment in the previous year of income. The AAT held that the payment was exempt income on the basis that the taxpayer derived the income at a time when he was a non-resident, and the source of the income was the US because the legal liability to make the payment arose from the taxpayer's employment contract which was entered into in the US.

An employment termination payment is more similar to a payment of compensation than a payment for services. Therefore, the most relevant factors in determining its source are where the liability to make the payment arose and where it was paid from, rather than where the services were performed.

Trading or business profits

The source of trading or business profits is generally determined by reference to the place where the trader (or its employees or agents) trades or renders services. Where the relevant acts consist largely of the making of contracts, and the place of their performance is unimportant, the place where the contracts are made may be the only significant determinant of source. Conversely, if the making of the contract is of little importance and the chief factor is its performance, then the place where the contract is performed may be the only relevant factor in determining source (*Thorpe Nominees*). The ATO considers that it is important to consider the substance of the transaction as a whole, particularly where it is plain that a transaction has been structured so as to avoid tax in Australia. In the case of a leveraged buyout arrangement, for example, the ATO does not consider the place of execution of the contracts to be determinative (TD 2011/24).

On this basis, income received by a Vanuatu-based insurance company was held *not* to have an Australian source where the insurance contracts were made and performed in Vanuatu, notwithstanding the taxpayer's close links to Australian companies (*Crown Insurance Services Ltd*). In contrast, income from trading in Australian-listed shares by a Vanuatu-based trader was held to have an Australian source, even where the transactions were conducted off-market, where the trading contracts were completed in Australia (*Picton Finance*).

Interest

The source is generally the place where the obligation to pay the interest arose, ie where the loan contract was made or the credit was given. The place where payment is to be made is also relevant. In *Spotless Services*, interest was paid to an Australian resident company by a Cook Islands bank on funds deposited against a certificate of deposit issued by the bank in the Cook Islands. However, the deposit was preceded by, and was dependent on, security being obtained for the deposit from a bank in Australia in the form of an irrevocable letter of credit. The Commissioner argued that the interest had its source in Australia from where all of the dealings between the parties originated and the contract for the letter of credit was made. However, the Full Federal Court identified the certificate of deposit as the crucial document and concluded that the interest had its source in the Cook Islands.

The source of tax indemnification payments made by a borrower to a non-resident lender will depend on where the contract is made and performed, the residence of the payer, the place and source of the payments and the reason the payment is made (TR 2002/4).

Dividends

The source of a dividend is not the location of the share register on which the shares giving rise to the dividend are effectively registered, but where the company paying the dividend made the profits out of which the dividend is paid (*Esquire Nominees*).

Royalties

If royalties are received in respect of property, such as a patent, trade mark, design, etc, or mine, owned by the recipient in the country from which the royalty flows, the source of those royalties will generally be that country. If received for technical know-how and services supplied outside that country under an agreement made outside that country, the source of those royalties would generally be outside that country. Note, however, that all ''royalty'' income derived by non-residents is deemed to have an Australian source to the extent that the payment is an outgoing of an Australian business (ITAA36 s 6C) and may therefore be subject to withholding tax when paid by a resident (¶22-030).

Pensions and annuities

The ATO treats the location of the fund from which a pension is paid as the source of the pension. On the other hand, it regards the source of an annuity payable under a contract to be the place where the contract was executed.

Income derived by residents of Norfolk Island

From 1 July 2016 the Australian taxation system applies to Norfolk Island resident individuals, companies and trustees in the same way it applies in mainland Australia with the exception of indirect taxes, including GST (¶10-640).

Natural resource payments to non-residents

Income derived by non-residents which is directly related to the development and exploitation of Australia's natural resources is treated as having a source in Australia where the payments of natural resource income are based on the level of production and recovery of natural resources (ITAA36 s 6CA).

The provisional views of the ATO on the application of s 6CA and the real property tax treaty articles to ''override royalties'' (payments made by the holder of a mining right based on the value of natural resources produced and/or sold) are given in *Draft* TR 2016/D3.

[FITR ¶28-520 – ¶28-620]

Withholding payment	How much to withhold
Withholding of GST from certain real estate supplies	1/11th of the contract price. If the margin scheme applies, 7% of the contract price (or such percentage as has been determined by legislative instrument).
FHSS released amounts	The amount of tax that the Commissioner in estimates will be payable by the individual in relation to the assessable FHSS released amount for an income year or If the Commissioner is unable to make an estimate — 17% of the individual's assessable FHSS released amount for an income year.

Commissioner's power to vary amounts to be withheld

The Commissioner may vary the amount to be withheld (including to nil) for the purposes of meeting the special circumstances of a particular case (TAA Sch 1 s 15-15). ''Special circumstances'' usually only arise where the payee's final liability for all income types for that year does not justify the standard withholding rate. Taxpayers who wish to request a variation can do so using the form available from the ATO website (PAYG withholding variation application). For foreign entities, the Commissioner may use this discretion to reduce the rate of withholding to nil if the relevant income is not assessable in Australia, or to reduce the rate of withholding to a more appropriate level, where the prescribed withholding rates are excessive in comparison to the amount of tax which will ultimately be payable by the foreign entity (PS LA 2006/10).

However, the Commissioner cannot vary a withholding amount in relation to an investment where the investor does not quote a TFN (or an ABN), employee share schemes where an employee does not quote a TFN or an investor becomes presently entitled to income of a unit trust. This is because the rate of withholding for those events is designed as a sanction. Further, the Commissioner's power to vary the withholding rate will generally not be relevant to a natural resource payment because, in that case, the Commissioner sets the rate of withholding on a case-by-case basis and is able to take into account any special circumstances affecting the recipient as part of that process.

A variation must be made by a written notice given to each entity affected. In the case of a class of entities, a copy of the notice may be published in the *Commonwealth Gazette*. Details of current variations are discussed in the relevant withholding payment.

▶ Planning point

A salaried individual who is entitled to significant deductions during an income year (eg if he/she enters into a negatively geared investment) may ask the ATO to vary the PAYG withholding rate, thus increasing take-home pay. It would, of course, be an offence to knowingly or recklessly make a false or misleading statement in a variation request (¶29-700).

[FTR ¶976-785, ¶976-795]

¶26-150 PAYG: payments for work or services

Employees

An entity that pays salary, wages, commission, bonuses or allowances to an individual as an employee must withhold an amount from the payment (TAA Sch 1 s 12-35). The individual may be an employee of the payer or of another entity. ''Employee'' in the PAYG system has its ordinary meaning (TR 2005/16). Whether a person is an employee of another is a question of fact to be determined by examining the terms and circumstances of the contract between them, having regard to the key indicators expressed in the relevant case law. Withholding may be required, not only from payments of salary or wages made to an employee as such, but also where there is a constructive payment of salary or wages to an employee.

An employer will be required to withhold an amount from a contribution to the trustee of an employee remuneration trust (ERT) when the contribution constitutes a payment of salary, etc, that is not exempt income or non-assessable non-exempt income (TR 2018/7). A trustee of an ERT that makes a payment to an employee (or deals with an amount on the employee's behalf or as the employee directs) of salary, etc, that is not exempt income or non-assessable non-exempt income must also withhold an amount. Where an employee has entered into an employee benefits trust arrangement in which bonus units are issued to the employee that are considered to be salary or wages, the trustee must withhold an amount from the payment (TR 2010/6).

Resident employers that have employees working in a foreign country may have withholding obligations. Foreign earnings that do not meet any of the exemption conditions (¶10-860) are assessable income and subject to PAYG withholding.

A non-resident employer can be subject to PAYG withholding in respect of Australian resident employees working overseas (TD 2011/1). A non-resident employer who pays an Australian resident for work performed overseas is subject to withholding obligations if the non-resident employer has a sufficient connection with Australia, ie if the non-resident carries on an enterprise or income-producing activities in Australia and has a physical presence in Australia.

Employees at common law

For a payment to be made to an employee, there must be a contract *of service* (formerly referred to as a ''master/servant'' relationship) between the payer and the payee. This exists where one person contracts to perform work for another and is substantially subject to the control and direction of that person in the manner in which the work is done. This is the basis of the employer/employee relationship at common law, as distinct from a principal/independent contractor relationship involving a contract *for services*.

The following persons have been found to be employees:

- certain land salespersons paid by way of commission only and over whom no detailed control was exercised (*Barrett*)
- workmen, and a supervisor, paid by the proprietor of a painting and decorating business (*Glambed*)
- lecturers in the Weight Watchers organisation who were under contractual obligations as to the manner in which the lectures were to be conducted and the information that was to be imparted (*Narich*)
- interviewers engaged by a survey research company and given very detailed instructions on how to proceed (*Roy Morgan Research Centre*)
- delivery drivers working for the taxpayer that had contracted with another company to make its bakery deliveries (*Trustee for the Farant Family Trust*).

However, consultants who sold a company's cosmetic products at private houses under a party plan system were not employees (*Mary Kay Cosmetics*).

The distribution of profits of a business to employees on the basis of their worth to the company were ''wages'' for payroll tax purposes even though they were paid pursuant to directions in the will of the founder of the business (*George Adams Estate Trustees*).

An employer may seek to change the status of an employee to that of an independent contractor by including a clause to that effect in the contract of engagement. However, that clause will have no effect if it does not reflect the true nature of the relationship under the contract as a whole. If the terms of the relationship (such as leave entitlements and other employee benefits) are not changed, it is likely that the worker's status would remain that of an employee (TR 2005/16).

- payments to entertainers and sportspersons who are USA residents for entertainment and sports activities carried on in Australia where the combined payments from such activities do not exceed US $10,000 (or its Australian dollar equivalent) for the relevant income year (*Legislative Instrument* F2014L00379).

[FTR ¶976-695 – ¶976-697]

¶26-267 PAYG: distributions of withholding MIT income

Withholding also applies to certain distributions (''fund payments'') from ''withholding MITs'' (Subdiv 12-H). Liability to this withholding tax is imposed under ITAA97 Div 840 (¶22-045). If there is no underlying liability to managed investment trust withholding tax, then there is no obligation to withhold.

Withholding MIT

A trust is a ''withholding MIT'' (s 12-383) if it is a managed investment trust (within the meaning in ITAA97 s 275-10(1)(a) or (2): see ¶12-660) and a substantial proportion of the investment management activities carried out by the trust in relation to certain assets are carried out in Australia throughout the income year. The relevant assets are all of the trust's assets that are, at any time in the income year:

- situated in Australia
- taxable Australian property (¶12-725), or
- shares, units or other interests listed on an approved Australian stock exchange.

Further, an AMIT (¶26-268) which only makes deemed payments and not cash distributions can be a withholding MIT if the other requirements are satisfied.

Fund payment

A fund payment is defined in TAA Sch 1 s 12-405 and is basically a component of a payment made by the trustee of a withholding MIT that, in effect, represents a distribution of the net income of the withholding MIT, disregarding:

- dividend, interest or royalty income subject to PAYG withholding
- capital gains and losses from a capital gains tax asset that is not taxable Australian property
- amounts that are not from an Australian source, and
- deductions relating to any of those amounts.

A fund payment must be made during the income year, within 3 months after the income year or within a longer period if agreed to by the Commissioner (but not exceeding 6 months from the end of the income year).

Section 12-405 generally applies to a trust that is not an AMIT; the meaning of ''fund payment'' for AMITs is contained in TAA Sch 1 s 12A-110 (¶26-268).

When withholding is required

For withholding to apply, the recipient of the fund payment must have a relevant connection outside Australia. This will occur if either: (i) according to any record in the payer's possession, the recipient has an address outside Australia; or (ii) the payer is authorised to make payment at a place outside Australia. This connection does not exist in relation to payments made to a recipient that carried on business in Australia at or through an Australian permanent establishment and the payment is associated with that establishment.

If the payer does not have an obligation to withhold at that time, it may have an obligation to give a notice to the recipient or make certain information available on a website in respect of the payment. The obligation to give a notice or make information available on a website will continue through a chain of entities until the obligation to withhold is triggered.

Where a foreign resident invests in a withholding MIT through an interposed entity (a custodian), the custodian is required to withhold from a payment it makes where:

- the payment is reasonably attributable to a payment received by the custodian that was covered by a notice or information that was made available on a website, and
- the recipient of the payment has a relevant connection outside Australia.

Withholding is not required in respect of a payment made by a corporate custodian unless the custodian is acting in the capacity of a trustee or as an agent for a principal. For this purpose, both a public trading trust and a corporate unit trust is a company.

A non-custodian is required to withhold an amount where:

- the non-custodian receives a payment, all or part of which is covered by a notice or information made available on a website, and
- a foreign resident is, or becomes entitled to, an amount attributable to the payment received by the non-custodian.

Amount to be withheld

If the place, address or country of residence of the recipient is in a jurisdiction with which Australia has effective exchange of information on tax matters (¶22-165), withholding is required at the rate of:

1. 30% for fund payments to the extent that they are attributable to non-concessional MIT income (see below), or
2. If 1 does not apply, 10% for fund payments to the extent that they are, or are attributable to, fund payments from a clean building MIT (see below), or
3. If 1 and 2 do not apply, 15%.

If the place, address or country of residence of the recipient is ***not*** in a jurisdiction with which Australia has effective exchange of information on tax matters, withholding is required at the rate of 30%.

Information exchange countries are specified in TAR reg 34.

Where a non-custodian is a trust that is required to withhold an amount and that trust has a different year end to the withholding MIT to which the payment relates, then the amount that is required to be withheld is calculated by reference to the withholding rate that corresponds to the income year of the withholding MIT to which the fund payment relates, not the resident trust's income year in which the beneficiary's entitlement arises (ID 2013/63).

Withholding from clean building MITs

A final withholding tax at the rate of 10% applies to fund payments from eligible clean building MITs that are made to foreign residents in information exchange countries. An eligible clean building MIT is a withholding MIT that holds one or more clean buildings (TAA Sch 1 ss 12-425; 12-430). These are new energy efficient buildings for which construction began on or after 1 July 2012 and must be office buildings, hotels or shopping centres, or a building consisting of a combination of these. The building must meet and maintain at least a 5-star Green Star rating as certified by the Green Building Council of Australia or a 5.5-star energy rating as accredited by the National Australian Built Environment Rating System. Land on which the clean building is a fixture is also

A negative validation notice is not a notice that the TFN quoted by the recipient is invalid. This is because a validation notice is not a notice under ITAA36 s 202CE(3) as that section relates exclusively to TFNs stated in a TFN declaration. If the Commissioner is unable to validate the information, then the employer can seek further information from the employee to resolve any discrepancies. The Commissioner may provide an electronic interface to receive information and give a notice.

Withholding declarations

A person who expects to receive a payment for work or services, a retirement payment, annuity, benefit or compensation payment, or an alienated personal services payment, and who wishes a matter relating to the person's income tax or certain other liabilities to be taken into account in working out the amount to be withheld from the payment, may give the payer a withholding declaration about the matter (TAA Sch 1 s 15-50). The declaration must be in the approved form (see further the ATO website Withholding declaration (NAT 3093)).

An individual may only make a withholding declaration if he/she has given the payer a TFN declaration or has entered into a voluntary agreement. A withholding declaration may also be used to change any information given in a TFN declaration. A withholding declaration can only be given about a particular matter to one payer at any given time.

Section 15-50(1)(b) lists the matters that may be taken into account in working out the amount to be withheld are any matters relating to the individual's liability to:

- income tax
- the Medicare levy, and
- repayments of accumulated higher education and trade support loans.

A payer must take the information in the declaration into account when working out how much to withhold. Where the payee's circumstances change in relation to a prescribed matter, the payee must provide a new withholding declaration (TAR reg 56).

[FTR ¶976-805]

Payer's Obligations

¶26-450 Obligation to withhold

If an entity is required to withhold an amount from a cash payment, it must do so when making the payment (TAA Sch 1 s 16-5). The provider of a non-cash benefit must pay the required amount to the Commissioner before providing the benefit.

If the obligation to withhold arises as a result of an investor becoming presently entitled to the income of a unit trust, the amount must be withheld at the time the investor becomes presently entitled.

If an entity is required to withhold an amount from a payment received by it, the entity must do so immediately after receiving the payment. Where a dividend, interest or a royalty is received for a foreign resident, an amount must be withheld either immediately or when the foreign resident becomes entitled to the payment (¶26-250).

Discharge of liability

An entity that withholds an amount (or pays to the Commissioner an amount associated with alienated personal services income or a non-cash payment) is discharged from all liability to pay or account for that amount to any entity except the Commissioner (TAA Sch 1 s 16-20). However, the entity may be required to refund the amount in some circumstances (¶26-680).

No deduction if amount not withheld

For certain payments and non-cash benefits, no deduction is allowed for the payer where the payer has not complied with the PAYG withholding requirements (s 26-105). This applies to a payment:

- of salary, wages, commissions, bonuses or allowances to an employee (¶26-150)
- of directors' fees (¶26-150)
- to a religious practitioner (¶26-150)
- under a labour hire arrangement (¶26-150), or
- for a supply of services where the payee has not quoted its ABN (excluding supplies of goods and supplies of real property) (¶26-220).

Withholding an incorrect amount will not affect the entitlement to a deduction. The payer will be entitled to a deduction if, in the original income year, the payer voluntarily notifies the Commissioner, in the approved form, of the mistake before the Commissioner commences an audit or other compliance activity. An employer will also not be denied a deduction if it honestly, but mistakenly, believes an employee is a contractor and has complied with the no ABN withholding rule.

[FTR ¶976-820, ¶976-825]

¶26-500 Obligation to pay: determining PAYG withholder status

The rules for when a withheld amount must be paid to the Commissioner depend on whether the "withholder" is a large, medium or small withholder. To determine an entity's status for a particular month, apply the following tests.

Withholder status	Test to be satisfied
Large (TAA Sch 1 s 16-95)	• it was a large withholder for June 2001 • the amounts withheld during a financial year ending at least 2 months before the current month exceeded $1m • at the end of a financial year ending at least 2 months before the current month, the entity was a member of a wholly-owned group of companies and the amounts withheld by those companies during that year exceeded $1m, or • the Commissioner determines that the entity is a large withholder.
Medium (TAA Sch 1 s 16-100)	It is not a large withholder and: • it was a medium withholder for June 2001 • the amounts withheld during a financial year ending before the current month exceeded $25,000, or • the Commissioner determines that the entity is a medium withholder.
Small (TAA Sch 1 s 16-105)	It has withheld at least one amount during the month and it is neither a large nor a medium withholder for that month.

Commissioner may vary an entity's status

The Commissioner may make a determination varying an entity's status either upwards or downwards (TAA Sch 1 ss 16-110; 16-115). The determination must be in writing and must state that the determination applies for specified months. The Commissioner may revoke or vary any such determination.

In making a determination varying an entity's status upwards, the Commissioner may have regard to:

Other cases

For all other determinations, notices or decisions, a *60-day* objection limit applies.

Calculating the objection period

An objection must actually be physically *received* by the Commissioner within the relevant objection period and is not considered as lodged until that occurs. The *first* day of the objection period is the day *after* the date of service of the notice of assessment (or taxation decision) or, in the case of companies, superannuation funds, ADFs and PSTs, the date of deemed service of the deemed notice of assessment (¶25-110). In practice, there should be some evidence of the date of service (or deemed service) of the assessment (such as a contemporaneous diary note or stamping the date of receipt on the assessment notice) and of the date when the objection notice was lodged.

Days that are not business days (ie Saturdays, Sundays, public and bank holidays) are counted in calculating when the objection period begins and ends. However, if the *last* day of the objection period is not a business day, the objection may be lodged on the next business day.

▶ Example 1

An individual taxpayer, Tom, is notified via a message on myGov that a notice of assessment for the 2017–18 income year, dated 8 December 2018, is available on myTax. The first day of the 2-year objection period is 9 December 2018 and that period would expire at midnight on 10 December 2020. An objection would have to be received by the Commissioner by that time and, therefore, an objection posted on or before midnight on 10 December 2020, but not received by the Commissioner until after that date, would be out of time (although an extension of time may be granted: ¶28-030).

▶ Example 2

A notice of assessment for the 2014–15 income year is served on a business taxpayer that is not a small business entity on 6 September 2016. Following an audit of the taxpayer's affairs, an amended assessment for that year is served on the taxpayer on 9 November 2017. The taxpayer is required to lodge an objection to the amended assessment by midnight on 6 September 2020, ie 4 years after the notice of the original assessment was served on the taxpayer (although an extension of time may be granted: ¶28-030).

If the notice of the amended assessment is served on the taxpayer on 9 August 2020, the taxpayer would be required to lodge the objection by midnight on 8 October 2020, ie 60 days after service of the notice of the amended assessment. If the assessment is further amended and notice of the further amended assessment is served on the taxpayer on 16 December 2020, the objection to the further amended assessment would have to be lodged by midnight on 14 February 2021, ie 60 days after service of the notice of the further amended assessment (although an extension of time may be granted: ¶28-030).

[FTR ¶972-830]

¶28-030 Extensions of time to object

An objection lodged outside the relevant period (¶28-020) cannot be considered unless an extension of time is granted. A taxpayer who is out of time should lodge the objection with the Commissioner *together with* a written application requesting him to deal with the objection as if it had been lodged in time. The application must provide full details of the reasons why the objection was not lodged in time (TAA s 14ZW(2), (3)). The Commissioner has the discretion to refuse or grant the application and must give the taxpayer written notice of the decision. Where an application for an extension of time is granted, the objection is taken to have been duly lodged within the relevant period (TAA s 14ZX). If the Commissioner refuses to grant an extension of time, the taxpayer must be notified of the right to have the decision reviewed by the AAT (*Administrative Appeals Tribunal Act 1975* (AAT Act), s 27A: ¶28-070).

Factors taken into account

The taxpayer bears the onus of establishing why an extension of time should be granted. The taxpayer should establish that the objection and the application for an extension were lodged as soon as circumstances reasonably permitted and must have an acceptable explanation for the delay (eg *Windshuttle*; *Case 36/94*). According to PS LA 2003/7, relevant factors to be taken into account by the Commissioner include:

- the reasons for the delay (eg the taxpayer's illness or absence overseas, postal delays, legislative amendments, new case law or rulings, and incorrect tax advice or misleading conduct by the ATO are all examples of where an extension of time may be appropriate)
- the circumstances of the delay, including whether the taxpayer took steps to inform the Commissioner that the decision in question was to be contested
- whether the taxpayer has an arguable case
- any prejudice to the Commissioner in granting an extension (eg the lapse of time may give rise to evidentiary difficulties if documents have been destroyed)
- evidence of negligence on the part of the taxpayer's tax agent.

Where an individual or STS taxpayer has a 2-year time limit for lodging an objection against an income tax assessment under s 14ZW(1), the Commissioner will generally accept a request for an extension of time to lodge an objection if it is received within 4 years after the original notice of assessment was given to the taxpayer and the objection discloses an arguable case for allowing the objection (PS LA 2003/7).

Appeal to AAT

A taxpayer who is dissatisfied with the Commissioner's decision to refuse an extension of time may have the decision reviewed by the AAT (s 14ZX(4)). An application for review must be made to the AAT and lodged within 60 days of the decision being furnished to the taxpayer (or such further time as may be allowed). An application fee is payable, subject to certain exceptions (¶28-085). The application is not taken to be lodged unless the prescribed fee (if any) is paid. A taxpayer seeking a review is entitled to request the Commissioner supply a statement of reasons for the decision refusing the extension (AAT Act s 28).

Given the wide discretion conferred by s 14ZX(1), a degree of inconsistency in the case law has evolved. However, the AAT will generally assess the evidence against the 4 considerations outlined in *Brown*, ie the taxpayer's explanation for the delay, the circumstances attendant upon that delay, whether the taxpayer has an arguable case, and such other matters as the circumstances of the case make relevant.

The merits of the substantive application may be properly taken into account in considering whether an extension of time should be granted. An insurance company was allowed an extension of time to lodge an objection nearly 4 years after the expiry of the objection period because it had an arguable case (based on rulings issued after the lodgment of its return) and the complexity of the objection meant that a lengthy delay was not unreasonable (*Case 15/96*). Similarly, a medical centre operator was allowed an extension of time to lodge an objection to claim deductions for earlier income years after a successful ''test case'' objection for a later income year (*Primary Health*).

Taxpayers who fail to provide an acceptable explanation for the delay in seeking a review of the objection decision are likely to be refused an extension of time (eg *Zizza*). However, this is not always the case (eg *Case 4/2000*). The weight to be given to various factors is a matter of fact for the AAT to determine. An inappropriate decision about the weight to be given to a finding about a particular factor is not an error of law (*Zizza*).

¶31-270 Delaying the derivation of income

Cash versus accruals basis

In determining when income is derived, different rules apply to different kinds of income and different kinds of taxpayers. For example, it seems that a sole practitioner is assessable on a receipts (or cash) basis, whereas a large professional firm (eg of accountants or solicitors) is assessable on an earnings (or accruals) basis (¶9-030).

In most instances, the tax planner will wish to ensure that professional clients and others in a similar position commence to return their income on a receipts basis and continue to do so for as long as possible, since this will provide an effective deferral of tax payable (¶31-120).

The Commissioner's guidelines on whether the receipts or earnings method applies are set out in TR 98/1. Note also the views (in TR 96/20 and TD 96/45) on the assessability and deductibility of prompt payment discounts (¶9-050). For example, there may be cases where the full invoice price, which is considered to be assessable at the time of sale, is returned in one income year while the discount, which is considered to be deductible when the account is settled, is not claimed as a deduction until the following year.

Services provided over period

The decision in the *Arthur Murray case* (¶9-090) has been the basis of arrangements designed to confer immediate deductions on one taxpayer (eg by the payment of a management charge) while the recipient returns the income over the period during which the income is said to be earned (ie as the services are provided). From a commercial point of view, the viability of such arrangements may depend on the accounting treatment of the payments and on what will happen if the services are not in fact performed.

In considering such arrangements, it is necessary to take into account not only the general anti-avoidance provisions of ITAA36 Pt IVA, but also the various prepayment rules (¶16-045, ¶16-110). ITAA36 Div 16E (ss 159GP to 159GZ) is also designed to match the assessability and deductibility of payments (other than periodic interest) on qualifying securities, thus overcoming potential mismatch opportunities arising from the *Australian Guarantee Corporation case* (¶23-320).

The TOFA regime provides rules for taxing gains and losses arising on certain financial arrangements (ITAA97 Div 230). The rules generally apply to large taxpayers but their scope is not limited to these taxpayers (¶23-020).

Instalments of profit

In *Thorogood's case*, it was held that the profit on the sale of certain land, where the purchase price was payable by instalments over a period, was derived only over the term of those instalment payments. The principle recognised in this case may be utilised by a taxpayer who anticipates that the profit on a sale of property would be assessable income under ITAA97 s 6-5 (¶10-112). Note *Gasparin's case* (¶9-170), where blocks of land ceased to be trading stock of a developer on settlement of the contracts of sale and not when the contracts became unconditional (which was before settlement). Where the arrangement is commercially justifiable, a taxpayer may arrange to sell the relevant property on terms to an appropriate recipient, eg a trust or company, with the recipient subsequently making the sale to the ultimate purchaser on terms that result in little or no profit to the recipient. The taxpayer then returns in each year only that proportion of the total profit that is appropriate to the instalments received in that year from the interposed recipient. However, the Commissioner does not agree to the spreading of profit in this manner where the disposal occurs in the course of carrying on a business. Further, the CGT provisions may apply even if the profit is not assessable under s 6-5.

Where there is a disposal of property under an instalment contract and the CGT provisions apply, it is important to remember that the whole of the capital gain accrues to the vendor in the income year in which the disposal occurs, ie usually the income year in which the contract is entered into.

Trading stock valuation options

By taking advantage of the option conferred by ITAA97 s 70-45 in relation to the valuation of trading stock on hand at the end of an income year, a taxpayer may adjust the respective taxable incomes of that year and the succeeding year (¶9-180). It is normal practice to value stock on hand at the end of the year at the lower of cost or market selling value, effectively postponing the taxation of any increase in the value of stock on hand.

Where there is a change in ownership of, or interests in, trading stock (eg on the formation or dissolution of a partnership), there is a notional disposal of the trading stock at market value (ITAA97 s 70-100). However, where there is at least a 25% continuing interest, the capacity of the old and new owners to elect to value the trading stock at its tax value (¶9-295) may enable there to be a derivation of profits on a notional sale of the entirety of trading stock.

Small business taxpayers are subject to modified trading stock provisions (¶9-170).

Disposal of depreciating assets

Roll-over relief may be available where a change occurs in the ownership of, or in interests of persons in, depreciating assets, eg where a partnership is created, varied or dissolved (¶17-780). The disposal of depreciated plant for a consideration in excess of its cost may, in appropriate circumstances, give rise to income, eg where the taxpayer trades in that kind of property and the disposal in fact occurs as part of the conduct of the business (¶17-630).

Capital gains

A capital gain (or loss) accrues in the income year in which the disposal of an asset occurs, ie regardless of whether any of the consideration for the disposal has been received. Where an asset is disposed of under a contract, the time of the disposal is the time of the making of the contract. For example, land is generally disposed of at the time the contract of sale is made, although the gain (or loss) is not returned until the change of ownership actually occurs (eg on settlement). Thus it is not possible to spread the derivation of a capital gain.

This should be taken into account when considering the disposal of an asset in circumstances involving the provision of vendor finance to the purchaser (¶11-250).

Methods of Diverting Income

¶31-280 Overview: diverting income

A common method of tax planning has been to ''divert'' income from a taxpayer who bears tax at high rates (the high rate taxpayer) to one who is taxed at low rates or not at all (the low rate taxpayer). Some methods by which income might be diverted are:

- the alienation of income or the transfer of the right to receive it (¶30-900)
- channelling of an individual's income from personal services into a ''business'' structure such as a company, partnership, trust or contractual arrangement, to facilitate income splitting and access to business deductions (for counter measures, see ¶30-600)
- the transfer of income-producing assets (¶31-290)

If the Board grants an application for registration, the Board may give a written notice requiring the maintenance of professional indemnity insurance as specified in the notice (TASA s 20-30(3)). Such a notice may be given at the same time as the giving of the notification of registration, or subsequently. The Board has released an explanatory paper on what is required to satisfy its requirements in relation to professional indemnity insurance (TPB(EP) 03/2010).

¶32-040 Tax agent notification obligations

If:

- a registered tax agent ceases to meet one of the ''tax practitioner registration requirements'' (ie one of the matters as to which the Board must be satisfied in order to grant registration)
- an event listed at ¶32-025 occurs in relation to an individual registered tax agent, an individual partner in a registered partnership or a director of a registered company, or
- there is a change in business or email address or of any other circumstance relevant to registration,

then notice must be given to the Board within 30 days of the day on which the agent became, or ought to have become, aware that the event occurred (TASA s 30-35).

In addition (within the same 30-day period):

- a partnership must notify the Board when the composition of the partnership changes, and
- a company must notify the Board when an individual becomes, or ceases to be, a director of the company (TASA s 30-35).

¶32-045 The Code of Professional Conduct

An important feature of the tax agent registration regime is a statutory Code of Professional Conduct which must be adhered to by a registered tax agent, a registered BAS agent and a registered tax (financial) adviser.

The Board has released an explanatory paper that deals with the Code of Professional Conduct generally (TPB(EP) 01/2010) and also information sheets and an explanatory paper which consider specific principles of the Code.

Code principles

The principles of the Code are that a registered tax entity must:

(1) act honestly and with integrity

(2) comply with the taxation laws in the conduct of their personal affairs

(3) account to a client for any money or other property received from or on behalf of a client and which is held on trust. The Board has issued an information sheet on this principle

(4) act lawfully in the best interests of a client

(5) have in place adequate arrangements for the management of conflicts of interest that may arise in relation to the activities that are undertaken in the capacity of a registered tax agent. The Board has issued an information sheet on this principle

(6) subject to any legal duty, not disclose any information relating to a client's affairs to a third party without the client's permission. The Board has issued an information sheet on this principle

(7) ensure that a tax agent service that they provide, or that is provided on their behalf, is provided competently

(8) maintain knowledge and skills relevant to the tax agent services that are provided

(9) take reasonable care in ascertaining a client's state of affairs, to the extent that ascertaining the state of those affairs is relevant to a statement to be made or a thing being done on behalf of the client. The Board has issued an information sheet on this principle

(10) take reasonable care to ensure that taxation laws are applied correctly to the circumstances in relation to which advice is provided to a client. The Board has issued an information sheet on this principle

(11) not knowingly obstruct the proper administration of the taxation laws

(12) advise a client of the client's rights and obligations under the taxation laws that are materially related to the tax agent services provided

(13) maintain professional indemnity insurance that meets the Board's requirements, and

(14) respond to requests and directions from the Board in a timely, responsible and reasonable manner (TASA s 30-10).

The operation of principles (1), (3) and (7) of the Code was considered by the AAT in *SRBP & Tax Practitioners Board*. The operation of principle (7) was considered in *ATMP* in the context of the drafting of a notice of objection.

Principle (1) is not confined in its operation to the provision of tax agent services; in other words, the principle may be infringed by conduct that is not itself the provision of a tax agent service (*Kishore v Tax Practitioners Board*).

The Board has released information products on various principles of the Code.

A practice note issued by the Board provides practical guidance and assistance in relation to the use of letters of engagement (TPB(PN) 3/2019). While letters of engagement are not a specific requirement of the Code, the Board considers that the provision of such letters is an important and effective mechanism to assist tax practitioners in ensuring that they comply with the requirements of the Code.

The Board has released an exposure draft practice note that considers the use and disclosure of a client's TFN and TFN information in email communications (TPB(PN) D42/2020).

Sanctions for failure to comply with Code

If the Board is satisfied, after conducting an investigation, that a registered agent has failed to comply with the Code of Professional Conduct, the Board may decide to take no action or to do one or more of the following:

- give the agent a written caution
- give the agent an order that requires the agent to take one or more actions (for example, to complete a specified course of education or training specified in the order, to provide tax agent services for which they are registered only under the supervision of a registered agent specified in the order or to provide only those tax agent services that are specified in the order)
- suspend the agent's registration
- terminate the agent's registration (¶32-050) (TASA ss 30-15 to 30-30).

With the exception of a decision to give a written caution, a decision of the Board to impose a sanction for a failure to comply with the Code is reviewable by the AAT.

funds the turnover will be less than $75,000, so registration will be optional. In deciding whether to register, the trustee will need to compare the costs of compliance with the limited amount of input tax credits it could claim.

[AMGST ¶10-080; GSTG ¶31-200]

¶34-210 GST and insurance

The supply of life insurance is treated as a financial supply (¶34-190) and is input taxed. Health insurance is GST-free. General insurance is taxable.

On an insurance settlement, the insured is technically making a supply to the insurance company by giving up its rights under the policy. However, the settlement it receives from the insurance company — whether in the form of money or goods and services — is generally not treated as consideration received or provided. GST will therefore not be payable (s 78-45) and the insurance company will not claim an input tax credit (s 78-20).

There is an exception to this where the insured — or other entity paying the premium — was entitled to an input tax credit for the premium, but failed to notify the insurance company of its credit entitlement, or understated it (s 78-50). To this extent a pro rata amount of GST will be payable on the settlement. The notification may be made when, or at any time before, a claim is first made under the policy. However, there is no requirement to make the notification if the insured was not registered or required to be registered (s 78-80).

In limited circumstances, the insurance company making a settlement will be eligible for a ''decreasing adjustment'' reducing its net GST. This will apply if the insured was not entitled to a full input tax credit on the premiums it paid under the policy (s 78-10). The adjustment only applies if the issue of the policy was taxable — it will not apply to wholly GST-free insurance (eg health insurance) or input taxed insurance (eg life insurance). The decreasing adjustment is calculated as 1/11th of the settlement amount.

Special rules also apply to subrogation, insurance excesses and the treatment of goods and services used in settlement of a claim (Div 78). Separate rules apply to CTP insurance settlements (Divs 79; 80).

For the GST consequences of insurance settlements, see GSTR 2006/10.

Transitional measures

- The GST rules do not apply if the loss or injury occurred before 1 July 2000, even though the settlement is on or after that date (*A New Tax System (Goods and Services Tax Transition) Act 1999* (GST Transition Act), s 22).
- Input tax credits cannot be claimed for motor vehicle compulsory third party (CTP) insurance premiums paid for cover commencing before 1 July 2003 (GST Transition Act s 23).
- If a *non-refundable* commission or fee was paid to an insurance broker or agent for arranging insurance cover before 1 July 2000, GST does not apply to that payment even though the cover extends beyond 1 July 2000 (GSTR 2000/5).

[AMGST ¶10-100; GSTG ¶32-000, ¶76-600]

¶34-220 Vehicles

In accordance with the normal rules, the supply of a car as part of an enterprise may be subject to GST. The GST would apply to the retail selling price, the cost of accessories, dealer delivery charges and insurance, but not to registration or stamp duty.

An additional luxury car tax applies where the market value exceeds a certain limit (see below). Input tax credits may also be limited in that situation.

Luxury cars

In addition to GST, a special tax known as the ''luxury car tax'' applies where the GST inclusive price of a car exceeds the luxury car tax threshold. For 2020–21, the luxury car tax threshold is normally $68,740, though a higher limit of $75,565 applies to certain ''fuel-efficient cars''. The amounts for 2019–20 were $67,525 and $75,526, respectively.

The tax is imposed at the rate of 33%, although the former rate of 25% continues to apply where the contract was entered into before 7.30 pm AEST on 13 May 2008. Primary producers and tourist operators are also entitled to refunds that may reduce their effective rates to 25% for certain cars.

The rate is applied to the amount of the excess, excluding GST (*A New Tax System (Luxury Car Tax) Act 1999*).

▶ Example

In 2020–21, Tuan buys a car (not a fuel-efficient car) for the GST inclusive price of $90,000. The luxury car tax is calculated as 33% × 10/11 × ($90,000 − $68,740) = $6,378. The total payable is therefore ($90,000 + $6,378) = $96,378.

Where the GST inclusive price of a vehicle exceeds the car limit ($59,136 in 2020–21, up from $57,581 in 2019–20), and an input tax credit is available, the credit is limited to 1/11th of that limit (s 69-10). Guidelines on how to claim input tax credits for car expenses are set out in *GST Bulletin* GSTB 2006/1.

Reimportation of luxury cars

From 1 January 2019, the liability for luxury car tax on cars that are reimported into Australia following service, repair or refurbishment overseas has been removed.

Other rules affecting vehicles

- Taxi operators are required to be registered for GST, irrespective of GST turnover (s 144-5). In *Uber*, the Federal Court ruled that services supplied by an Uber driver constituted the supply of ''taxi travel'' within the meaning of s 144-5. The decision confirms a view previously expressed by the ATO that providers of ''ride-sourcing services'' are essentially providing taxi travel services and are required to be registered for GST (*Ride-sourcing and tax*).
- Supplies of cars to disabled veterans (s 38-505) and other disabled people (s 38-510; Taxation Administration (Remedial Power — Certificate for GST-free supplies of Cars for Disabled People) Determination 2020) may be GST-free in certain circumstances. Concessions also apply to motor cycles (ss 38-505; 38-510).

[AMGST ¶12-080, ¶23-200; GSTG ¶68-300, ¶76-760]

¶34-230 Real property

In general, the sale of pre-existing residential premises is input taxed if the premises are real property to be used predominantly for residential purposes (s 40-65; *Sunchen*). In most cases, the sale of an existing home will not be subject to GST in any event, as the owner will normally not be selling in the course of business and will not be required to be registered.

The sale of *new* residential premises is generally taxable, but will be input taxed in certain exceptional situations. ''New'' residential premises fall into the following 3 categories (s 40-75):

(1) those that have not previously been sold as residential premises, or have not previously been subject to a long-term lease

(2) those that have been created by ''substantial'' renovations, or

(3) those that have been built to replace demolished premises.