If the trustee fails to satisfy the reporting requirements, trustee beneficiary non-disclo tax is imposed at the highest marginal rate plus Medicare levy in respect of the un part of the share of the net income. The reporting requirements are contained primari Pt III Div 6D (ss 102UA to 102UV).

It is also provided that, where the trustee of the closely held trust becomes pres entitled to an amount that is reasonably attributable to the whole or a part of share of the net income of the closely held trust, tax is imposed on the amount a highest marginal rate plus Medicare levy (s 102UM). See further below under "Circ distributions".

What trusts are affected?

The rules only apply to closely held trusts where a trustee beneficiary is presently enti to a share of a tax-preferred amount in the trust, or where a share of the net income of trust is included in the trustee beneficiary's assessable income under ITAA36 s 97 and share comprises or includes an untaxed part. A closely held trust is:

- a trust where an individual has, or up to 20 individuals have between them, fi entitlements to at least a 75% share of the income or capital, or
- a discretionary trust (s 102UC).

An individual and their relatives are treated as being one individual. A trustee o discretionary trust who holds a fixed entitlement to a share of the income or capital fixed trust is taken to hold that fixed entitlement as an individual. A trustee beneficiar a beneficiary of the trust in the capacity of trustee of another trust.

Certain trusts are excluded from the closely held trust measures. These are: (a) complyi superannuation funds, complying ADFs and PSTs; (b) deceased estates for 5 years after death; (c) fixed unit trusts wholly-owned by tax-exempt persons; and (d) listed unit tru For income years before the 2019–20 income year the following trusts were also exclu from the closely held trust measures: (i) family trusts; (ii) trusts in relation to which interposed entity election has been made; and (iii) trusts whose income or capital is fi owned by family members and/or family trusts. The effect of amendments made in 201 that, from 1 July 2019, categories (i), (ii) and (iii) ceased to be excluded from the op of the closely held trust measures. The effect of these amendments was to extend to fam trusts, etc, the trustee beneficiary disclosure rules and the anti-avoidance rule that appl to other closely held trusts that undertake circular trust distributions (see under "Circul distributions" below).

What is the "untaxed part"?

Only "untaxed parts" of a share of the net income of a closely held trust are subject the trustee reporting rules. The "untaxed part" of a share of the net income of a close held trust is so much of that share as does not fall in one of the following categories 102UE(2)):

- the trustee of the closely held trust is assessed and liable to pay tax under s 98(4) respect of the share
- the share is reasonably attributable to the net income of a part of another trust esta in respect of which the trustee of the other trust estate is assessed and liable to p tax under s 98(4)
- the share is represented by, or reasonably attributable to, an amount from which a entity was required to withhold an amount under TAA Sch 1 Subdiv 12-H (regardi situations where an Australian managed fund or custodian pays amounts to no resident trustees), or
- the share is reasonably attributable to a part of the net income of another trust esta in respect of which the trustee of the other trust estate was liable to pay trust beneficiary non-disclosure tax.

Lodgment of trustee beneficiary statements

The trustee of a closely held trust must generally provide a correct trustee beneficiary (TB statement by the due date for lodgment of the trust's tax return (s 102UH).

A "correct TB statement" is a written statement in the approved form by the trustee of the closely held trust which correctly sets out:

- the amount of the untaxed part of the share
- the amount of the share of the tax-preferred amount.

A correct TB statement must also contain:

- the name and tax file number of each trustee beneficiary who is resident at the end of the year of income, and
- the name and address of each trustee beneficiary who is not a resident at the end of the year of income (s 102UG).

The trustee of a closely held trust can amend an incorrect TB statement about amounts of net income outside the TB statement period where the following conditions are satisfied (s 102UK(2A)):

- the correction must be made before the trustee beneficiary non-disclosure tax becomes due and payable or within 4 years of any such tax becoming due and payable
- the trustee must have believed on reasonable grounds that the statement was correct when it was made, and
- the event that led to the need to correct the original statement could not reasonably have been foreseen by the trustee.

Trustee beneficiary non-disclosure tax

The trustee is liable to pay "trustee beneficiary non-disclosure tax" at the top marginal rate if:

- a share of the net income of a closely held trust is included in the assessable income of a trustee beneficiary under s 97
- the share comprises or includes an untaxed part
- the Commissioner has not exempted the trustee of the closely held trust from the reporting requirements
- during the TB statement period, the trustee of the closely held trust does not give to the Commissioner a correct TB statement about the share (s 102UK(1)).

Circular distributions

In order to discourage the use of circular chains of trusts to disguise the identity of the final beneficiary of trust income, trustee beneficiary non-disclosure tax is also payable on the whole or that part of the untaxed part if:

- a share of the net income of a closely held trust for a year of income is included in the assessable income of a trustee beneficiary of the trust under s 97
- the trustee of the closely held trust becomes presently entitled to an amount that is reasonably attributable to the whole or a part of the untaxed part of the share, and
- trustee beneficiary non-disclosure tax is not otherwise payable by the trustee of the closely held trust on the untaxed part (s 102UM).

For a recent decision where the general issue of circular trust distributions was considered, see *Advanced Holdings Pty Ltd as trustee for The Demian Trust & Ors* (appeal heard).

Payment of tax etc

If a trustee has a trustee beneficiary non-disclosure tax liability, the trustee must pay the tax within 21 days of the due date for lodgment of the trust return (unless the Commissioner allows further time). If the tax is outstanding 60 days after the due date for payment, GIC will be payable (¶29-510).

Trustees of closely held trusts can sue trustee beneficiaries to recover the trustee beneficiary non-disclosure tax (and any GIC) paid by them where the trustee beneficiary has received the full distribution (s 102USA). A trustee may only take recovery action if 4 conditions are satisfied:

(1) the trustee pays trustee beneficiary non-disclosure tax under s 102UK and any GIC

(2) a gross entitlement (including the amount of the trustee beneficiary non-disclo tax) has been distributed (ie the trustee has not withheld tax from the payment)

(3) the trustee failed to make a correct TB statement because the trustee benefici refused or failed to give information to the trustee, or the trustee made an incor TB statement because the trustee was given incorrect information by the tru beneficiary and the trustee honestly believed on reasonable grounds that information was correct, and

(4) the person refusing or failing to provide information, or providing incor information, was the trustee beneficiary.

If these conditions are satisfied, the trustee can sue for the recoverable amount from source of the incorrect information, ie the trustee beneficiary.

Tax-preferred amounts

A tax-preferred amount is any income of the trust that is not included in assessable inco when calculating the trust's net income, and any capital of the trust (s 102UI). A fail by a trustee of a closely held trust to provide a TB statement in relation to the share a tax-preferred amount constitutes an offence unless the trustee: (a) did not have all information required to be included in the TB statement; (b) took reasonable steps to get information; and (c) gave whatever information was available to the Commissioner (s 102U

[FTR ¶53-00

¶6-277 TFN withholding rules

The TFN withholding arrangements now extend to closely held trusts and certain other trus

The trusts affected by this extension are trusts that are closely held trusts as defined i 102UC (¶6-275), family trusts, trusts in relation to which an interposed entity election h been made and certain fixed trusts which fall within a family group under the family tr provisions.

Withholding is potentially required where there is a distribution of ordinary or statuto income to, or a present entitlement to ordinary or statutory income arises to, a beneficia who is an Australian resident, is not exempt from tax and is not under a legal disab and the beneficiary has not quoted their TFN to the trustee. There are rules which opera where the circumstances requiring withholding overlap and distributions out of income or a present entitlement that arose in, the 2009–10 or an earlier income year are exclude

No withholding is required where the trustee is required to make a correct TB stateme under the rules explained at ¶6-275 or if family trust distribution tax is payable connection with the distribution or present entitlement.

For further discussion of these TFN withholding rules, see ¶26-200.

Public Trading Trusts

¶6-310 Public trading trusts taxed as companies

Certain public unit trusts, called "public trading trusts", are treated as if they are compani for tax purposes (Pt III Div 6C: ss 102M to 102T). The trust is taxed at the company rate tax (¶3-055) and distributions to equity holders (¶6-330) are assessable on the same ba as dividends. However, the trust loss measures (¶6-262) apply to public trading trusts an in certain circumstances, a public trading trust must work out its net income in a speci way (¶6-262, ¶6-265). The simplified imputation system applies to public trading trus (¶4-400). Public trading trusts that elect to be taxed like companies may head consolidate groups (¶8-000). The accruals measures in Div 6AAA (¶6-075) do not apply in relation arm's length transfers to non-resident public unit trusts (s 102AAT(1)).

[FTR ¶52-90

¶6-320 What is a public trading trust?

A "public trading trust" is a public unit trust that is also a trading trust, and that is eith a resident in the income year concerned or was a public trading trust in a previous incom year (s 102R).

Whatever is encompassed by the concept of a unit trust within Div 6C there is a necessity for something which fits a description of "units" within the functional, and descriptive, notion of a unit trust. This includes a focus upon one of the core indicia of a unit, namely a beneficial interest in any of the income or property of the estate (*ElecNet*).

A unit trust is a "public unit trust" for the purposes of these provisions where (s 102P):

(1) any of the units are listed for quotation on a stock exchange

(2) any of the units were offered to the public (but not where the offer was merely to secure public status under Div 6C)

(3) the units are held by 50 or more persons, or

(4) a tax-exempt entity (ie in broad terms an entity whose ordinary and statutory income is exempt) holds a beneficial interest in 20% or more of the property or income of the trust, or during the income year concerned was paid 20% or more of the moneys paid by the trust to unitholders, or an arrangement exists whereby such an entity could have been given such a holding during the year or could have been entitled to 20% or more of any moneys paid to unitholders during the year concerned.

A unit trust that would otherwise be a public unit trust under (1), (2) or (3) above is *not* treated as a public unit trust if 20 or fewer persons hold 75% or more of the beneficial interests in the property or income of the trust, unless the Commissioner rules otherwise. Nor is it a public unit trust if 20 or fewer persons during the income year were paid 75% or more of moneys paid by the trust to unitholders, or an arrangement exists whereby such persons could have been entitled to 75% or more of any moneys paid to unitholders during the year (unless the Commissioner considers that it is not intended to implement that arrangement).

For the purpose of determining whether a unit trust is a public unit trust, a beneficiary under a trust is deemed to hold any units held by the trust of which they are a beneficiary and a person and their relatives or nominees are regarded as one. For the 2016–17 and later income years this provision does not apply where units are held by the trustee of a complying superannuation fund.

For a recent Full Federal Court decision in which the operation of Div 6C was considered, see *Trustee for the Michael Hayes Family Trust*. Note that the ultimate conclusion in this case would now be different because the facts involved an arrangement that relied on the use of a complying superannuation fund.

A unit trust is a "trading trust" if it carries on a trading business *or* controls or is able to control, directly or indirectly, a trading business carried on by another person (s 102N). A unit trust is not a trading trust if it is an interposed trust in relation to a scheme for reorganising the affairs of stapled entities in terms of the CGT roll-over under Subdiv 124-Q (¶12-440) (s 102NA).

A "trading business" is any business that does *not* consist wholly of "eligible investment business" (s 102M). Eligible investment business means any of the following:

- investment in land for rental, including investing in fixtures and certain moveable property. There is also a 25% safe harbour allowance for non-rental non-trading income from investments in land
- investment or trading in loans (secured or unsecured), securities, shares, units in a unit trust, futures contracts, forward contracts, currency swap contracts, interest rate swap contracts, forward exchange rate contracts, forward interest rate contracts, life insurance contracts, or rights or options in respect of any of these, or any similar financial instruments, or
- investing or trading in financial instruments arising under financial arrangements (other than certain leasing or property arrangements, interests in a partnership or trust estate, general insurance policies, guarantees and indemnities, superannuation and pension rights, and retirement village arrangements) (s 102MA).

The trustee of a unit trust is not treated as carrying on a trading business if not more than 2% of the gross revenue of the unit trust is not from eligible investment business and that

For example, the head company may be entitled to deductions in relation to a subsidiary's pre-joining expenditure on borrowing expenses, gifts (where the deduction is spread over multiple periods), water facilities (ID 2007/37), power or telephone connection costs, and costs allocated to a project pool. The head company may also be entitled to bad debt deductions where accounts and loans receivable of the joining entity become uncollectable (ITAA97 s 716-400; ID 2004/3). The head company may also need to include assessable income due to events that took place before an entity joined the group. For example, due to a prepayment received by a subsidiary or the recoupment of expenditure made by a subsidiary before it joined the group.

The entry history rule preserves the pre-CGT status of assets brought into the group, subject to the rules concerning a change in majority underlying interests (¶12-870).

If a finance subsidiary had entered into borrowings to finance its group companies in the ordinary course of its business prior to consolidation of the group, the head company is taken to have done the same under the entry history rule (ID 2010/100).

The Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No 1) 2002 confirms that private binding rulings (¶24-560) issued to the entity before the joining time will apply to the head company insofar as the relevant facts have not changed either by reason of consolidation or otherwise.

History that is not related to working out the head company's income tax liability or losses is not inherited. Examples include franking credits (¶8-300) and foreign income tax offsets (¶8-600), for which there are separate rules.

For the purposes of the business continuity test in the loss recoupment rules, the entry history rule does not operate when an entity joins a group. This means that a head company's business will not include the business of a joining entity before it became a member of the group when determining if the head company satisfies the business continuity test (ITAA97 s 165-212E).

The entry history rule is also effectively overridden by excluding a subsidiary member's pre-joining income tax liability when calculating the head company's available income tax liability for purposes of the temporary loss carry back rules (ITAA97 s 160-30(2)).

The entry history rule is affected by the cost setting rules for assets brought into the group (¶8-200) and the rules for transferring and utilising losses (¶8-100). This is because the operation of the core rules is subject to any contrary provisions in ITAA97 Pt 3-90 or another part of the income tax law (ITAA97 s 701-85).

Exit history rule

When a subsidiary member leaves a consolidated group, taking with it any asset, liability or business, the entity inherits the tax history associated with that asset, liability or business (ITAA97 s 701-40). This "exit history rule" applies for the purposes of working out the leaving entity's income tax liability or loss for any period after it leaves the group (ie for "entity core purposes"). The history in relation to a business might, for example, extend to whether the business qualifies for tax treatment that applies to specific types of business such as primary production or exploration or prospecting for minerals.

The exit history rule is also relevant to pre-CGT assets and private binding rulings (see above). It also operates to fix the holding time for a depreciating asset that a leaving entity takes with it to determine if an asset is a second-hand asset under the temporary full expensing rules (*Draft* LCR 2021/D1; ¶17-430).

As in the case of the entry history rule, the exit history rule is affected by contrary provisions, such as the cost setting rules for assets taken from the group and the rules that result in losses and foreign income tax offsets remaining in the group (ITAA97 ss 701-85; 707-410; 717-10).

Treatment for irrevocable entity-wide elections

When an entity joins a consolidated group either at its formation time or a later date, it will not always be appropriate for the head entity to be bound by irrevocable elections ("choices") that the joining entity has made. Similarly, it will not always be appropriate for

a leaving entity to be bound by irrevocable choices made by the head entity. Accordingly, separate rules may apply to override the entry history rule and exit history rule in relation to such choices (ITAA97 Subdiv 715-J; 715-K; ITTPA Subdiv 715-J; 715-K). There are 3 lists of choices, each with a distinct method of treatment.

Resettable choices treatment

Some choices are eligible for resettable choices treatment. This treatment allows the head company to decide whether or not to reset a joining entity's irrevocable choices at the joining/consolidation time according to the head company's preferences. It will not be bound by earlier choices made by the joining entity. Such choices are effective from the consolidation time or joining time (ITAA97 s 715-660). A similar decision is available to a leaving entity at the leaving time (ITAA97 s 715-700). The head company (or leaving entity) generally has 90 days after the joining time (or leaving time) in which to make its new choice.

The list of choices that are subject to resettable choices treatment comprises choices made under:

- a provision of ITAA36 Pt X – attribution of income in respect of controlled foreign companies
- a provision of ITAA97 Subdiv 420-D – choosing a valuation method for a registered emissions unit
- item 1 in the table in ITAA97 s 960-60(1) – choosing to use a functional currency (¶8-600)
- ITAA97 ss 230-210, 230-255, 230-315 and 230-395 – choice about the treatment of gains and losses from Div 230 financial arrangements
- any other matter prescribed by regulations.

Limited resettable choices to overcome inconsistencies

The second treatment category permits the head company or leaving entity to reset choices only where there would otherwise be inconsistency of treatment among joining entities, between a joining entity and the group, or between the head company's choice status and the choice status that a leaving entity had before joining the group (ITAA97 s 715-665; 715-705). The head company (or leaving entity) generally has 90 days after the joining time (or leaving time) in which to make its new choice. This treatment is applicable to irrevocable choices made in respect of:

- ITAA36 s 148 – reinsurance with foreign residents. However, the reset applies only to new reinsurance contracts entered into with foreign residents at or after the consolidation/joining time (or leaving time)
- ITAA97 ss 230-210, 230-255, 230-315 and 230-395 – choice about the treatment of gains and losses from Div 230 financial arrangements
- ITAA97 s 775-80 – forex realisation gains and losses
- any other matter prescribed by regulations.

Choices with ongoing effect

The third treatment category ensures that a choice that affects certain assets, liabilities or transactions will continue to have ongoing effect when the relevant entity joins a consolidated group (ITAA97 s 715-670). Consistent with this approach, a leaving entity will simply inherit the choice status of the head company under the exit history rule.

This treatment applies to a choice made under ITAA97 s 775-150 to disregard certain forex realisation gains and losses. However, a s 775-150 election made by an entity when it is already a subsidiary member of a consolidated group is not taken to be a valid election by the head company of the consolidated group (ID 2006/201).

Bad debts and swap losses

Special bad debt rules ensure that an entity can deduct a bad debt that for a period has been owed to a member of a consolidated group, and for another period has been owed

(b) the value of the available fraction for the bundle changes during the period. The second circumstance may occur where another loss bundle is transferred to the head company, or there has been a capital injection or a non-arm's length transaction (see table above).

Available fraction where head company joins a new group

Where the head company of a consolidated group (the "old group") becomes a subsidiary member of another group (the "bigger group") and transfers losses to the bigger group, the ex-head company's modified market value or market value is worked out as if each subsidiary member of the old group were part of the ex-head company (ITAA97 s 707-330).

Losses of an insolvent joining entity

If an entity's liabilities exceed its assets at the joining time (ie it is insolvent), losses transferred to the head company will have a nil available fraction. In absence of transitional concessions, such losses cannot be utilised. However, such losses can be utilised in the following situations under ITAA97 s 707-415:

- where the losses are wholly or partly attributable to a debt owed by the joining entity to a party outside the group and the debt is forgiven after the joining entity joins the consolidated group. The losses can reduce the total net forgiven amount of the debt under the commercial debt forgiveness rules (ITAA97 Div 245) up to the gross forgiven amount of the debt (ITAA97 s 245-75) (¶16-910)
- where the losses are a result of a debt terminated after the joining entity joins the group subjecting the head company to the limited recourse debt rules (ITAA97 Div 243). The losses can be used to reduce a capital allowance under the limited recourse debt rules (ITAA97 s 243-35(1); ¶23-260)
- the losses can be used to reduce the head company's CGT event L5 capital gain when a joining entity subsequently leaves the group if the entity's liabilities are the same as they were on joining.

[FITR ¶542-920 – ¶542-945]

Assets

¶8-200 Accounting for assets brought into a consolidated group

Under the single entity rule (¶8-010), all of the assets of a consolidated group are treated as being owned by a single entity, being the head company. Intra-group assets and liabilities (such as membership interests in subsidiaries) are ignored. When an entity joins a consolidated group, it is therefore necessary to set the head company's tax cost for the assets brought into the group by the joining entity, and to eliminate the tax cost of the membership interests that the head entity holds in the joining entity. A detailed set of rules known as the "tax cost setting rules" are provided for this purpose.

The tax cost setting rules are set out in 5 subdivisions of ITAA97 Div 705, as follows:

- basic case: a single entity joining an existing consolidated group (ITAA97 Subdiv 705-A: ¶8-210)
- case of group formation (ITAA97 Subdiv 705-B: ¶8-220)
- case where a consolidated group is acquired by another (ITAA97 Subdiv 705-C: ¶8-230)
- case where multiple entities linked by membership interests join a consolidated group (ITAA97 Subdiv 705-D: ¶8-240)
- adjustments for errors (ITAA97 Subdiv 705-E: ¶8-250).

[FITR ¶541-200 – ¶541-205]

¶8-210 Where single entity joins existing consolidated group

When an entity joins an existing consolidated group, the tax cost of each asset brought into the group is set at the asset's "tax cost setting amount" (ITAA97 s 701-10). The relevant tax cost setting amounts are worked out by allocating the consolidated group's "allocable cost amount" (ACA) for the joining entity to the joining entity's assets. The ACA is broadly

representative of the cost of equity in the joining entity and its liabilities. Depending on the type of asset, its original tax cost may either be retained or changed by resetting it to either a higher or lower amount.

Use of tax cost setting amount

An asset's tax cost setting amount is used by the head company when applying relevant provisions of the income tax law depending on the type of asset. Under ITAA97 s 701-55, specific provisions deal with the use of the tax cost setting amount of depreciating assets, trading stock, registered emissions units (¶19-130), qualifying securities, assets taxed under CGT provisions, assets which are ITAA97 Div 230 financial arrangements (¶23-030), work-in-progress (WIP) amount assets (¶8-580) and consumable stores. For example:

- to work out the decline in value of a depreciating asset, the head company is taken to have acquired a joining entity's asset at the joining time and for a cost equal to its tax cost setting amount (ITAA97 s 701-55(2)). For example, the joining time will be the relevant holding time to determine if timing conditions for the head company to access temporary full expensing are satisfied, although there are limitations to cap the tax cost setting amount of reset cost base assets (see below). The deemed acquisition also treats a joining entity's asset as a second-hand asset of the head company, making the asset ineligible for temporary full expensing if the head company's aggregated turnover is $50 million or more (*Draft* LCR 2021/D1)
- trading stock on hand at the start of the relevant income year whose deemed value is equal to its tax cost setting amount (ITAA97 s 701-55(3))
- the CGT provisions apply such that the asset's cost base or reduced cost base is its tax cost setting amount (ITAA97 s 701-55(5))
- for the purposes of applying ITAA97 Div 230, a head company is deemed to have acquired a Div 230 financial arrangement at the joining time for a payment equal to the asset's tax cost setting amount if the accruals, realisation or hedging methods apply. If the fair value, financial reports or retranslation methods apply, the cost of the asset is its "Div 230 starting value" at the joining time (ITAA97 s 701-55(5A) and (5B)). Any excess of the Div 230 starting value over the tax cost setting amount is included in the head company's assessable income and a shortfall is allowed as a deduction, over 4 years (ITAA97 s 701-61). Any prior history for the financial arrangement or inherited transitional balancing adjustment amounts are disregarded for purposes of applying ITAA97 Div 230 (ID 2012/41; ID 2012/42)
- for the purposes of applying ITAA97 s 25-95, the head company is treated as having paid a WIP amount equal to the tax cost setting amount of the joining entity's WIP amount asset (ITAA97 s 701-55(5C)) as it generally applies to entities joining a consolidated group after 30 March 2011. ITAA97 s 25-95 applies to determine if the WIP amount is then deductible
- when an entity joins a consolidated group holding an asset that is consumable stores, for the purposes of a ITAA97 s 8-1 deduction, the head company is taken to have incurred an outgoing to acquire the asset at the joining time equal to its tax cost setting amount (ITAA97 s 701-55(5D)).

Other assets are dealt with by the "residual tax cost setting rule" (ITAA97 s 701-55(6)) which allows the asset's tax cost setting amount to be used when applying other provisions of the income tax law. Under this rule, the head company is taken to have incurred expenditure to acquire a joining entity's assets equal to their tax cost setting amount at the joining time. Broadly, for entities joining a consolidated group after 30 March 2011, the head company is also taken to have acquired these assets of the joining entity as part of acquiring the joining entity's business as a going concern. This means that the revenue or capital nature of the asset depends on the asset's character in the hands of the head company and not the joining entity, making the entry history rules irrelevant for the purpose of determining the treatment of these assets (ITAA97 s 701-56). The assets will therefore generally be taken to be on capital account and their tax costs only recognised when a CGT event happens and no immediate revenue deductions are available. Certain capital expenditure is excluded

Incidental costs

Incidental costs incurred by a head company in acquiring or disposing shares in a subsidiary member are not deductible under ITAA97 s 40-880(2) by virtue of ITAA97 s 40-880(5)(f) if they are incurred when the subsidiary is not part of the consolidated group (TD 2011/8; TD 2011/10). A deduction is not prevented by ITAA97 s 40-880(5)(f) if the head company incurs the incidental costs when the subsidiary is part of the consolidated group (TD 2010/1; TD 2011/9). The incidental costs are described in s 110-35(2) and include legal and accounting fees but not remuneration to a member of the group.

[FITR ¶544-900 – ¶544-970]

Special Consolidation Rules

¶8-500 Interposing a shelf head company

Special provisions enable a shelf company to be interposed between the head company of a consolidated group (the "original company") and its shareholders without disbanding the consolidated group (ITAA97 s 615-30(2); 703-70). For this to happen, the interposition of the new company must be achieved through an exchange of shares in accordance with the conditions set out in ITAA97 Div 615 (¶12-370).

If, immediately after the completion time (for Div 615 purposes), the interposed company is the head company of a consolidatable group consisting only of itself and the members of the consolidated group immediately before the completion time, then the interposed company must choose for the consolidated group to continue in existence. The choice must be made within 28 days after the completion time, or such further time as the Commissioner allows (ITAA97 s 615-30(3)).

The effects of the choice on the consolidated group are set out in ITAA97 ss 703-65 to 703-80. Broadly, the interposed company is taken to have become the head company and the original company is taken to have become a subsidiary member of the group. However, the rules that apply when a subsidiary member joins a consolidated group do not apply when the original company becomes a subsidiary member, subject to any specific exceptions (s 703-70(3)). The interposed company is treated as substituted for the original company at all times before the completion time, and is taken to be the head company of the consolidated group for the income year that ends after the completion time. The group will not fail the continuity of ownership test for recoupment of company losses (¶3-105) merely because of the interposition of the new head company (ID 2007/106; ID 2007/107).

There is compulsory deferral of capital gains or capital losses on disposal, cancellation or redemption of shares in the original company until the replacement shares of the interposed company are disposed of. Where some of the original shares were trading stock or revenue assets of the shareholder, (broadly) the cost of the shares is included in the shareholder's assessable income, and a like amount is taken to have been paid for the relevant replacement shares (ITAA97 s 615-50; 615-55).

[FITR ¶540-675]

¶8-550 Consolidation and particular kinds of entities

ITAA97 Div 713 contains rules for particular kinds of entities.

Discretionary trusts

There are special rules for working out the allocable cost amount (ACA) of a discretionary trust that joins a consolidated group (ITAA97 Subdiv 713-A). Where a membership interest in a trust is neither a unit nor an interest in the trust, has no cost base and only began to be owned because something was settled on the trust, the ACA will be increased to properly reflect the settled capital that would have been distributed tax free to the group if the trust had ended when it joined the group (ITAA97 s 713-20 to 713-50).

Unit trusts

Certain public trading trusts (PTTs) that elect to be taxed like companies are able to head consolidated groups. Such a trust has the benefit of income it receives; it does not receive the income as a trustee but as the head of a consolidated group (*Intoll Management*). The

consolidation must take effect on the first day of the trust's income year (ITAA97 s 713-130; ID 2006/206). Once a trust chooses to head a consolidated group, it continues to be taxed like a company, even if the group it heads deconsolidates or it fails the definitional requirements of a PTT (ITAA97 Subdiv 713-C).

Partnerships

Special rules (ITAA97 Subdiv 713-E) apply where a partner or partnership joins a consolidated group (¶8-210), or a partnership leaves a consolidated group (¶8-400).

Life insurance companies

For the special rules for life insurance companies, see ¶3-527.

General insurance companies

ITAA97 Subdiv 713-M sets out special rules for a general insurance company becoming or ceasing to be a subsidiary member of a consolidated group.

[FITR ¶545-700 – ¶546-440]

¶8-580 Miscellaneous special consolidation rules

Miscellaneous special rules, including provisions for spreading assessable income, deductions and fully-deductible capital expenditure over more than one membership or non-membership period, are set out in ITAA97 Div 716.

Assessable income spread over 2 or more income years

Special rules apply where the tax law requires an entity to recognise an amount of assessable income over 2 or more years, and the entity is a member of a consolidated group for part but not all of one of those years. In that case, that part of the amount that was to be recognised as assessable income in the relevant year will be split between the entity and the head company of the consolidated group. The proportion attributable to the head company is determined by *dividing*: (a) the number of days when the entity was a member of the group that are in both the income year and the spreading period *by* (b) the total number of days that are in both the income year and the spreading period (ITAA97 s 716-15). The remaining proportion will of course be attributable to the entity's non-membership period and will be allocated to the entity itself.

▶ Example 1

Get Fit Co sells a 5-year gym membership on 1 March 2021 for $3,000 (ie $50 per month). On 1 June 2021 Get Fit joins a consolidated group.

Of the $3,000, $200 (4 months) is assessable in 2020–21. The spreading period is 1 March 2021 to 28 February 2026, and the period falling within both the spreading period and the income year (ie 1 March 2021 to 30 June 2021) consists of 122 days. Of those 122 days, Get Fit was a member of the consolidated group for 30 days and a non-member for 92 days.

Get Fit will include $150.82 (ie $200 × 92/122) in its assessable income, and the head company will include the remaining $49.18 (ie $200 × 30/122) in its assessable income for 2020–21.

Deductions spread over 2 or more income years

A similar allocation mechanism operates where an amount incurred by an entity is deductible over 2 or more income years and the entity is a member of a consolidated group for only part of a relevant income year (ITAA97 s 716-25).

▶ Example 2

Continuing from Example 1, Get Fit Co had incurred $5,000 of borrowing expenses on 1 August 2017. The expenses were deductible over 5 years (the spreading period), with $1,000 deductible in 2020–21.

As 365 days of the spreading period fall within 2020–21, and Get Fit is a member of the consolidated group for 30 of those days, the head company will deduct $82.19 (ie $1,000 × 30/365) and Get Fit will deduct $917.81 (ie $1,000 × 335/365) for 2020–21.

Exception for depreciation

This provision does not apply to deductions for the decline in value of a depreciating asset. The reason for the exclusion is that the tax value of assets is reset at the time an entity joins a consolidated group, so that the basis of the deductions changes. Furthermore, the existing

also TR 2018/7 from para 30). Dividends credited to a shareholder and, at the shareholder's direction, retained by the company as an advance are constructively received when credited. Cheques are generally regarded as payment when received and not when presented.

A share in uncollected book debts sold as part of a retiring partner's interest in a partnership (that lodges returns on a cash basis) is capitalised on sale of the interest and assessed to the retiring partner. The purchaser is not assessed on subsequent collections of those debts (¶5-060).

An amount is not taken to *be dealt with on a taxpayer's behalf* (and therefore constructively received) when a debtor refrains from making a payment otherwise due to a taxpayer, at the request of a creditor (*Brent*). It is so dealt with once the amount is paid to the creditor on the taxpayer's behalf (*Blank*).

See TR 93/6 (¶10-470) for the Commissioner's views on interest offset arrangements. For a discussion on the transfer of rights to receive income, see ¶30-900.

[FITR ¶18-200, ¶28-000; FTR ¶6-700]

¶9-090 Prepaid or estimated income

Where advance amounts are received for a specific number of discrete services (eg dance or sport lessons) and such payments are *brought to account as income in the taxpayer's accounts only when earned*, they are treated as unearned income not assessable for tax purposes until they are earned (*Arthur Murray*).

This rule has been applied to prepaid magazine subscriptions (*Country Magazine*) and to an advance payment for a fixed-term maintenance and service contract (*Case C86*). The Commissioner applies the same principle to: (a) advance deposits for goods to be manufactured and delivered later at the buyer's request; (b) goods acquired under take or pay contracts, eg in the natural resource industry (TR 96/5); and (c) other cases where services are to be rendered over a fixed period of time (eg television servicing contracts).

To be able to apply the *Arthur Murray* principle it is necessary that the taxpayer's financial accounts are prepared on the basis that advance payments are kept in a suspense or unearned income account and not treated as income until earned, or where the advance payments are credited to gross revenue account in the books but a balance date adjustment is made at the close of the income year to exclude unearned income from the profit and loss account.

Once an up-front payment is brought to account as assessable income under one apportionment method using the *Arthur Murray* principle, a different apportionment method cannot later be adopted in relation to that payment (*Commercial Union*).

The Commissioner does not accept that Arthur Murray is authority for the proposition that where a vehicle is sold subject to a warranty (whether a sale by a manufacturer or distributor to a dealer, or a sale of a new or used car by a dealer to a retail customer), a portion of the sale price relates to the warranty and is not derived at the time of the sale. The Commissioner treats the whole of the sale proceeds as derived by the manufacturer, distributor or dealer at the time of sale (IT 2648). This view should be contrasted with the decision in *Mitsubishi Motors*.

Income received but never earned, as such, cannot escape tax altogether. Adjustments are made so that receipts are treated as income after a reasonable time has passed and there is no longer any likelihood that the taxpayer will be called upon to *earn* the income.

See ¶18-030 for the derivation of income by primary producers under pool contracts.

Schemes under which income is deferred to a later year are specifically countered (¶16-110).

[FITR ¶18-200, ¶27-000]

Timing of Deductions

¶9-100 Prepaid expenses, deferred charges and other timing considerations

The main issues governing when a deduction is allowable are the *time* when expenditure is incurred and the *period* to which it is properly referable (ITAA97 s 8-1: ¶16-040) (*Coles Myer Finance*).

If either a cash or accruals taxpayer pays for supplies that will not be fully used until a future year, the taxpayer is generally entitled to a deduction in the year of payment, ie the year in which the expenditure is incurred.

If the liability incurred or payment made creates an asset having a useful life that extends substantially beyond the end of the income year in which it is paid or incurred, the expense or outgoing may be capital in nature and either not deductible at all or only partly deductible in that year. If payment is made or a liability is incurred for a depreciating asset or other capital expenditure, a depreciation deduction (¶17-005) or special write-off may be available (¶18-000, ¶19-000, ¶20-000).

Conditional contracts. The buyer is allowed a deduction at the time the purchase order is accepted but is assessable on the cost of any goods returned under the terms of the contract (TR 97/15).

Gold forward fees. See *Case 5/98*; TR 92/5; ¶16-045 (deductions for prepayments spread over time).

Prepayments for franchise/renewal fees. Deductible over the eligible service period under the prepayment provisions in ITAA36 Subdiv H of Div 3 (¶16-045; *Inglewood & Districts Community Enterprises Limited*).

Prepayments for services provided over long term. Special rules affect the timing of deductions for expenditure incurred in advance of the provision of services (¶16-045). Deductions for otherwise allowable expenses may also be deferred or denied altogether where the expenses have been incurred under certain types of tax avoidance schemes (¶9-110).

Prepayments for trading stock. ITAA97 s 70-15 prevents expenditure incurred in acquiring trading stock from being claimed as a deduction until the income year in which the stock is on hand (¶9-170, ¶16-040).

Trading stock discounts. Where trading stock is purchased under an arrangement that provides for a prompt payment discount (eg 5% discount on invoice price if paid within 30 days), a deduction is allowable to the purchaser at the time of purchase for the full invoice price. If the discount is subsequently accepted, then the difference between the invoice price and the discounted price is assessable at the time of payment. The High Court decision in *Ballarat Brewing* suggests that only the discounted price should be recognised at the time of purchase where receipt of the discount is virtually certain. For the deductibility of trading stock generally, see ¶16-040. Where the discount is taken up at the time of purchase, such as cash discounts, trade discounts and quantity or bulk discounts only the discounted price is deductible (TR 96/20). This treatment of trading stock discount still applies where the discount is dealt with at the buyer's instruction (TD 96/45).

Solicitor disbursements. A deduction is generally allowable to a solicitor for disbursements on behalf of a client at the time the amount is incurred, whether or when the amount is recovered from the client is not relevant (TR 97/6).

[FTR ¶47-500 – ¶47-550; FITR ¶114-410]

¶9-110 Prepayment and tax deferral schemes

Special provisions apply to counter schemes involving the prepayment of certain deductible expenses, such as interest, rent and expenditure in acquiring trading stock, etc, where the taxpayer (or associate) receives a compensatory benefit in return for the prepayment. Special provisions also apply to counter schemes between associated parties under which taxation of an amount passing between the parties is deferred to a later year (¶16-045, ¶16-110).

[FTR ¶46-801 – ¶47-216]

¶9-120 Deductions for provisions for estimated expenses

Accounting provisions or reserves established for anticipated future outgoings such as advertising, legal expenses, doubtful debts are not allowable deductions as they are not incurred. Although provisions established in respect of incurred expenses may be deductible,

The amount of the deduction for the employer is an amount equal to the discount on ESS interest which the employee would not have to include in their assessable in (by operation of the upfront exemption but disregarding the income test); a maxi deduction of $1,000 is available (s 83A-205(2), (3)).

Where 2 or more employers jointly provide the ESS interest, the deduction mus apportioned between them on a reasonable basis (s 83A-205(4)).

Arrangements

An employer may provide an amount of money or property to another entity to an indirect arrangement (eg an employee share trust) for the purpose of providing interests to its employees under an employee share scheme. In these cases, the deduc for the employer is delayed until such time as the employee acquires an ESS intere 83A-210).

[FITR ¶131-100 - ¶131-

¶10-096 Miscellaneous ESS matters

Indeterminate rights

In some cases, it is unclear at the time of acquisition whether a right to a benefit will re in the receipt of an ESS interest, or it may be that the exact number of ESS interests t received is unknown. If and when it becomes clear that a right to the benefit will resu the receipt of a definite ESS interest or a definite number of ESS interests, the right wi treated as an ESS interest from the time that the original right was acquired (s 83A- *Davies* and ATO *Decision Impact Statement*). For the circumstances when a contra right, which is subject to the satisfaction of a condition, becomes a right to acqui beneficial interest in a share, see TD 2016/17.

For the purposes of taxing a benefit which becomes an ESS interest, the Commissioner the power to amend an assessment at anytime (ITAA36 s 170(10AA)).

Ceasing employment

For the purposes of Div 83A, an employee is considered to have ceased employment he/she is no longer employed either by his/her employer, a holding company or subsi of their employer, or a subsidiary of a holding company (s 83A-330).

Entities treated like companies

Division 83A purports to apply to interests in corporate limited partnerships and pu trading trusts acquired in the same way as it applies to shares and rights in companies

Dividend equivalent payments

A dividend equivalent payment is assessable to an employee as remuneration (and there ordinary income) when the employee receives such a payment for, or in respect of, servi they provide as an employee, or similarly, where the payment has a sufficient connec with their employment (TD 2017/26). TD 2017/26 explains when a dividend equiva payment is for services provided as an employee and sets out the Commissioner's practi administrative approach. It applies to employee share scheme interests granted on or a 1 January 2018.

[FITR ¶131-140, ¶164-1

Business Income

¶10-105 Carrying on a business

The question whether "a business is being carried on" is fundamental to determi whether the earnings or proceeds of a business are to be included in assessable inco and, conversely, whether deductions are allowable for all revenue expenses incurred in course of deriving that income (¶16-015).

Whether or not a taxpayer's activities amount to carrying on a business is "a questio fact and degree" and is ultimately determined by a weighing up of the taxpayer's individ facts and circumstances.

Under the definition in s 995-1, a "business" includes any profession, trade, vocation or calling. In most cases, it is obvious whether a business is being carried on. Where it is not obvious, in particular where the relevant activity is subsidiary to a person's main income-producing activity, eg where the person engages in share transactions or vigorously pursues a hobby, the most important factors in determining whether a business is being carried on appear to be:

- *Profitability* – the fact that a profit is being made is a strong indication that a business is being carried on. However, the lack of profit does not necessarily mean that there is no business.
- *Size* – the bigger the operations, the more likely it is that there is a business being carried on.
- *Effort* – if the activities involve a substantial and regular effort over a period of time, they are more likely to constitute a business. However, it is possible to carry on a business as a part-time sideline to the taxpayer's main activities. Similarly, a single transaction can amount to the carrying on of a business if it results from a concerted effort, especially if it is connected in some way with the taxpayer's normal business activities. Apart from this, however, the mere realisation of capital assets would not normally constitute a business.
- *Business records* – if detailed business records are kept, this is a strong pointer to the existence of a business. The lack of records is a common weakness in cases presented by persons seeking to obtain deductions for losses incurred from their alleged business activities.

A more detailed list of the factors involved is given below.

Positive factors	Negative factors
More likely to be a business if ...	*Less likely to be a business if ...*
Large scale operations	Small scale operations
Involves employees	One person operation
Frequent acts/transactions	Infrequent acts/transactions
Conducted with a view to profit	Conducted as mere hobby
Profitable	Non-profitable
Conducted over long period	Short-term
Conducted continuously and systematically	Spasmodic
In commercial premises	At home
Involves items typically dealt with commercially	Involves items not ordinarily dealt with commercially
Involves exercise of specialised knowledge	Involves little knowledge or skills
Significant capital investment	Little or no capital investment
Business records kept	Records not kept, or inadequate
Full-time	Part-time
Market research done	No market research
Associated with other commercial activities of taxpayer	No other commercial activities
Existence of business organisation, business name	Conducted personally/privately
Advertising	No advertising
Active	Inactive or preliminary

For the Commissioner's views, see TR 2019/1 (when a company carries on a business for the purposes of the definition of a "small business entity": ¶7-050), TR 97/11 (business of primary production), TR 2005/1 (business as a professional artist), and TR 2008/2 (horse industry). See also *Gilbert* (motorcycle sidecar racing), *Block* (horse and sheep breeding), *Kennedy* (film-making business), *Phippen* and *Hattrick* (boat-chartering business: ¶16-420),

- a bare trust is created by transferring an asset to a trustee
- the conversion of a property holding from a joint tenancy to a tenancy in comm in equal shares
- the conversion of a co-operative into an unlisted public company (CR 2008/68)
- 2 or more CGT assets are merged into a single asset (TD 2000/10)
- a partnership converts into a limited partnership (ID 2010/210)
- a contract falls through before completion, or if, after completion, a contract rendered void from the start, eg due to fraud (TR 94/29).

▶ Planning point

When considering a sale of a business, the CGT consequences of selling the business assets distinct from the sale of the shares in the company should be analysed to determine the best outco (¶31-100).

When selling the assets of the business, the CGT consequences of each asset being sold, and concessions available, needs to be considered (¶31-610).

Where a taxpayer owns assets which are identical and were acquired at different times, it m not be possible to identify which particular assets are being disposed of, eg shares, trust uni coins and stamps. In these circumstances, a taxpayer may adopt the first-in first-out (FIF basis or specifically select which assets are being disposed of (TD 33). Alternatively, avera cost may be used for shares which are in the same company, are acquired on the same da and involve identical rights and obligations. However, any shares which have a market val cost because of the market value substitution rule must be excluded from the average co calculation (TD 33). Where shares are held as revenue assets by banks or insurance companie the FIFO method must be used if the individual shares are not sufficiently identifiable. As a alternative to FIFO, average cost may be used on the same conditions as above (TR 96/4).

Where shares are proposed to be sold under a "wash sale" the potential application of th distribution washing provisions in s 207-157 and the general anti-avoidance provisions ITAA36 Pt IVA need to be considered (TR 2008/1; TD 2014/10; ¶30-195).

Before considering a wash sale, a taxpayer should find out if the liquidator is in a pos declare the shares worthless so as to crystallise a capital loss under CGT event G3 (¶11-310).

The CGT consequences arising in relation to certain arrangements are considered by th Commissioner as follows:

- disposing of insurance registers – TR 2000/1
- immediate and deferred transfer farm out arrangements – MT 2012/1 and MT 2012/
- Prepaid Forward Purchase Agreements which attempt to reduce the assessable incom of an Australian resident taxpayer – TA 2009/2.

Leasehold fixtures and improvements

For CGT purposes, a lessee continues to own an asset which the lessee has affixed to th lessor's land if: (i) the lessee is taken to be the owner of the asset within the terms of T 175 (¶17-020); or (ii) a relevant state or territory law provides for the ownership of th asset to remain with the lessee (TD 46). In these circumstances, there is no disposal of th asset by the lessee to lessor when it is affixed to the land during the period of the lease

The owner of the land will become the owner of a fixture that is taken to be owned by lessee during the period of a lease if it remains affixed to the land at the end of the lea (TD 47). As a result, CGT event A1 happens to the fixture at the end of the lease giving ris to a capital gain or loss by the lessee.

Similar rules apply to capital expenditure made by a lessee on leasehold improvements ie if a lessee continues to own the improvements during the period of the lease, the co base of the improvements includes the capital expenditure incurred in making them. If th improvements remain affixed to the land on expiry or termination of the lease, CGT even A1 happens to the improvements and a capital gain or loss is worked out accordingly. I the parties are not dealing at arm's length or no capital proceeds are received on disposa the market substitution rule applies (TD 98/23).

If a fixture installed by a lessee is regarded as no longer owned by the lessee, the lessee has disposed of the asset in terms of CGT event A1 and the owner of the land is treated as having acquired it, usually at the time the asset is affixed to the land (TD 48). However, there are also circumstances where ownership of the asset immediately vests in the lessor and ownership is not transmitted as such (eg where the asset is constructed on the leasehold land). In those cases, the asset is taken to be acquired by the lessor immediately without ever having been owned by the lessee.

Time of CGT event A1

If the asset is disposed of under a contract, the time of CGT event A1 is when the taxpayer enters into the contract. For this purpose, a contract may be an oral contract, provided it has all attributes required by common law, eg an intention for the parties to be immediately bound. In this manner, CGT event A1 has been held to occur on the countersigning of a letter of offer (*Scanlon & Anor*) and the signing of a heads of agreement despite the express statement it was "subject to and conditional upon" signing of formal agreement (*Case 2/2013*). Similarly, CGT event A1 was held to occur on the signing of the contract even though the terms of the contract were subsequently varied (*Case 7/2014*). Under NSW conveyancing practice, a binding contract for the sale of land would not normally be entered into until there is an exchange of written contracts (*McDonald*). However, a contract for the sale of land in Victoria was accepted as having occurred at the time a written offer and a written acceptance had been made, even though formal contracts were not entered into until over 2 months later (*Gardiner*).

If there is no contract for disposal of the asset, CGT event A1 happens when the change of ownership in the asset occurs. In cases where an asset is acquired from a taxpayer under a power of compulsory acquisition, CGT event A1 happens at the earliest of when: (i) compensation is received; (ii) the change of ownership happens; (iii) the acquiring entity enters upon the asset; or (iv) the acquiring entity takes possession.

For example, the timing of CGT event A1 may be when: (i) an instrument evidencing a transaction is executed; (ii) a transaction is otherwise entered into; (iii) an asset is transmitted by operation of law; or (iv) the asset is delivered.

A taxpayer is not required to report any capital gain or loss from CGT event A1 until an actual change of ownership occurs, eg at settlement. This means that when the change in ownership takes place in a later year, an earlier assessment for the year in which the contract was made may have to be amended. In such cases, late payment interest is generally waived if an amendment is sought within one month after settlement (TD 94/89). If a contract is subject to a condition (such as obtaining approval for finance), it does not affect the time the contract was made unless it is a condition precedent to the formation of the contract (*Case 24/94*).

▶ Planning point

As a capital gain (or loss) arises in the income year in which the disposal of an asset occurs (ie regardless of whether any of the proceeds for the disposal have been received) the terms for payment of the proceeds should be carefully considered. This is particularly relevant in circumstances involving vendor finance to the purchaser as the vendor may be liable for taxation prior to the receipt of the proceeds.

Where a business is being sold the use of look-through earnout rights may delay the point of taxation of the earnout payment: see ¶11-675.

If there are 2 or more contracts that affect the rights and obligations of parties to a disposal of assets, it is necessary to determine which contract is the source of the obligation to effect the disposal (*Sara Lee*).

If an option is exercised, the time of CGT event A1 in relation to the asset which is the subject of the option, is the date of the transaction entered into as a result of the exercise of the option (TD 16). The date the option was granted is not relevant (*Van*; ¶12-700). Similarly, if an unexercised option is assigned, the time of CGT event A1 is the date of the assignment with the acquisition date being when the option was granted.

Time of acquisition as a result of CGT event A1

If an asset is acquired by a taxpayer as a result of CGT event A1, it is acquired at the time of that CGT event.

is given merely as a matter of form by a vendor who is retiring from a particular business and does not wish to compete further. If a vendor has been fully remunerated for goodwill based on normal industry valuation methods, any further amount must reasonably relate to the restrictive covenant. If a vendor of a business who is also an employee of that business receives a payment for a restrictive covenant on the sale of the business, the amount may be characterised as a component of the intangible elements that comprise goodwill (TR 95/D).

The person entitled to the benefit of a restrictive covenant normally incurs a capital loss when it expires (¶11-270). If, however, the covenant is part of business goodwill, there are no CGT consequences until a CGT event happens to that goodwill (TD 95/54).

Timing of CGT event D1

The time of CGT event D1 is when the taxpayer enters into the contract or creates the other right. If a contractual or other right is acquired by a taxpayer as a result of CGT event D1, it is acquired at the time of that CGT event.

Capital gains and losses

A taxpayer makes a capital gain from CGT event D1 if the capital proceeds from creating the right are more than the incidental costs incurred in creating it. If the capital proceeds are less than the incidental costs, a capital loss is made. A capital gain from CGT event D1 cannot be a discount capital gain (¶11-033).

The market value substitution rule does not apply to capital proceeds received from CGT event D1.

The expenditure incurred in creating the right can include giving property. However, the incidental costs do not include any non-assessable recoupment of those costs nor any part of those costs that is deductible.

CGT event D2 — Granting an option

CGT event D2 happens if a taxpayer grants an option to an entity, or renews or extends a previously granted option (s 104-40). CGT event D2 does not happen if CGT event C2 (¶11-270) applies to the situation. CGT event D2 also does not happen if an option relates to a collectable or personal use asset.

In some cases, the grantor of an option may not, at the time of granting it, own the property in respect of which the option is granted and in fact may never own that property if the option expires, or is cancelled, released or abandoned. Similarly, the option may bind the grantor to acquire property which, because the option expires or is cancelled, released or abandoned, is not acquired. Nevertheless, CGT event D2 includes the granting of such an option.

The time of CGT event D2 is when the taxpayer grants, renews or extends the option. If an option is granted to a taxpayer and CGT event D2 applies to the grantor in relation to that option, the taxpayer acquires the option at the time of that CGT event. If CGT event D2 applies to the grantor of an option because it is renewed or extended, the option is still taken to have been acquired by the grantee when it was originally granted.

A taxpayer makes a capital gain from CGT event D2 if the capital proceeds from granting, renewing or extending the option are more than the expenditure incurred in making the grant, renewal or extension. If the capital proceeds are less than the incurred expenditure, a capital loss is made. A capital gain from CGT event D2 cannot be a discount capital gain (¶11-033).

The expenditure incurred in granting, renewing or extending the option can include giving property. However, the incurred expenditure does not include any non-assessable recoupment of the expenditure nor any part of the expenditure that is deductible.

A capital gain or loss from CGT event D2 is disregarded if the option is exercised. For the consequences of an option being exercised, see ¶12-700.

There is no exception to CGT event D2 if an option is granted on or after 20 September 1985 in relation to property acquired by the grantor before that date. This is because the relevant CGT asset is the option and not the original property from which the option was derived.

The happening of CGT event D2 from a deferred transfer farm out arrangement is considered in MT 2012/2.

CGT event D3 — Granting a right to income from mining

CGT event D3 happens if a taxpayer owns a prospecting or mining entitlement, or an interest in one, and grants another entity a right to receive income from operations carried on under the entitlement (s 104-45). If CGT event D3 happens, there is no disposal of the entitlement so CGT event A1 (¶11-250) does not happen.

If the right to the income is granted to the other entity under a contract, the time of CGT event D3 is when the taxpayer enters into the contract. If there is no such contract, the time of CGT event D3 is when the right to the income is granted. If a right to receive income from mining is acquired by a taxpayer as a result of CGT event D3, it is acquired at the time of that CGT event.

A taxpayer makes a capital gain from CGT event D3 if the capital proceeds from granting the right to the income are more than the expenditure incurred in granting that right. If the capital proceeds are less than the incurred expenditure, a capital loss is made. A capital gain from CGT event D3 cannot be a discount capital gain (¶11-033).

The expenditure incurred in granting the right to the income can include giving property. However, the incurred expenditure does not include any non-assessable recoupment of the expenditure nor any part of the expenditure that is deductible.

Special income tax arrangements apply to taxpayers who carry on mining operations (¶19-010) who incur mining transport capital expenditure (¶19-090). In line with these arrangements, assets that fall within the various capital expenditure categories which attract income tax deductions and balancing adjustments on disposal are treated as separate assets for CGT purposes (¶11-410). Where such assets are not treated as separate assets, they are included in the cost base of the prospecting permit or mining right.

CGT event D4 — Conservation covenants

CGT event D4 happens if a taxpayer enters into a conservation covenant over land that it owns (s 104-47). The time of the event is when the taxpayer enters into the covenant. For the definition of a conservation covenant, see ¶16-972.

If the capital proceeds from entering into the covenant are more than the part of the cost base of the land that is attributed to the covenant, the taxpayer makes a capital gain. If the capital proceeds are less than the part of the reduced cost base of the land attributable to the covenant, the taxpayer makes a capital loss. Where the taxpayer enters into the covenant for no material benefit and is entitled to a deduction under s 31-5 (¶16-972), the capital proceeds are the amount of that deduction (s 116-105). If there are no capital proceeds and no deduction, CGT event D1 will apply instead of CGT event D4. There will be no capital gain or loss in any event if the taxpayer acquired the land before 20 September 1985.

The part of the cost base of the land that is attributed to the covenant is:

$$\text{cost base of land} \times \frac{\text{capital proceeds from entering into the covenant}}{\text{those capital proceeds plus the market value of the land just after the taxpayer enters into the covenant}}$$

▶ **Example**

The cost base of land owned by the taxpayer is $200,000. The taxpayer received $10,000 for entering into a conservation covenant covering part of the land. The market value of the land just after the covenant was entered into is $285,000. The part of the cost base of the land that is attributed to the covenant is:

$$\frac{\$200{,}000 \times \$10{,}000}{\$10{,}000 + \$285{,}000} = \$6{,}780$$

The taxpayer, therefore, makes a capital gain of ($10,000 – $6,780) = $3,220.

[FITR ¶151-900 – ¶151-935]

The expenditure incurred can include giving property. However, the incurred expenditure does not include any non-assessable recoupment of the expenditure nor any part of the expenditure that is deductible.

Lease premiums versus goodwill

Lease premiums must be distinguished from payments for goodwill, which may attract concessional CGT treatment. In *Krakos Investments*, a case involving the sale of a hotel business on a leasehold basis, it was found that the parties' bona fide allocation of $420,000 of the sale price to goodwill was effective for tax purposes. There was no suggestion that the agreement was a sham, or that the rent was below market value. This conclusion was supported by a provision in the contract which obliged the vendor to buy back the goodwill, if required to do so by the purchaser, at the original price (see TR 96/24).

Lease inducements

It has been held that a cash lease inducement paid to a partnership of solicitors on the taking up of a lease of premises by the partnership's service company was assessable as ordinary income (¶10-116) (*Cooling*; *Montgomery*). Such a payment also gives rise to a capital gain from CGT event D1 (¶11-280). However, in such circumstances, the capital gain is reduced to prevent double taxation (¶11-690).

CGT event F2 — Granting a long-term lease

CGT event F2 happens if a lessor grants, renews or extends a lease over land that is for a period of at least 50 years and the lessor chooses for CGT event F2 to happen instead of CGT event F1 which deals with ordinary leases (s 104-115). Additional special rules may also apply to some lease transactions (¶12-680).

The time of CGT event F2 is when the lease is granted, renewed or extended. If a lease is granted to a lessee, or is renewed or extended, as a result of CGT event F2, it is acquired at the time of that CGT event.

A lessor makes a capital gain from CGT event F2 if the capital proceeds from the grant, renewal or extension are more than the cost base of the lessor's interest in the land. If the capital proceeds are less than that cost base, a capital loss is made. A capital gain from CGT event F2 cannot be a discount capital gain (¶11-033).

A capital gain or loss from CGT event F2 is disregarded if the land, or the lease to the lessor, was granted before 20 September 1985. This is also the case if the lease to the lessor was last renewed or extended before 20 September 1985.

CGT event F3 — Lessor pays lessee to get lease changed

CGT event F3 happens if a lessor incurs expenditure to get the lessee's agreement to vary or waive a term of the lease (s 104-120). However, CGT event F3 does not happen if the lessor can and does choose for CGT event F2 (see above) to apply. The expenditure can include giving property. For consequences relating to lease surrender payments, see ¶12-680 and ¶16-640.

The time of CGT event F3 is when the lease term is varied or waived.

A lessor makes a capital loss from CGT event F3 equal to the amount of expenditure incurred in getting the lessee's agreement to the lease variation. A capital gain cannot be made from CGT event F3.

CGT event F4 — Lessee receives payment for changing lease

CGT event F4 happens if a lessee receives a payment from the lessor for agreeing to vary or waive a term of the lease (s 104-125). The payment can include giving property. For consequences relating to lease surrender payments, see ¶12-680 and ¶16-640.

The time of CGT event F4 is when the lease term is varied or waived.

A lessee makes a capital gain from CGT event F4 if the capital proceeds from the event are more than the lease's cost base. A capital loss cannot be made from CGT event F4.

The cost base of the lease to the lessee is reduced to nil if the lessee makes a capital gain. If the capital proceeds are less than the cost base, the cost base of the lease to the lessee is reduced by the capital proceeds.

A capital gain from CGT event F4 is disregarded if the lease was granted before 20 September 1985 or was last renewed or extended before that date.

CGT event F5 — Lessor receives payment for changing lease

CGT event F5 happens if a lessor receives a payment from the lessee for agreeing to vary or waive a term of the lease (s 104-130). The payment can include giving property. For consequences relating to lease surrender payments, see ¶12-680 and ¶16-640.

The time of CGT event F5 is when the lease term is varied or waived.

A lessor makes a capital gain from CGT event F5 if the capital proceeds from the event are more than the expenditure incurred in relation to the variation or waiver. If the capital proceeds are less than the incurred expenditure, a capital loss is made.

Where CGT event F5 happens, the payment made by the lessee is capital expenditure incurred to enhance the value of the lease and is included in the fourth element of the lessee's cost base and reduced cost base for the lease.

The expenditure incurred can include giving property. However, the incurred expenditure does not include any non-assessable recoupment of that expenditure.

A capital gain or loss from CGT event F5 is disregarded if the lease was granted before 20 September 1985 or was last renewed or extended before that date.

[FITR ¶152-100 – ¶152-150]

¶11-310 CGT events involving shares

CGT event G1 — Capital payment for shares

CGT event G1 happens if:

(i) a company makes a payment to a taxpayer in relation to a share the taxpayer owns in the company

(ii) some or all of the payment (the non-assessable part) is not a dividend or a liquidator's distribution that is taken to be a dividend, and

(iii) the payment is not included in the taxpayer's assessable income (s 104-135).

The payment can include giving property, eg the distribution of an asset in specie.

Any part of the payment that is:

(i) non-assessable non-exempt income (¶10-890)

(ii) repaid by the taxpayer

(iii) compensation the taxpayer provided that can reasonably be regarded as a repayment of all or part of the payment, or

(iv) an amount referred to in s 152-125 (¶7-165) as an exempt amount, is disregarded when working out the non-assessable part.

However, the non-assessable part is not reduced by such amounts that are deductible to the taxpayer.

CGT event G1 does not apply to bonus shares issued out of a share capital account (TD 2000/2; ¶12-600) or to a payment made in relation to CGT event A1 (¶11-250) or C2 (¶11-270) happening to the share.

CGT event G1 may arise where a company makes a distribution to its' shareholders that constitutes an unauthorised reduction and return of share capital due to the distribution not complying with the requirements in the *Corporations Act 2001*, s 254T or Pt 2J.1 for the payment of a dividend or a reduction of capital (TR 2012/5).

CGT event G1 potentially applies where a liquidator's interim distribution is made more than 18 months before the company ceases to exist, but for other liquidators' distributions CGT event C2 will apply (TD 2001/27). See ¶11-270.

The time of CGT event G1 is when the company makes the payment.

- costs of the transfer
- stamp duty or other similar duty
- in relation to the acquisition of a CGT asset, the costs of advertising to find a se and, in relation to a CGT event, the costs of advertising to find a buyer
- costs relating to the making of any valuation or apportionment
- penalty interest (TR 2019/2)
- marketing expenses
- search fees relating to a CGT asset
- the cost of a conveyancing kit (or a similar cost)
- borrowing expenses (such as loan application fees and mortgage discharge fees)
- certain expenses incurred by the head company of a consolidated group or M group (¶8-920)
- termination and other similar fees incurred as a direct result of a CGT asset endin

Third element: ownership costs

The *third element* is the costs of owning an asset (but only if the asset was acquired after August 1991) (s 110-25(4)). However, there is no third element for collectables or perso use assets.

Costs of owning an asset consist of any expenditure incurred by a taxpayer to the extent which it is incurred in connection with the continuing ownership of the asset. These co include interest on money borrowed to acquire an asset, costs of maintaining, repairing a insuring an asset, rates and land tax, interest on money borrowed to refinance the mon borrowed to acquire an asset, and interest on any money borrowed to finance capi expenditure incurred to increase an asset's value.

The cost of obtaining a loan is not part of the cost base of the asset acquired, ie it is which relates to the borrowing, not the asset financed by the borrowing (TD 93/1).

Costs of ownership that are disallowed under ITAA36 Pt IVA (¶30-000) do not form p the cost base of an asset unless the Commissioner makes a compensating adjustment to t effect. A compensating adjustment is not available in the case of split loan arrangeme of the type discussed in TR 98/22 (TD 2005/33).

Fourth element: enhancement costs

The *fourth element* is capital expenditure incurred to increase or preserve the value of t CGT asset (s 110-25(5)). The fourth element includes capital expenditure that relates installing or moving the asset. However, it does not apply to capital expenditure incurr in relation to goodwill.

TD 98/23 details the inclusion of expenditure incurred by a lessee on capital improvemen to a leased property. The cost of non-deductible initial repairs (¶16-700) incurred after acquisition of an asset may be included in the fourth element of the cost base of an as (TD 98/19).

Fifth element: title costs

The *fifth element* is capital expenditure incurred to establish, preserve or defend t taxpayer's title to the asset (s 110-25(6)). An amount of damages paid by a taxpayer a potential purchaser upon the acceptance of the termination of contract to sell the as following repudiation of the contract by the taxpayer may be included in the fifth elem of the cost base of that asset (ID 2008/147).

Amounts not included in cost base

Assets acquired after 7.30 pm on 13 May 1997

Expenditure does not form part of the cost base of an asset to the extent that the taxp can deduct it, eg interest, or to the extent that a non-assessable recoupment is recei in respect of it (s 110-45). An amount received pursuant to the First Home Owners Gra for building a home is excluded from the cost base of the property. Where a taxpayer h

omitted to claim a deduction and the amendment period for claiming the deduction has expired, the cost base of the asset will not be reduced by the deduction that was previously available (TD 2005/47).

Capital expenditure incurred by another entity, such as a previous owner, in respect of the asset which the taxpayer can deduct, eg under the capital works provisions of Div 43 (¶20-470), reduces the cost base of that asset. In certain circumstances the Commissioner will accept that the taxpayer cannot deduct an amount under Div 43 and is therefore not required to reduce the asset's cost base (PS LA 2006/1 (GA)).

Expenditure does not form part of the cost base to the extent that heritage conservation expenditure or landcare and water facilities expenditure incurred after 12 November 1998 gives rise to a tax offset. Where the benefit of a deduction is effectively reversed by a balancing adjustment, the relevant expenditure is increased. Similar rules apply to a partnership in which the taxpayer is a partner where expenditure is deductible or a recoupment is not assessable (s 110-50).

For this purpose, compensation received for permanent damage to an asset is treated as a non-assessable recoupment. To the extent that the compensation exceeds the unindexed costs of an asset, no CGT implications arise (TR 95/35). Where a taxpayer purchases an asset using a limited recourse loan and the taxpayer defaults on the loan resulting in the asset being transferred to the lender in full satisfaction of the loan at a time when its market value is less than the balance of the outstanding loan, the shortfall is a recoupment and accordingly excluded from the cost base of the asset (ID 2013/64).

These rules also apply to expenditure incurred after 30 June 1999 on land and buildings acquired before 13 May 1997 where the expenditure forms part of the fourth element (ie enhancement costs) of the cost base of the land or building.

▶ **Example**

John bought a building on 1 December 2011 for $200,000. The building qualifies for capital works deductions at the rate of 2.5% a year. If the building was sold on 30 November 2020, then, for the purpose of working out the capital gain on disposal, the cost base (indexed where relevant) is reduced by $45,000 to account for the capital works deductions available to John in the 9 years leading up to 30 November 2020.

Assets acquired before 7.30 pm on 13 May 1997

Where assets were acquired before 7.30 pm EST on 13 May 1997, expenditure is not included in the second and third elements of the cost base if it is deductible nor in any element if a non-assessable recoupment is receivable in respect of the expenditure (s 110-40). Similar rules apply where expenditure was deductible, or a recoupment was not assessable, to a partnership in which the taxpayer was a partner (s 110-43).

Other exclusions

Expenditure does not form part of any element of the cost base of an asset to the extent that it (s 110-38):

- relates to illegal activities for which a deduction is denied under s 26-54 (¶16-105)
- is a bribe to a public official or foreign public official
- is in respect of entertainment
- is a penalty that is excluded from deduction under s 26-5 (¶16-845)
- is for the excess of boat expenditure over boat income that is excluded from deduction under s 26-47 (¶16-420)
- is for political contributions and gifts that are excluded from deduction (s 110-38(6)).
- travel expenditure related to the use of residential premises for rental for which a deduction is denied pursuant to the s 26-31 (s 110-38(4A)).

GST net input tax credits are excluded from all elements of the cost base and reduced cost base of a CGT asset (s 103-30).

A share that falls within (1) will also be a convertible interest if it satisfies (4) above (TD 2007/26). For other examples of the application of the test, see ID 2003/325 to ID 2003/327 and ID 2003/873.

Related schemes – Two or more related schemes may also be categorised as together giving rise to an equity interest where the economic substance of the combined schemes is equivalent to an equity interest (ITAA97 s 974-70(2)). This will not be the case where each of the constituent schemes individually gives rise to an equity interest or the Commissioner exercises the discretion to treat the schemes as not giving rise to an equity interest.

Note that a new scheme aggregation rule has been proposed, which, if enacted, will replace the related schemes rule in s 974-70(2). The new rule is discussed below.

Equity override integrity provision – An equity override integrity provision in s 974-80 can apply to complex circumstances where a group raises capital by issuing an effective equity interest through the issue of debt to an interposed entity connected to the issuer. The central test is whether the return on a debt interest in one scheme is designed to be used to fund the return on an equity interest in a separate scheme. If these criteria are satisfied, the debt issued is treated as an equity interest. Clarification on this equity override provision is provided in TD 2015/3 and TD 2015/10. The equity override provision will not apply merely because a non-resident entity has chosen to invest indirectly in a debt interest issued by an Australian resident company and there are one or more equity interests interposed between the non-resident entity and the entity holding the debt interest (TD 2015/2).

Note that a new scheme aggregation rule has been proposed, which if enacted will replace the equity override integrity provision in s 974-80. The new rule is discussed directly below.

New scheme aggregation rule – The government released draft legislation in 2016, which proposed a new scheme aggregation rule to replace the existing related scheme rules in ss 974-15(2) and 974-70(2), and the equity override integrity provision in s 974-80. The proposed new rule ensures multiple schemes are treated as a single scheme only if this accurately reflects the economic substance of the schemes. Under the proposed rule, it is necessary to consider whether the pricing, terms and conditions of the schemes are interdependent in a way that would change their debt or equity treatment under Div 974, and whether it would be concluded that the schemes were designed to operate to produce their combined economic effect – a link that is either accidental or present, without any element of design, is not sufficient to cause the schemes to be aggregated.

Exception for at call loans – From 1 July 2005, related party at call loans are deemed to be debt for a company if the company satisfies a less than $20 million annual turnover test in that year. This deeming rule applies whether the loan was made before or after 1 July 2005. As there may be fluctuations in turnover, the taxpayer may elect to alter the loan so that it is a debt interest (as if the change occurred at the beginning of the previous year). The election must be made before the earlier of the due date for the company's return or the actual lodgment date (ITAA97 s 974-110). See also ATO Guide "Debt and equity tests: guide to 'at call' loans", and CCH *Tax Week* ¶734 (2005).

"Non-share equity interest" – A non-share equity interest in a company is an equity interest in the company that is not solely a share (ITAA97 s 995-1(1)), eg it may be an interest that is not a share or stapled security that includes a share (eg ID 2003/901; ID 2004/56). An investment in an unsecured note to be issued by a private investment company to a director is a non-share equity interest (ID 2002/794).

Tax treatment of equity interests

A company cannot deduct a dividend paid on an equity interest as a general deduction and cannot deduct a non-share distribution (¶23-125) or a return that has accrued on a non-share equity interest (ITAA97 s 26-26).

The dividend franking provisions (¶4-880) apply generally to a non-share equity interest and an equity holder in the same way that they apply to a share and a shareholder.

Most of the other relevant provisions of ITAA97 and ITAA36 apply in a similar manner, as noted in the commentary dealing with those provisions.

[FITR ¶762-823 – ¶762-850]

¶23-120 Non-share capital accounts

A company will have a notional account called a "non-share capital account" if it issues non-share equity interest (¶23-115) in the company (ITAA97 s 164-10). Furthermore a company will have a non-share capital account if: (a) a debt interest changes to an equity interest as a result of a material change under s 974-110 (¶23-100); (b) a related party at call loan that was a debt interest becomes an equity interest on 1 July 2005 (¶23-115); or (c) the small company related party at call loan deeming rule ceases to apply to an interest (¶23-115). Special provisions applied to interests issued before 1 July 2001 that were still in existence on that date. The account records contributions to the company in relation to those non-share equity interests and returns of those contributions made by the company.

Once established, the non-share capital account continues indefinitely, even if the company ceases to have any non-share equity interests in existence. The balance cannot fall below nil.

Credits to non-share capital account

The only credits that may be made to the non-share capital account are those provided for in ITAA97 s 164-15. These are:

- where the company issues a non-share equity interest (¶23-115), the account is credited with the consideration the company receives *less* any credit made to its share capital account in respect of the issue (eg where the interest is a stapled security that includes a share). Where the consideration is other than money, it is valued at its market value at the time it is provided
- where a debt interest changes to an equity interest under (a) to (c) above, the account is credited with the consideration the company received for the issue of the interest, less any credit made to its share capital account in respect of the issue, *less* so much of the original consideration received that has been returned to the holder of the interest before the change occurs.

Debits to non-share capital account

The only debits that may be made to the non-share capital account are those that are provided for in ITAA97 s 164-20. These are as follows.

- All or part of a non-share distribution is debited to the account to the extent that: (a) the distribution is made as consideration for the surrender, cancellation or redemption of a non-share equity interest; or (b) the distribution is made in connection with a reduction in the market value of a non-share equity interest and equals that reduction.
- Where: (a) an equity interest changes at any time to a debt interest, as a result of a material change (¶23-100); or (b) the small company related party at call loan deeming rule applies to an interest that was an equity interest at the end of the previous year (¶23-115), the account is debited with the sum of all the credits that have been made to the account in relation to the interest *less* the sum of all the debits that have been made to the account in relation to the interest before the change occurs (ie the net balance in relation to that interest is offset to nil).

The total debits to the account in respect of a non-share equity interest cannot exceed the total credits in respect of the interest, ie there cannot be a negative balance in respect of any particular interest.

[FITR ¶178-000 – ¶178-030, ¶762-873]

¶23-125 Non-share distributions

A company makes a "non-share distribution" to a person if the person holds a non-share equity interest in the company and the company distributes money or other property, or credits an amount, to that person as the holder of the interest. A non-share distribution is characterised as: (a) a "non-share dividend"; and/or (b) a "non-share capital return". Such distributions are not deductible (¶23-115).

Every non-share distribution is a non-share dividend, except to the extent that it is debited to the company's non-share capital account or share capital account. To the latter extent, it is a non-share capital return (ITAA97 Subdiv 974-E).

[FITR ¶762-873 – ¶762-880]

Proposed changes to taxation of hire purchase arrangements

The government announced in its 2016–17 Budget that key barriers to the use of asset backed financing arrangements, which are supported by assets, such as deferred payment arrangements and hire purchase arrangements will be removed. The government will clarify the tax treatment of asset backed financing arrangements and ensure they are treated in the same way as financing arrangements based on interest bearing loans or investments. When enacted, the changes are intended to apply from 1 July 2018.

[FITR ¶225-000 – ¶225-810]

¶23-260 Limited recourse debt arrangements

Limited recourse debt arrangements are subject to specific rules in ITAA97 Div 243. The TOFA regime in Div 230 does not apply to these arrangements.

Division 243 limits the deductions that a taxpayer may claim in respect of property acquired using "limited recourse debt". The Division achieves this by recouping excess capital allowance deductions claimed with respect to capital expenditure where the taxpayer has not been fully at risk in relation to the expenditure because it is financed by a limited recourse debt and has not fully repaid the debt upon termination.

Limited recourse debt

Division 243 only applies where there is a limited recourse debt. A creditor's rights of recourse can be limited by contractual terms or by the overall effect of an arrangement, eg where a special purpose entity debtor predominantly holds and operates the financed assets. In both situations, the debtor is not fully at risk with respect to the debt and therefore the capital expenditure which is financed by the debt.

The definition of "limited recourse debt" was intended to apply to both contractually limited recourse debt arrangements as well as debt arrangements where recourse is effectively limited through arrangements. However, the High Court held that the definition applied to contractually limited debt recourse arrangements (*BHP Billiton*).

To ensure that Div 243 applies to debt arrangements where recourse is effectively limited through arrangements, the definition of limited recourse debt has been amended to cover debt arrangements where it is reasonable to conclude that the debtor has not been fully at risk with respect to the debt because the creditor's recourse is effectively limited to the financed property or property provided to secure the debt. This amendment applies to debt arrangements terminated at or after 7.30 pm AEST in the ACT, on 8 May 2012.

Limit to capital allowance deductions

Where property is acquired under limited recourse debt (including hire purchase and instalment sales), the purchaser or hirer will only be able to obtain capital allowance deductions equal to the amount actually paid under the arrangement. The deduction limit applies where the debt is terminated and, on termination, the debtor does not fully pay out the capital amounts owing. Capital allowance deductions are those under ITAA97 Div 40 (depreciating assets and other expenditure: Chapters 17, 18 and 19), ITAA36 Pt III Divs 10B and 10BA (films: ¶20-340, ¶20-350), the capital works provisions (¶20-470) and the rules for small business entities (Chapter 7).

The amount to be included in the debtor's assessable income on termination of the debt arrangement is worked out by comparing:

(1) the deductions that would be allowable if the expenditure were reduced by the unpaid amount of debt (the "deduction limit"), and

(2) "actual deductions".

If the actual deductions exceed the deduction limit, the excess is assessable.

"Actual deductions" comprise the deductions allowed or allowable in the years up to the end of the debt termination year in respect of the financed property (including any deductible balancing adjustment on disposal) *less* any amount assessable on disposal that effectively reverses such a deduction (eg an assessable balancing adjustment).

The "deduction limit" is calculated as if the deductions continued to be available after the debt was terminated. This means that generally a 100% write-off of the expenditure is assumed, reduced by the amount of the unpaid debt. No reduction to the deduction limit is made for any assessable balancing adjustments made as a result of the disposal.

Special rules apply if *after the debt arrangement is terminated*: (a) a capital allowance deduction entitlement arises (ITAA97 s 243-55); (b) an assessable balancing adjustment arises from a disposal (ITAA97 s 243-57); or (c) a payment is made for the debt or a replacement debt (ITAA97 ss 243-45; 243-50).

Such adjustments are not taken into account in calculating the cost base of the asset for CGT purposes.

For limited recourse finance arrangements which have triggered the operation of the general anti-avoidance provisions, see ¶30-160 and ¶30-170.

▶ Example

Property is bought under hire purchase for $100,000 on 1 July 2018. Its decline in value is calculated over 5 years using the prime cost method. A limited recourse loan of $100,000 finances the purchase. The arrangement is terminated on 30 June 2021 when the property is surrendered to the financier and the amount of $70,000 remains unpaid. The market value of the property on that date is $50,000.

The decline in value of the property for the 3 years is $60,000 and the adjustable value of the property on 30 June 2021 is $40,000. As the termination value of the property is $50,000, there is an assessable balancing adjustment of $10,000. "Actual deductions" are $50,000, ie the total capital allowance deductions ($60,000) less the assessable balancing adjustment ($10,000).

The amount of the deductions that would otherwise be allowable (ie the deduction limit) is $30,000, calculated on the assumption that the original expenditure ($100,000) was reduced by the unpaid amount ($70,000), and that deductions continued for the effective life of the property.

As the actual deductions ($50,000) exceed the deduction limit ($30,000), the excess ($20,000) is assessable.

[FITR ¶230-000 – ¶230-340]

¶23-270 Tax loss incentive for designated infrastructure projects

Nationally significant infrastructure projects designated by the Infrastructure CEO (a statutory officeholder under the *Infrastructure Australia Act 2008*) benefit from certain tax loss incentives. The window for receiving designation closed on 30 June 2017 and no new projects can benefit from the incentives unless prescribed by regulation. For details of this incentive see earlier editions of the *Australian Master Tax Guide*.

[FITR ¶389-000 – ¶389-050]

Financial Instruments

¶23-300 Financial instruments overview

The enactment of Div 230 changed the taxation rules applicable to gains and losses on financial arrangements (¶23-020). The rules in Div 230 do not apply, however, to all arrangements. The following paragraphs deal with the taxation consequences, under both general principles and specific provisions, of using certain financial instruments where the rules in Div 230 do not apply.

Financial instruments

For accounting purposes, a financial instrument is a contract that is a financial asset of one entity and the financial liability or equity instrument of another entity. A financial asset is an asset that is cash, or an equity instrument of another entity, or the contractual right to receive cash or another financial asset from another entity, or the contractual right to exchange other financial instruments on potentially favourable terms with another entity. Financial liability is a contractual obligation to deliver cash, or another financial asset to another entity, or to exchange other financial instruments on potentially unfavourable terms with another entity. Thus, financial instruments include a broad range of products, from simple debt instruments (eg loans) to derivative instruments (eg swaps, financial options, futures and forward contracts) and hybrids such as perpetual debt and certain preference shares.

to the Australian Transactions Reports and Analysis Centre (AUSTRAC). These reporting obligations are imposed to combat money laundering, terrorism financing and tax evasion. The data collected is shared with the ATO and other government bodies.

The obligation to report significant cash transactions, and suspect transactions, is imposed by the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act), the AML/CTF Regulations and the AML/CTF Rules issued by AUSTRAC. The AML/CTF Act largely replaces the *Financial Transaction Reports Act 1988* (FTRA). The FTRA continues to have limited application, including to "cash dealers" who are not subject to the AML/CTF Act (see below).

Persons subject to the AML/CTF Act

The AML/CTF Act applies to persons ("reporting entities") who provide "designated services". These reporting entities must enrol with AUSTRAC and fulfil certain reporting obligations described below.

Reporting entities include financial services entities (banks, insurance providers, superannuation funds, finance and leasing providers, stockbrokers, remittance dealers and digital currency exchange providers), bullion dealers and gambling service providers. Accountants and lawyers are also affected to the extent they provide financial services (they are not captured for providing advice and services relating to other aspects of their business).

Financial services, which are designated services, include opening an account, accepting money on deposit, making a loan, issuing a bill of exchange, a promissory note, or a letter of credit, issuing a debit or stored value card, issuing travellers' cheques, sending and receiving electronic funds transfer instructions, making money or property available under a designated remittance arrangement, acquiring or disposing of a bill of exchange, promissory note or letter of credit, issuing or selling a security or derivative, accepting a contribution, roll-over or transfer in respect of a member of a superannuation fund, exchanging currency and buying or selling emissions units.

AML/CTF obligations

The principal obligations for reporting entities under the AML/CTF Act are to:

- enrol with AUSTRAC
- register with AUSTRAC if the entity provides remittance services
- implement and maintain an AML/CTF program to identify, assess, mitigate, and manage the risk of money laundering and terrorism financing. Members of a designated business group may operate a joint AML/CTF program with other members of the group
- identify customers and undertake ongoing customer due diligence. This obligation includes a requirement to determine the ultimate beneficial owner of each customer and collect, and verify the beneficial owner's details, including full name, address and date of birth. Identification of a domestic company includes verifying their registered ASIC name, registered office and the company's ACN
- lodge transaction reports and compliance reports with AUSTRAC, including an annual AML/CTF compliance report, which can be submitted through AUSTRAC Online. Compliance reports must be submitted between 1 January and 31 March of each year. The due date for the 2021 annual report is 31 March 2022, and
- comply with various AML/CTF related record-keeping obligations including reporting:
  - suspicious matters
  - the provision of a designated service, which is the transfer of an amount of $10,000 or more (physical currency or electronic transfer)
  - the provision of designated services in relation to international funds transfer instructions to or from Australia.

AUSTRAC may exempt certain persons from specified provisions of the AML/CTF Act – see further the AUSTRAC website.

Penalties for non-compliance

Penalties for non-compliance with the AML/CTF Act include civil penalties of up to $22.2 million for bodies corporate and $4.44 million for other persons. Criminal penalties may also be imposed. The AML/CTF Act establishes offences for producing false or misleading information or documents, forging a document for use in an applicable customer identification procedure, providing or receiving a designated service using a false customer name or customer anonymity, and structuring a transaction to avoid a reporting obligation. In addition to the penalties imposed under the AML/CTF Act, producing false or misleading information or documents may also lead to penalties under other acts, eg under the *Corporations Act 2001* for failure to maintain proper records and under the *Criminal Code Act 1995* for false accounting.

Information exchange agreements

AUSTRAC has signed nearly 100 intelligence sharing agreements with foreign counterparts, including foreign law enforcement and national security agencies. Information exchange may also occur under tax information exchange agreements and some tax treaty articles (¶22-140), and the US Foreign Account Tax Compliance Act (¶22-075).

Australia has enacted legislation giving effect to a number of OECD/G20 initiatives allowing for the automatic exchange of information with partner countries. These initiatives include the Common Reporting Standard, the new single global standard for the collection, reporting and exchange of financial account information on foreign tax residents, and the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) (¶22-165). Australia is also a member of the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes, which supports the fight against tax evasion by ensuring the effective implementation of international standards on tax transparency and exchange of ownership, accounting and financial account information (both "on request", and "automatically").

Financial Transaction Reports Act 1988

The FTRA has largely been replaced by the AML/CTF Act, but continues to have limited application to "cash dealers" who are not subject to the AML/CTF Act. In practice, the only entities with reporting obligations to AUSTRAC under the FTRA are:

- businesses selling traveller's cheques, such as Australia Post and travel agents
- insurers
- motor vehicle dealers who act as an insurer or insurance intermediary, and
- solicitors.

The reporting obligations imposed by the FTRA include:

- cash dealers must provide: a *significant cash transaction report* to AUSTRAC for any transaction that involves a cash component of $10,000 or more, or its equivalent in a foreign currency; an *international funds transfer instruction report* for any instruction for the transfer of funds, which is transmitted electronically into or out of Australia on behalf of a customer; a *suspect transaction report* where any transaction leads to reasonable grounds to suspect that information may be relevant to investigation of criminal offences, including terrorism financing, tax evasion and other criminal activity, or may assist in enforcing the proceeds of crime legislation, and
- solicitors must report significant cash transactions of $10,000 or more, or its equivalent in a foreign currency.

[FTR ¶979-360 – ¶979-630]

Neither a public ruling nor a private ruling is altered by a contrary court or AAT decision except, in the case of a private ruling, if the court or AAT decision is given on a review or appeal relating to the particular private ruling. However, if a court or AAT decision is more favourable than a public, private or oral ruling, the decision may be relied on by the taxpayer.

Status of old rulings

A legally binding ruling about a provision under ITAA36 (old law) will be a binding ruling about a corresponding provision under ITAA97 (new law) in so far as the old and new provisions express the same ideas (TAA Sch 1 s 357-85). In deciding whether the new law expresses the same ideas as the old law, taxpayers can assume that there has been no change in those ideas unless announced otherwise (TR 2006/10; TR 2006/11).

A public, private or oral ruling in force immediately before 1 January 2006 has effect on and after that day as if it were a public, private or oral ruling made under the new rulings framework (ie TAA Sch 1 Divs 358; 359; 360).

Conflicting rulings

Where more than one ruling applies to a taxpayer and the rulings are inconsistent, the following rules apply (TAA Sch 1 s 357-75):

(1) if the earlier ruling is a public ruling, the taxpayer may rely on either ruling regardless of the later type of ruling

(2) if both the earlier and the later rulings are private or oral rulings, the earlier ruling is taken not to have been made if the Commissioner was informed about the existence of the earlier ruling (otherwise the later ruling is taken not to have been made)

(3) if the earlier ruling is a private or an oral ruling and the later ruling is a public ruling, the earlier ruling is taken not to have been made if, when the later ruling is made, the period to which the rulings relate has not begun and the scheme to which the ruling relates has not begun to be carried out (otherwise either ruling can be relied on).

Disregard of rulings

There is no penalty for a shortfall resulting from failure to follow a ruling; however, such failure may go towards determining whether a position taken by a taxpayer is reasonably arguable or whether the shortfall was caused by a lack of reasonable care for the purposes of the tax shortfall penalty provisions (TAA Sch 1 s 357-65; ¶29-160).

[FTR ¶978-504, ¶978-520, ¶978-552]

¶24-540 Public rulings

The Commissioner may make public rulings (including determinations) on the way in which a tax law applies to: (i) entities generally or to a class of entities; (ii) entities in relation to a class of schemes; or (iii) entities in relation to a particular scheme (TAA Sch 1 s 358-5). The Commissioner can make public rulings on matters of administration, collection, ultimate conclusions of fact, risk management material, safe harbours, ABN matters and matters specific to a single entity.

TR 2006/10 explains the public rulings system. A public ruling must state that it is a public ruling and must contain a subject heading and a number for identification. The Commissioner must publish a brief description of the ruling in the *Commonwealth Gazette*. A public ruling is "made" at the later of the time when it is published and the time when the notice of it is published in the *Gazette*. However, if the latter does not occur, the ruling can still be relied on and will bind the Commissioner. A ruling does not apply to schemes that have already begun to be carried out if it changes the Commissioner's general administrative practice and is less favourable to a taxpayer than the practice (TAA Sch 1 s 358-5; 358-10). Only part of a ruling may be a public ruling; the "explanations" part of a public ruling is not binding on the Commissioner (*Taneja*).

Rulings and determinations are usually first issued in draft form for public comment. Where a final ruling takes a position contrary to the draft ruling, and the draft ruling represents the Commissioner's general administrative practice, the final ruling cannot apply retrospectively to a taxpayer's detriment. A general administrative practice is a

practice which is applied by the Commissioner generally as a matter of administration (TD 2011/19). Where the draft ruling represents the Commissioner's only public statement on an issue, it will usually represent the Commissioner's general administrative practice (Explanatory Memorandum to Tax Laws Amendment (Improvements to Self Assessment) Bill (No 2) 2005, para 3-53 and 3-130).

The expression of the Commissioner's opinion in a draft ruling is not, however, a decision of an administrative character made (or proposed to be made) under an enactment, and hence is not reviewable under the *Administrative Decisions (Judicial Review) Act 1977* (*Barkworth Olives Management Ltd*).

The Commissioner may withdraw a public ruling in whole or in part by publishing a notice of withdrawal in the *Commonwealth Gazette*. If a public ruling is withdrawn, it remains applicable to schemes begun to be carried out before the withdrawal (TAA Sch 1 s 358-20).

Product rulings

PR 2007/71 explains the operation of the product ruling system. The Commissioner issues product rulings to rule publicly on the availability of claimed tax benefits from "products". These are arrangements in which a number of taxpayers individually enter into substantially the same transactions with a common entity or a group of entities, eg primary production schemes or investment arrangements. Promoters, or the persons involved as principals in the carrying out of the arrangement (but not the participants), may make a written application for a product ruling using the format outlined in PR 2007/71.

A product ruling applies to all persons within a specified class who enter into the specified arrangement during the term of the ruling, ie the investors. These persons need not seek a private ruling on the tax consequences of their investment in the product. The product ruling is legally binding on the Commissioner and investors can rely on the statements it contains, provided that the arrangements are carried out in accordance with the details provided by the applicant and described in the ruling.

If the arrangement implemented is materially different from that described then the Commissioner may withdraw the ruling and the ruling will not apply to arrangements begun to be carried out after the date of withdrawal. In *Carey v Field* the Federal Court pointed out that the statutory provisions do not suggest that the Commissioner can only withdraw a public ruling if the differences between the arrangements ruled upon and the arrangements implemented *must* result in a different tax outcome. However, the court went on to say that the Commissioner is not expected to withdraw a ruling unless he is of the view that the differences are at least *likely* to result in a different tax outcome.

Product rulings only apply to arrangements entered into after the date the ruling is made. Persons investing in the product before the ruling is made cannot rely on the ruling.

Class rulings

CR 2001/1 outlines the class rulings system and the information that must be provided by an entity requesting such. Class rulings enable the Commissioner to provide advice in response to a request from an entity about the application of a tax law to a specific class of persons in relation to a particular arrangement. Their purpose is to provide certainty to participants and overcome the need for individual participants to seek private rulings. To this end, the Commissioner may also issue a class ruling where a member of a class of persons affected by a particular arrangement requests a private ruling on the arrangement.

A class ruling applies to all persons within a specified class who participate in the specified arrangement during the term of the ruling. Such rulings are legally binding on the Commissioner and participants can rely on the statements they contain, provided the arrangements are carried out as described in the ruling. Class rulings will *not* be issued in relation to investment schemes and similar products (for which a product ruling should be sought). Nor will a class ruling be issued where the Commissioner has announced a change to the law on which he has been asked to rule. Where the Commissioner is unable to rule favourably, a private ruling may be obtained to enable the issues to be tested through the relevant review processes.

to be paid to the vendor, or as the vendor directs, as remains after the mortgage has been discharged (PS LA 2011/18). However, the result in *Park*, where the Commissioner enforced a notice ahead of 2 secured creditors, seems to sit uneasily with his stated policy in PS LA 2011/18.

A notice does not override an equitable lien held by the taxpayer's solicitor over the moneys charged by a notice for costs reasonably incurred in recovering those moneys (*Government Insurance Office of NSW*; *Heath*).

A notice issued to a third party after the commencement of the winding up of the taxpayer company, ie where a liquidator has been appointed, is invalid (*Bruton Holdings*); TAA Sch 1 s 260-45 provides a specific regime for the collection and recovery of tax liabilities of such companies, ie by requiring liquidators to set aside from the available assets of the company an amount sufficient to pay the Commissioner the amount recoverable as an unsecured creditor in the liquidation.

Further, once the taxpayer's debt is discharged, whether by payment or otherwise (eg where the taxpayer successfully challenges the relevant assessment), the notice ceases to have effect (*Government Insurance Office of NSW* – in that case, the tax debt was discharged upon the taxpayer being discharged from bankruptcy).

Review of s 260-5 notices

A decision to issue a notice under TAA Sch 1 s 260-5 is subject to judicial review (*Edelsten v Wilcox*); however, it is not reviewable by the AAT under TAA Pt IVC because it is not a reviewable objection decision (*Rossi*).

[FTR ¶977-690]

¶25-550 Departure prohibition orders

The Commissioner can issue a departure prohibition order (DPO) to stop a person with a tax debt leaving Australia (TAA ss 14Q to 14ZA). The issue of a DPO ensures that the debtor does not leave Australia without discharging an outstanding tax liability or without making satisfactory arrangements for it to be discharged. The penalty for defying a DPO is severe: a fine of up to 50 penalty units (¶29-000); and/or one year's imprisonment.

Where a DPO is in force, the debtor may still leave Australia temporarily if he/she obtains a departure authorisation certificate from the Commissioner. These will generally only be issued if the Commissioner is satisfied that the debtor will return to Australia and the tax liability will be discharged or that a temporary departure should be allowed on humanitarian or general policy grounds.

The Commissioner is required to revoke a DPO if: (1) the debtor's tax liabilities have been wholly discharged and the Commissioner is satisfied that any future tax liabilities in respect of matters that have occurred will be wholly discharged or completely irrecoverable; or (2) the Commissioner is satisfied that the debtor's tax liabilities are completely irrecoverable.

An appeal lies to the Federal Court or the Supreme Court against the making of a DPO. An appeal is not simply a rehearing of the matter and the onus is on the debtor to prove the DPO is invalid (*Poletti*). A decision to make a DPO is also reviewable under the *Administrative Decisions (Judicial Review) Act 1977* (ADJR Act) (¶28-180), but is not reviewable by the AAT (*Case 7/95*). The Commissioner's refusal to revoke a DPO or to issue a departure authorisation certificate is reviewable by the AAT or, in appropriate circumstances (eg where the matter involves the interpretation of the legislation), by the Federal Court under the ADJR Act (¶28-180). A taxpayer who wanted to go overseas to visit sick relatives, spend time with his wife and children and participate in certain volunteer works was granted a departure authorisation certificate by the AAT on humanitarian grounds (*Crockett*). However, the Commissioner's refusal to issue a departure authorisation certificate has been upheld in cases where taxpayers had previously breached DPOs and failed to provide any security for their return (*Eid*; *Koueider*). Further, a taxpayer who owed $23 million in tax debts and offered some security but not enough to satisfy the Commissioner could not obtain a departure authorisation certificate even though his wife was dying overseas (*Lui*).

Penalties will be attracted if a person fails to answer questions from police or Customs officers directed at determining whether the person is affected by a DPO (maximum penalty is a fine of 10 penalty units: ¶29-000) and for knowingly making a false reply to such a question (maximum penalty is a fine of 10 penalty units (¶29-000) or 6 months' imprisonment, or both).

Appeals against DPOs were unsuccessful in the *Briggs*, *Winter* and *Poletti cases*.

However, an appeal was successful in *Pattenden* because the DPO had been altered by an ATO officer after it had been authorised by the decision-maker and reasonable grounds did not exist for the belief that the taxpayer was a flight risk. Further, in *Skase's case*, the Federal Court said that because the taxpayer had very few assets in Australia, the recovery of tax could not be affected by his departure. In *Edelsten's case*, the Federal Court held that the taxpayer's bankruptcy released him from his tax liabilities at the time the sequestration order was made. Similarly, the AAT in *Walsh* revoked a DPO the ATO granted almost 3 years previously, after balancing its severe intrusion on the taxpayer's freedom of movement (his principal place of residence was in the USA with his wife and young daughter) against the protection of the revenue.

[FTR ¶970-700]

¶25-560 Directors penalties

Special regimes enable the Commissioner to recover from the directors of companies unpaid amounts under the PAYG withholding system (¶26-500), unpaid superannuation guarantee charge (SGC: ¶39-000) and liabilities under the GST Act relating to GST (¶34-000), luxury car tax (LCT: ¶34-220) and wine equalisation tax (WET: ¶34-360).

Estimated liabilities

Under TAA Sch 1 s 268, the Commissioner may make a reasonable estimate of a person's liability for any unpaid and overdue amount of PAYG under TAA Sch 1 s 16-70, SGC for a quarter (to the extent that the charge has not already been assessed), and/or a net amount for a tax period under the GST Act relating to GST, LCT and WET (to the extent that the net amount has not been assessed), having regard to anything that the Commissioner considers is relevant (s 268-10).

When the Commissioner makes such an estimate, the person must be notified in writing of the estimate, and that the estimate may be reduced if the person makes a statutory declaration or affidavit specifying the actual amount of liability or declaring that no amounts had to be withheld or paid (TAA Sch 1 ss 268-40(1), item 1; 268-90). Where an estimate remains unpaid after 7 days, GIC is payable (TAA Sch 1 s 268-75).

Once an estimate has been made, the Commissioner may commence recovery proceedings based on that estimated liability (TAA Sch 1 s 268-20(2)). The person liable may defend the recovery proceedings by proving, by means of an affidavit, that the actual liability never existed, has been discharged or is less than the Commissioner's estimate (TAA Sch 1 ss 268-40(1), items 2 and 3; 268-90).

Company directors personally liable

In conjunction with the regime for the recovery of unremitted amounts, the director of a non-remitting company may be personally liable to pay an amount equal to the company's tax liabilities (TAA Sch 1 Div 269). The regime applies where a company is required to remit an amount in respect of PAYG withheld; an alienated personal services payment received; a non-cash benefit provided; SGC for the relevant quarter; an assessed net amount under the GST Act for the relevant tax period; or a GST instalment for the relevant GST instalment quarter (TAA Sch 1 s 269-10).

Under Div 269, there is a duty on a director to ensure that the company:

- meets its obligations to remit amounts deducted or pay estimated liabilities (see above)
- goes into voluntary administration or restructuring, or
- begins to be wound up (TAA Sch 1 s 269-15).

If the company has not undertaken one of these options on or before the due date for the remittance of the deductions or amounts withheld, the directors of the company are each

end of the third and fourth quarters in the case of a two instalments payer who is not a deferred BAS payer, and 28 days after the end of the third and fourth quarters for deferred BAS payers. This allows those individuals to pay PAYG instalments more in accordance with the fluctuating nature of their income flows. The two instalments payer will be able to vary the amount of an instalment by estimating their expected tax liability for the year, but GIC will be imposed if the varied amount is too low (¶27-320).

Lodgment concessions

The ATO grants lodgment concessions which *generally* offer a 4-week extension for the first, third and fourth quarterly activity statements if lodged electronically by agents or the taxpayer is an active STP reporter (¶26-630). Full details of the *Lodgment program 2021–22* are available on the ATO website.

There is also a lodgment concession for entities that do not use tax agents for the lodgment of activity statements. This concession *generally* offers a 2-week extension for lodgment of the first, third and fourth quarterly activity statements if lodged electronically. However, this concession does *not* apply to:

- monthly activity statements
- monthly GST payers with quarterly PAYG instalments (or other quarterly obligations)
- monthly PAYG withholding payers
- head companies of consolidated groups
- large businesses with substituted accounting periods (a large business is one with annual total income over $10 million, annual GST turnover over $20 million, annual withholding payments over $1 million, or a member of a company group where at least one member of the group has annual total income over $10 million)
- statements that did not have an original due date of the 28th of the month
- quarterly instalment notices (PAYG instalment only, GST instalment only, PAYG and GST instalment only).

When annual PAYG instalments are payable

The first instalment for annual instalment payers is the instalment for the year in which the Commissioner first gives the taxpayer an instalment rate.

A PAYG instalment is not payable if the Commissioner withdraws a taxpayer's instalment rate during the income year.

All annual PAYG instalment payers must pay the annual PAYG instalment on or before the 21st day of the fourth month following the end of the income year (TAA s 45-70). For a taxpayer whose income year ends on 30 June, this means that the annual PAYG instalment is due on or before *21 October*.

Taxpayers should finalise their annual PAYG instalment before lodging their income tax return for the year, especially if they will have tax to pay. This will ensure that taxpayers receive credit in their income tax assessments for their annual PAYG instalments. Where taxpayers wish to vary their annual PAYG instalment, they should lodge the variation **before** lodging their annual income tax return (allowing enough time for postage and processing where the variation is lodged by mail). If taxpayers lodge their annual income tax return before finalising their annual PAYG instalment, they will receive a credit with their assessment for the amount notified on their instalment notice. Taxpayers are required to pay their annual PAYG instalment amount by 21 October even if their income tax return has been assessed. To alleviate this timing issue, for June balancing taxpayers the ATO generally issues the instalment notice in early July. However, if the taxpayer's income tax return has already been assessed, the ATO should be contacted to confirm whether the amount payable has changed.

When monthly instalments are payable

Notification and payment of monthly instalments must be undertaken on or before the 21st day of the next month, unless specified by other means by the Commissioner.

If a monthly payer is a deferred BAS payer, the payment must be made by the 28th day of the next month. The payment of a December monthly PAYG instalment by a deferred BAS payer must be made on or before the 28th of February.

Method of payment

Monthly PAYG instalments must be paid electronically. Other PAYG instalments must be paid electronically if the taxpayer is required to pay a net amount of GST electronically for that period (¶34-150) or is a large PAYG withholder (¶26-500) with a net amount payable for that month (TAA s 8AAZMA). Otherwise, the taxpayer is free to pay the instalment by any other method acceptable to the Commissioner.

Extensions of time to pay PAYG instalments

The Commissioner may extend the due date for the payment of a PAYG instalment for a period that is warranted by the circumstances (TAA s 255-10).

An amount due and payable on a non-business day (ie Saturday, Sunday or public holiday) is due and payable on the next business day (TAA s 8AAZMB).

Consequences of not paying a PAYG instalment on time

PAYG instalments are a debt due to the Commonwealth and may be sued for and recovered in any court of competent jurisdiction. Further, GIC is payable if a taxpayer fails to pay some or all of a PAYG instalment by the due date (TAA s 45-80). The GIC is payable on the amount that remains unpaid for the period that commences on the due date of the PAYG instalment and ends when the instalment, and the associated GIC, has been fully paid (¶29-10).

[FTR ¶977-125]

Calculation of Instalments

¶27-220 Amount of quarterly PAYG instalments

Instalment income as a basis for calculating quarterly instalments

Where a quarterly payer is not eligible to pay quarterly instalments on the basis of GDP-adjusted notional tax (¶27-470) or, if eligible, has elected to become a quarterly payer who pays on the basis of instalment income, the amount of a PAYG instalment for a particular quarter is calculated as follows (TAA s 45-110):

applicable instalment rate × instalment income for the quarter

The "applicable instalment rate" means whichever of the following is applicable:

- the latest instalment rate notified to the taxpayer by the Commissioner before the end of the quarter (¶27-450)
- where the taxpayer has chosen to use a different instalment rate for the current quarter – the rate chosen by the taxpayer, or
- if the taxpayer has chosen in a previous quarter in the current income year to use a rate other than the one notified by the Commissioner – the rate previously chosen by the taxpayer. In subsequent years, the taxpayer must use the most recent rate given by the Commissioner or may choose another instalment rate (TAA s 45-205).

The procedure for varying the instalment rate is discussed at ¶27-280.

The "instalment income for the quarter" is the taxpayer's instalment income for the particular PAYG instalment quarter worked out under the rules in ¶27-260.

▶ **Example 1**

Mighty Big Tractors Pty Ltd is required to pay quarterly PAYG instalments based on its instalment rate and instalment income for each quarter. The Commissioner has advised Mighty Big Tractors Pty Ltd of an instalment rate of 22.57% prior to the end of the current instalment quarter. The company has decided not to vary its instalment rate. During this instalment quarter, Mighty Big Tractors Pty Ltd derived instalment income of $1,025,891. Therefore, the PAYG instalment for Mighty Big Tractors Pty Ltd for the current quarter is:

22.57% × $1,025,891 = $231,543.60

Penalty relief outlined in ¶29-140 may apply to inadvertent errors in tax returns and activity statements that are due to failing to take reasonable care.

No reasonably arguable position

Where a shortfall amount arises from a statement of the taxpayer or its agent that treats an income tax law (or the PRRT law) as applying in a particular way, and the position taken is not "reasonably arguable", the penalty is 25% of the amount by which the shortfall amount (s 284-90, item 4) exceeds the "reasonably arguable threshold" (s 284-90(3)). For an entity other than a trust or partnership, the threshold is the greater of $10,000 or 1% of the income tax (or PRRT) payable for the relevant tax year, worked out on the basis of the taxpayer's relevant tax return. For a trust or a partnership, the threshold is the greater of $20,000 or 2% of the entity's net income for the income year, worked out on the basis of the taxpayer's income tax return (s 284-90(1), item 5).

The threshold is applied separately to each non-identical (or similar but distinct: MT 2008/2) situation in which the taxpayer did not take a reasonably arguable position. For example, if the taxpayer lacks a reasonably arguable position in respect of 2 non-identical matters, each of which involves a shortfall amount of $9,000, no penalty will be attracted under s 284-75(2) even though the shortfall total is $18,000. If the matters were identical, the penalty would apply because identical matters are treated as a single matter, in respect of which the total shortfall of $18,000 exceeds the threshold.

The Commissioner's views outlined in MT 2008/2 in respect of a reasonably arguable position are:

- The position taken must involve a contentious area of the law.
- The test does not require the taxpayer's position to be the "better view"; the standard is "about as likely as not". However, the taxpayer's position must be defensible and sufficient to support a reasonable expectation that the taxpayer could win in court.
- An opinion expressed by an accountant, lawyer or other adviser is not in itself authority, although the authorities used to support that an opinion may support the position taken by the taxpayer.
- The absence of authority for a position will not be fatal provided the taxpayer has a well-reasoned construction of the particular provision that is about as likely as not to be the correct interpretation (*Cameron Brae*).
- Other authorities could include statements in texts recognised by professionals as being authoritative about how the law operates, particularly where there are few relevant authorities, although the weight of the authority would depend on the circumstances.
- The mere existence of a contrary public ruling does not mean that alternative treatments cannot be reasonably arguable.
- As a broad rule, liability will not arise under this category where the false or misleading nature of a statement is caused by an error of primary fact or calculation.

While the reasonably arguable position test is an objective test (*Orica Ltd*; *Thomas & Ors* and *Traviati*), the standard of the reasonable care is an objective standard that considers the subjective circumstances of the individual in question. These 2 distinct standards are independently determined (*Sanctuary Lakes* and ATO *Decision Impact Statements* on *Sanctuary Lakes* and *Shin*).

A taxpayer who is uncertain whether a position is reasonably arguable may be able to seek a private ruling on the matter.

No penalty applies where a taxpayer, with circumstances similar to those of an ATO Interpretative Decision (ID), relies on the ID, if the ID is subsequently found to be incorrect. However, GIC (¶29-510) may be payable (PS LA 2001/8).

Penalty relief as outlined in ¶29-140 may apply to inadvertent errors in tax returns and activity statements arising from taking a position on income tax that is not reasonably arguable.

Where 2 or more penalties apply

Where 2 or more penalties may apply, the taxpayer is liable to pay only the highest applicable penalty. For example, if a particular part of a shortfall is attributable to both recklessness and failure to take reasonable care, only the 50% penalty for recklessness applies (s 284-90(2)).

Where there is a shortfall and various parts of it are attributable to different categories of behaviour, penalties are determined by breaking the shortfall amount into its component parts. Factors such as overstatements and progressive tax rates are taken into account as illustrated in worked examples in TR 94/3.

Partners and trustees

All of the partners in a partnership can be held liable to penalties under Div 284 where one of the partners, or the partnership's agent, makes a statement about the partnership net income or loss, or the partnership participates in a scheme (s 284-35).

Where the false or misleading nature of a statement is caused by intentional disregard, recklessness or lack of reasonable care, the normal penalties for such behaviour apply (s 284-90(1), item 6).

For penalties other than those relating to partnership net income or loss, for example a PAYG withholding amount, TAA Sch 1 s 444-30 makes each partner jointly and severally liable. Although a non-culpable partner may take action against the culpable partner, this does not affect the non-culpable partner's liability to pay the penalty.

The trustee of a trust is liable to pay any penalty arising from statements made about the trust's net income or obligations, or any penalty arising from the trust's participation in a scheme. Where relevant, any shortfall amount or scheme shortfall amount of a beneficiary that relates to the trust's net income or obligations is treated as if it were the shortfall amount of the trustee (s 284-30). Where there are multiple trustees of a trust, the penalty applies to all trustees and they are jointly liable for the whole amount owed by the trust (*Hutson*). The thresholds applicable to reasonably arguable positions are noted above.

If SMSF corporate trustees are liable to a penalty under s 284-75(1) or (4), the directors (at the time the liability arises) are jointly and severally liable to the tax-related liability in respect of the penalty (s 284-95).

[FTR ¶978-055]

¶29-180 Penalties relating to schemes

Different base penalty amounts apply to benefits (scheme benefits) that would arise where the taxpayer has entered into a tax avoidance scheme under a taxation law. Broadly, the amounts of the scheme benefits are "scheme shortfall amounts" (TAA Sch 1 ss 284-145 to 284-160). Scheme shortfall amounts can also arise under the anti-avoidance provisions of the income tax law and of other taxation laws, eg GST Act Div 165 and FBTAA s 67.

For most taxpayers, the penalty applies if the *sole or dominant purpose* of participating in the scheme was for the taxpayer (or another entity) to obtain a scheme benefit. For a scheme that limits a non-resident entity's taxable presence in Australia under ITAA36 s 177DA (¶30-200), the penalty applies if a *principal purpose* was for the taxpayer (or another entity) to obtain a scheme benefit. For Div 165 GST Act schemes, the penalty may be triggered where the *principal effect* of the scheme is that the entity itself obtained, directly or indirectly, a scheme benefit from the scheme (s 284-145(1)).

The base penalty amount in respect of schemes is expressed as a percentage of the scheme shortfall amount, and reduced where the taxpayer has a "reasonably arguable" case that the relevant anti-avoidance provisions do not apply (s 284-160). Penalties are doubled for significant global entities entering into tax avoidance and profit shifting schemes without a reasonably arguable position (s 284-155(3): ¶22-630).

Different base penalty amounts apply to schemes involving transfer pricing under ITAA97 Div 815 (¶22-630) or non-arm's length income of managed investment trusts (MITs: ¶6-405) under ITAA97 Subdiv 275-L (s 284-145(2A) to (2C)). The scheme shortfall

The simple disposition of an income-producing asset by a natural person to a wholly-owned private company is not an arrangement to which ITAA36 Pt IVA will be applied. However, where there are other associated transactions, transfers or arrangements (whether antecedent or subsequent), the application of Pt IVA may need to be considered in that broader context (TD 95/4).

In any particular situation, it is likely that there will be a number of schemes that can be identified. For example, there may be a scheme involving a large number of the steps that were actually taken, and another scheme involving a fewer number of those steps. In *Peabody*, the High Court said that a set of circumstances will not constitute a scheme if they are incapable of standing on their own without being robbed of all practical meaning, although whether this is still the case as a result of the subsequent High Court decision in *Hart* (¶30-170) is uncertain. Unfortunately, there was no clear precedent arising from the 3 separate judgments in *Hart* as to the definition of "scheme", as noted by Hill J at first instance in *Macquarie Finance*.

On appeal to a court against a Pt IVA determination, the Commissioner is entitled to put his case in alternative ways. If, within a wider scheme which has been identified, the Commissioner also seeks to rely on a sub-scheme as meeting the requirements of Pt IVA, the Commissioner may rely on it as well as the wider scheme. The ability to isolate sub-schemes to which Pt IVA can apply may make it easier to assert that a scheme was entered into for the sole or dominant purpose of obtaining a tax benefit.

In *British American Tobacco Australia Services Limited*, the Full Federal Court held the relevant scheme included the transfer of assets between related companies, the making of a CGT roll-over election by the first company and sale of the assets outside of the group by the second company which used significant capital losses to offset the capital gain. The effect of the scheme was to reduce tax by shifting a profit into a related company that could offset tax losses against it on ultimate sale. The court rejected an argument that the scheme was limited to the making of the CGT roll-over election as it would have opened the possibility that Pt IVA did not apply by virtue of s 177C(2A).

[FTR ¶81-200, ¶81-307]

¶30-160 Was a tax benefit obtained?

There must be a "tax benefit" in connection with a scheme for Pt IVA to apply (s 177D). Establishing a tax benefit is a 2-step enquiry (s 177C). First, a taxpayer must have achieved at least one of the following beneficial outcomes from the scheme:

- an amount is not included in assessable income (s 177C(1)(a))
- a deduction is allowable (s 177C(1)(b))
- a capital loss is incurred by the taxpayer (s 177C(1)(ba))
- a foreign income tax offset is allowable (s 177C(1)(bb)), or
- withholding tax is not payable on an amount (s 177C(1)(bc)).

Second, it must be established that the beneficial tax outcome would not have happened, or it is reasonable to expect that it would not have happened, if the scheme had not been entered into or carried out. So, for example, a tax benefit may be obtained by a taxpayer if an amount is not included in the taxpayer's assessable income which would have been or might reasonably be expected to have been included if the scheme had not been entered into or carried out (ITAA36 s 177C(1)(a)).

The prediction about events which would have taken place if the relevant scheme had not been entered into or carried out is known as the alternative postulate or the counterfactual. The prediction must be sufficiently reliable for it to be regarded as reasonable (*Peabody*).

Before the amendments to Pt IVA that apply on and from 16 November 2012 (¶30-110), the courts had interpreted the requirements in s 177C(1) that a tax effect "would have" or "might reasonably be expected" to have happened, as a composite phrase representing a range of certainty or likelihood of the alternative postulate. However, the amendments applying on and from 16 November 2012 are intended to have the effect that the "would have" and "might reasonably be expected to have"

limbs in the paragraphs of s 177C(1) are *alternative bases* upon which the existence of a tax benefit can be established. Further, there are rules for working out when and how a tax benefit is established under the 2 limbs (s 177CB).

The "would have" limb

A decision, for example, that an amount "would have" been included in assessable income if the scheme had not been entered into or carried out, must be made solely on the basis of a postulate comprising all of the events or circumstances that actually happened or existed, other than those that form part of the scheme (s 177CB(2)). This is described in the relevant explanatory memorandum (EM) as the "annihilation approach". When postulating what would have occurred in the absence of the scheme, the scheme must be assumed not to have happened, ie it must be "annihilated" or extinguished. Cases that appear to have been decided on the basis of this approach to the first limb include the Full Federal Court decisions *Puzey* (2003) and *Sleight* (2004).

The "might reasonably be expected to have" limb

A decision, for example, that a deduction "might reasonably be expected not to have been allowable" if the scheme had not been entered into or carried out, must be made on the basis of a postulate that is a reasonable alternative to the scheme (s 177CB(3)). Whether a postulate is a reasonable alternative to a scheme must be worked out having particular regard to the substance of the scheme and its results and consequences for the taxpayer, and disregarding any potential tax results and consequences.

This is referred to in the relevant EM as the "reconstruction approach". The EM states that a reconstruction approach is a way to identify a tax benefit in relation to a scheme that also achieves substantive non-tax results and consequences. In these cases, simply annihilating the scheme would be inconsistent with the non-tax results and consequences sought by the taxpayer in the scheme.

▶ Example 1 (based on the EM to the amending Bill)

Mr and Mrs H want to borrow money to acquire both a family home and a holiday house that they plan to rent to holidaymakers. They borrow the money under an arrangement in which the repayments are applied exclusively to the borrowing in relation to the family home. The result is that the deductible interest payments are increased for the holiday home borrowing and the non-deductible interest payments for the family home borrowing are minimised.

Merely annihilating the scheme would not leave a sensible result because there would be no borrowing at all, so some reconstruction is necessary. It is therefore necessary to consider what might reasonably be expected to have happened if the scheme had not been entered into. A reasonable alternative in this case might be that Mr and Mrs H took out 2 loans, one for each of the homes they wished to acquire, each of which was entered into on normal commercial terms.

Examining the substance of a scheme requires a consideration of its commercial and economic substance as distinct from its legal form or shape. Where a scheme forms part of a broader commercial transaction, a postulate would be a reasonable alternative to the scheme if it performed the same role in relation to the broader transaction as the scheme itself performs, disregarding its tax effects. If a scheme is integral to a broader transaction in the sense that it is intertwined with it and facilitates it in some way, then it would be reasonable for an alternative postulate to involve a reconstruction of the broader transaction, so long as that produces the same non-tax results and consequences as were in fact achieved by the broader transaction.

▶ Example 2 (based on the EM to the amending Bill)

Assume that in order for Kerry to secure a tax deduction for borrowing money to invest in an offshore company (Offshore Co) it is necessary for her to interpose a resident Australian company. She does this by using the borrowed funds to buy shares in an Australian shelf company (Oz Co). In turn, Oz Co buys ordinary shares in Offshore Co. Oz Co performs no other role.

The Commissioner makes a Pt IVA determination on the basis that the interposition of Oz Co is a scheme to which Pt IVA applies. Objectively viewed, the interposition of Oz Co achieves 2 effects. One is securing a deduction for interest on the borrowing, and the other is the acquisition of shares in Offshore Co.

A correct alternative postulate should be another way in which Kerry could reasonably be expected to have acquired ordinary shares in Offshore Co. An alternative postulate that involved Kerry lending the borrowed monies to Offshore Co would achieve a different effect. So too would be a postulate that involved Kerry investing the borrowed monies in a completely different company.

General Criteria for Fringe Benefits

¶35-060 Outline of fringe benefits

A taxable fringe benefit will arise where:

- a benefit is provided to an employee, an associate of an employee, or some other person at the direction of an employee or an associate of an employee
- the benefit is provided by the employee's employer, by an associate of the employer, or by a third party under an arrangement with the employer or with an associate of the employer, and
- the benefit is provided in respect of the employment of the employee (s 136(1)).

The tax extends to benefits that are provided to prospective or former employees in connection with their prospective or past employment.

Connection with Australia

FBT applies to benefits provided in relation to an employee who is a resident of Australia, except where the relevant salary or wage of the employee is exempt from income tax, and to a non-resident employee whose salary or wage from the employment has an Australian source (definition of "employee" in s 136(1); ID 2007/25). Where an employee is a non-resident for part of the year, benefits provided during the year will be taxable in proportion to the period of residence. Whether FBT is included as a tax to which a particular DTA applies depends on how "Australian tax" is defined in the agreement. For example, the New Zealand DTA and the United Kingdom DTA include references to FBT. For the application of FBT to benefits provided to a non-resident employee from New Zealand or the United Kingdom, see ID 2005/166.

FBT applies irrespective of whether the acts, omissions, and so on giving rise to a liability under the Act occurred inside or outside Australia (s 163(1)).

[AFB ¶6-000, ¶5-7

¶35-070 Benefit must be provided

A "benefit" includes any right, privilege, service or facility. Some benefits are expressly *excluded* as fringe benefits and do not give rise to any FBT liability. The main exclusions are:

- exempt benefits (¶35-645)
- salary or wages
- most superannuation fund contributions (see below)
- payments from certain superannuation funds
- benefits under employee share schemes or employee share trusts, including in respect of individuals engaged in foreign service, and including certain stapled securities acquired under such schemes and indeterminate rights (¶10-085; ID 2010/142)
- payments on termination of employment
- capital payments for enforceable contracts in restraint of trade
- capital payments for personal injury
- payments deemed to be dividends for income tax purposes and loans that comply with the deemed dividend provisions in ITAA36 Div 7A (¶4-200, eg ID 2011/33)
- payments to an associated person to the extent that they are not considered by the Commissioner to be deductible
- amounts that have been subject to family trust distribution tax (¶6-268)
- certain distribution entitlements of individual venture capital managers (s 136(1)).

The following are salary and wages (rather than fringe benefits):

- an allowance paid to employees in place of medical benefits insurance (*Tubemakers of Australia*)
- payments made to employees for the cost of fares to and from work, regardless of whether public transport was used (*Roads and Traffic Authority of NSW*: ¶35-330)

- retention payments made to a person in consideration of the person providing services for 12 months and paid in addition to normal periodic salary (*Dean*).

Benefits provided under an "effective" salary sacrifice arrangement are not salary and wages and, conversely, benefits provided under "ineffective" arrangements are salary and wages and not subject to FBT (TR 2001/10: ¶31-120). Costs incurred by an employer in administering such arrangements do not give rise to a fringe benefit (ID 2001/333). Where a person is being paid parental leave pay by an employer in accordance with the *Paid Parental Leave Act 2010*, the employee can salary sacrifice his/her parental leave pay for non-cash remuneration as parental leave pay is salary and wages as defined for FBT purposes when paid by the person's employer.

A benefit is not "provided" if it is obtained through the employee's fraudulent activity that is not condoned by the employer (ID 2003/458).

Superannuation contributions

Employer superannuation contributions are not fringe benefits if they are contributions for an employee to:

- a complying superannuation fund or a fund that the contributor reasonably believed was complying (¶13-100)
- a non-resident superannuation fund where the employee for whom the benefit is provided is a temporary resident of Australia (generally an employee with a temporary visa), or
- an RSA under the *Retirement Savings Accounts Act 1997* (¶13-470).

Employer superannuation contributions not falling under any of those exclusions may constitute a fringe benefit. In particular, superannuation contributions on behalf of [illegible] of employees (eg a spouse) are subject to FBT (s 136(1), definition of "fringe benefit").

Payments by an employer of a superannuation fund's expenses (that are treated as a superannuation contribution) are not a fringe benefit (MT 2005/1).

[AFB ¶6-020, ¶6-360]

¶35-080 Benefit provided to employee

To be a fringe benefit, a benefit must be provided to an employee of the employer concerned (s 136(1)). Additionally, a fringe benefit arises where a benefit is provided to an associate of the employee, or to a third party under an arrangement between the employer or an associate of the employer, and an employee or an associate of the employee (s 148(2): ¶35-110).

The test of whether there is an employment relationship is – if the benefit had been provided in cash form, would it have been salary or wages for PAYG purposes? In addition, past and prospective employees are treated as employees, so that benefits provided to such people or to their associates are subject to FBT if those benefits meet the other criteria. However, benefits provided to relatives of deceased employees (eg travel benefits provided to a widow or widower of a Member of Parliament) are not subject to FBT (TR 1999/10) nor is the payment of funeral expenses of a deceased employee (ID 2006/159). An "employee" is a person who is entitled to receive "salary or wages", ie payments to employees, company directors and office holders, as well as other specified payments that are subject to PAYG (TR 2005/16).

Where an employee directs the employer to pay part of the agreed salary to a third party (such as a bank by way of loan repayment) the amount remains part of the employee's salary (*Wood*; *Case 1/97*).

A person who is provided only with non-cash benefits instead of salary or wages is treated as an employee if, had any benefit been in the form of cash, that cash would have been salary or wages and that person would have been an employee (s 137).

Contributions made by an employer to an industry welfare trust (CR 2004/76) and contributions of apprentice levies to a redundancy fund (CR 2004/97) do not give rise to a fringe benefit. See also CR 2004/113 (payments for worker income protection and portable sick leave insurance policies) and ID 2002/848 (employee share plan).

- an employee has agreed to receive the food or drink in return for a reduction in the employee's entitlement to receive salary or wages and this would not have happened apart from the agreement, or
- it is reasonable to conclude that the employee's salary or wages would be greater if the food or drink were not provided as part of the employee's remuneration package.

This type of agreement or arrangement includes arrangements whereby an employee forgoes salary and wages to have food and drink supplied to them on their employer's premises. The exclusion does not apply to a subsidised canteen which is available to all employees and which does not form part of a salary sacrifice arrangement. Under such arrangements, an employer pays for an employee's meals which have been provided by an independent caterer located on, or the independent caterer delivers to, the employer's premises.

[AFB ¶45-110]

Taxable Value of Property Fringe Benefits

¶35-510 Valuation rules for property fringe benefits

There are different rules for valuing property fringe benefits, depending on whether the concession for "in-house" benefits applies.

Non-concessional rules

Except where the concessional rules for in-house benefits apply, the taxable value of a property fringe benefit is generally the amount by which the arm's length cost of the goods to the employer exceeds the price charged to the employee (¶35-530). FBT is payable on the grossed-up taxable value of the benefit (¶35-025).

In-house benefits

Concessional valuation rules apply where the benefit is an in-house benefit (¶35-520). An "in-house property fringe benefit" is one provided in respect of tangible property where:

- the employer or an associate (not a third party) provides the benefit, and the property is of a sort normally sold as part of the provider's business, or
- a third party provides the property, after acquiring it from the employer or an associate of the employer, and the property is of a sort normally sold by both the provider and the person from whom it is acquired as part of their businesses (s 136(1)).

"Tangible property" means goods and includes animals, gas and electricity. It does not include real property (ID 2004/211), gift cards (ID 2010/135) or a payment of money (ID 2010/151). When a retail store employer provides an employee with a voucher/coupon, entitling the employee to merchandise from the store, the employer provides the employee with an in-house property fringe benefit only when the employee redeems the voucher/coupon for merchandise (ID 2014/17).

The concessional valuation rules extend to cases where, rather than being directly provided with in-house property, the employee purchased the property and the employer either paid the bill or reimbursed the employee for the cost. It does not matter whether the employee purchased the property from the employer, an associate or a third party supplier. Although the benefit in these cases is an expense payment benefit, it is valued under the concessional rules applying to in-house property (¶35-350). The only special rules to be taken into account are:

- the employee must obtain a receipt or invoice from the supplier and give it to the employer, and
- any amount paid to the supplier by the employee and not reimbursed is treated as a contribution for the benefit by the employee and deducted from the taxable value of the property.

Where employee could have obtained deduction

Where there is a property fringe benefit and the employee could have obtained a once-only income tax deduction for all or part of the expenditure on the property (such as the cost of deductible work clothing: TR 97/12), the taxable value of the benefit is

reduced accordingly (s 44). For details of the reduction, see ¶35-680. For example, light lunches provided by a computer training company to its trainers as part of the conduct of the training courses were property benefits subject to the "otherwise deductible rule" which reduced the taxable value of the benefit (*Pollak Partners*). Generally, the value of the benefit is reduced by the same amount as the amount that would have been allowed as an income tax deduction to the employee. Where the employee would have received only a partial deduction, the value of the benefit is reduced only by that partial amount.

[AFB ¶45-200]

¶35-520 Valuing in-house property benefits

There are 2 sets of rules for valuing in-house benefits, depending on who provided the property and the activities of that person.

Property produced for sale

Where the property is provided by an employer or associate, and that person manufactures, produces, processes or treats the type of property concerned, the valuation rules are as follows:

- If the goods are identical to goods normally sold by the employer to manufacturers, wholesalers or retailers, the taxable value of the benefit is the amount by which the employer's lowest arm's length selling price exceeds the amount, if any, paid by the employee.
- If the goods are identical to goods normally sold by the employer to the public by retail, the taxable value of the benefit is the amount by which 75% of the lowest price charged to the public exceeds the amount, if any, paid by the employee.
- Where the goods are similar, but not identical, to those sold by the employer (eg "seconds"), the taxable value of the benefit is 75% of the amount which the employee could be expected to pay for the goods at arm's length, less the amount, if any, paid by the employee (s 42(1)(a)).

Property purchased for resale

Where the property was acquired by the provider, and is of a sort that the person would normally sell in the course of business, the taxable value of the benefit is the arm's length price paid by that person less the amount, if any, paid by the employee (s 42(1)(b)).

If the goods have lost value (eg through obsolescence or deterioration), the taxable value is the amount the employee would have paid for them at arm's length if that is less than the employer's purchase price.

Arm's length price

Where the property is acquired by the provider of the benefit in the ordinary course of business under an arm's length transaction (s 42(2)(a)), the arm's length price is the "cost price" of the property, ie the expenditure that is directly attributable to purchasing or obtaining delivery of the property (s 136(1)). Where the property is either not acquired in the ordinary course of business or is not acquired in an arm's length transaction, the arm's length price is the amount the provider could reasonably be expected to pay for the property if the acquisition had been in the ordinary course of business under an arm's length transaction (s 42(2)(b)). An arm's length transaction is a transaction in relation to which the parties are dealing with each other at arm's length (s 136(1)).

Airline transport benefits

The taxable value of airline transport benefits is calculated as 75% of the stand-by airline travel value of the benefit, less the employee contribution. Where the transport is on a domestic route, the stand-by airline travel value is 50% of *the* carrier's lowest standard single economy airfare for that route as publicly advertised during the year of tax. Where the transport is on an international route, the stand-by airline travel value is 50% of the lowest of *any* carrier's standard single economy airfare for that route as publicly advertised during the year of tax.