2004-2005

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

SENATE

TAX LAWS AMENDMENT (2004 MEASURES No. 7) BILL 2005

REVISED EXPLANATORY MEMORANDUM

THE MEMORANDUM TAKES ACCOUNT OF AMENDMENTS MADE BY THE HOUSE OF REPRESENTATIVES TO THE BILL AS INTRODUCED

(Circulated by authority of the
Treasurer, the Hon Peter Costello MP)

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Glossary

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

Abbreviation	***Definition***
ACA	allocable cost amount
ATO	Australian Taxation Office
CGT	capital gains tax
Commissioner	Commissioner of Taxation
ESS	employee share scheme
FBT	fringe benefits tax
FBTAA 1986	*Fringe Benefits Tax Assessment Act 1986*
GDP	gross domestic product
ITAA 1936	*Income Tax Assessment Act 1936*
ITAA 1997	*Income Tax Assessment Act 1997*
PAYG	pay as you go
PRRTAA 1987	*Petroleum Resource Rent Tax Assessment Act 1987*
STS	simplified tax system
TAA 1953	*Taxation Administration Act 1953*

General outline and financial impact

25 per cent entrepreneurs' tax offset

Schedule 1 to this Bill amends the *Income Tax Assessment Act 1997* and the *Taxation Administration Act 1953* by introducing a 25 per cent entrepreneurs' tax offset on the income tax liability attributable to business income for small businesses in the simplified tax system (STS) that have an annual turnover of $75,000 or less.

Where STS turnover is greater than $50,000 the offset will be phased out so that the offset ceases once STS turnover reaches $75,000.

The introduction of a 25 per cent entrepreneurs' tax offset on the income tax liability attributable to business income will provide an incentive for very small, micro and home-based businesses.

Date of effect: These amendments will apply to assessments for income years commencing on or after 1 July 2005.

Proposal announced: This measure was announced by the Government in its election statement *Promoting an Enterprise Culture* on 26 September 2004.

Financial impact: This measure will cost the revenue $400 million in 2006-07 and $390 million in 2007-08.

Compliance cost impact: Small businesses will be required to isolate their gross business income and their deductions incurred in gaining that income, and then calculate the net income after deductions.

Summary of regulation impact statement

Regulation impact on business

Impact: This measure will have implications for small businesses with turnover less than $75,000 and who are in the STS.

Main points:

- Small businesses in the STS will need to calculate their turnover and their net income from business.

- People with other non-business income will need to isolate their business income from their total income.

- This measure will increase administrative costs for the Australian Taxation Office. Forms and systems changes will be required to capture the required data and undertake the calculation of the tax offset.

Extending the simplified tax system

Schedule 2 to this Bill amends the *Income Tax Assessment Act 1997* and the *Income Tax (Transitional Provisions) Act 1997* to remove the requirement that taxpayers in the simplified tax system (STS) must use the STS accounting method (generally referred to as a cash basis of accounting).

For many small businesses the cash accounting requirement is not appropriate for their business or financial circumstances. The requirement to use this method has been seen as a restriction which has prohibited many small businesses from accessing the benefits of the STS.

The removal of this restriction will permit more businesses, including many in the farming sector, to take advantage of the concessions associated with the STS. The removal of the cash accounting requirement will enable more businesses to access the benefits of the STS whilst calculating their taxable income using the most appropriate method applicable to their circumstances.

Date of effect: These amendments will apply to assessments for income years commencing on or after 1 July 2005.

Proposal announced: The proposals were announced by the Government in its election statement *Promoting an Enterprise Culture* on 26 September 2004.

Financial impact: This measure will cost the revenue as follows:

2004-05	***2005-06***	***2006-07***	***2007-08***
Nil	$15 million	$125 million	$130 million

Compliance cost impact: Negligible.

Roll-over of income taxing point for shareholders in employee share schemes

Schedule 3 to this bill amends the *Income Tax Assessment Act 1936* to allow taxpayers who have deferred the income tax liability on a discount received on shares or rights acquired under an employee share scheme (ESS), to roll-over a taxing point that would otherwise occur because of a corporate restructure.

Date of effect: This amendment applies to shares and rights that have been acquired as a result of corporate restructures that happen on or after 1 July 2004.

Proposal announced: This measure was announced jointly by the Treasurer and the Minister for Employment and Workplace Relations in Press Release No. 14 of 27 March 2003.

Financial impact: The cost to revenue of this proposal is unquantifiable but expected to be small.

Compliance cost impact: This measure is expected to have a minimal impact on compliance costs.

Summary of regulation impact statement

Regulation impact on business

Impact: The main impact will be on employees that hold shares or rights in ESS and their employers in the event of a corporate restructure.

Main points:

- This amendment does not introduce new compliance requirements for employers so their compliance costs from this measure are expected to be minimal.

- Employees and employers may incur some costs in determining whether the roll-over relief would apply. These costs are expected to be minor.

- The Australian Taxation Office may incur some implementation costs where employees and employers seek advice on whether the roll-over relief is available for participants.

Fringe benefits tax exemption thresholds for long service award benefits

Schedule 4 to this Bill amends the *Fringe Benefits Tax Assessment Act 1986* to increase the fringe benefits tax (FBT) exemption thresholds for long service award benefits.

Date of effect: This amendment applies for the FBT year beginning 1 April 2005.

Proposal announced: This measure was announced in the 2004-05 Budget and in the Treasurer's Press Release No. 34 of 11 May 2004.

Financial impact: Less than $1 million per year.

Compliance cost impact: Unquantifiable but expected to be insignificant.

Petroleum exploration incentive

Schedule 5 to this Bill introduces an amendment to the *Petroleum Resource Rent Tax Assessment Act 1987* to allow petroleum exploration companies conducting exploration work in a designated frontier area to obtain an uplift on expenditure incurred. These amendments will:

- enable the Minister responsible for the *Petroleum (Submerged Lands) Act 1967* to allocate up to 20 per cent of the annual offshore petroleum acreage release areas as designated frontier areas; and

- apply a 150 per cent uplift to certain exploration expenditure conducted in the first term of an exploration permit in a designated frontier area.

Date of effect: The uplift will apply to annual offshore petroleum acreage releases from 2004 to 2008.

Proposal announced: The *Offshore Petroleum Exploration Incentive* was announced by the Treasurer and the Minister for Industry, Tourism and Resources on 11 May 2004.

Financial impact: This measure is estimated to cost $17 million over the period 2004-05 to 2007-08.

Compliance cost impact: This measure is expected to have a minimal impact on compliance costs.

Summary of regulation impact statement

Regulation impact on business

Impact: This measure is expected to impact favourably upon petroleum exploration companies willing to conduct exploration in a designated frontier area. It is estimated that around 60 petroleum exploration companies currently hold interests in exploration permits in Australian offshore areas.

Main points:

- To enable the Minister responsible for the *Petroleum (Submerged Lands) Act 1967* to designate up to 20 per cent of the annual offshore petroleum acreage release areas as designated frontier areas.
- To apply a 150 per cent uplift to certain exploration expenditure conducted in the first term of an exploration permit in a designated frontier area.

Consolidation: providing greater flexibility

Schedule 6 to this Bill provides greater flexibility, clarifies certain aspects of the consolidation regime and ensures that the regime interacts appropriately with other aspects of the income tax law.

Date of effect: These amendments have retrospective effect to 1 July 2002, which is the date of commencement of the consolidation regime. These amendments clarify the operation of the regime and the interaction of the regime with other areas of the tax law and as such are beneficial to taxpayers.

Proposal announced: Three of the amendments were foreshadowed in the former Minister for Revenue and Assistant Treasurer's Press Release No. C116/03 of 4 December 2003. The amendment to ensure that there is 'no double reduction in working out step 3 of the allocable cost amount on entry' was not previously announced but addresses an anomaly that was detrimental to taxpayers.

Financial impact: These amendments are not expected to impact on the revenue.

Compliance cost impact: The amendments in this Bill will provide taxpayers with additional flexibility in the transition to consolidation and are not expected to impact on compliance costs.

Simplified tax system roll-over

Schedule 7 to this Bill amends Division 328 of the *Income Tax Assessment Act 1997* to ensure that the roll-over relief available for partnerships under the uniform capital allowances regime is also available in relation to depreciating assets allocated to simplified tax system (STS) pools.

Date of effect: These amendments will apply to assessments for the income year following the income year in which this Bill receives Royal Assent.

Proposal announced: This measure was announced by the Treasurer and the Minister for Small Business in Press Release No. 36 of 11 May 2004.

Financial impact: This measure will have a cost to revenue as follows:

2004-05	***2005-06***	***2006-07***	***2007-08***
Nil	$6 million	$5 million	$5 million

Compliance cost impact: Taxpayers will only incur a small increase in their compliance costs where they elect for roll-over relief.

Family trust and interposed entity elections

Schedule 8 to this Bill amends the *Income Tax Assessment Act 1997* to provide greater flexibility, reduce compliance costs and ongoing uncertainty surrounding family trust elections and interposed entity elections.

These amendments will allow trustees to make family trust elections and interposed entity elections at any time, in relation to earlier years.

Date of effect: These amendments will apply from the date this Bill receives Royal Assent.

Proposal announced: This measure was foreshadowed in the former Minister for Revenue and Assistant Treasurer's Press Release No. 36 of 18 May 2004.

Financial impact: Nil.

Compliance cost impact: This measure will provide taxpayers with additional flexibility, remove ongoing uncertainty and is expected to reduce compliance costs.

Non-commercial loans

Part 1 in Schedule 9 to this Bill corrects a minor technical defect in Subdivision EA of Division 7A of the *Income Tax Assessment Act 1936* (ITAA 1936). This will ensure that a loan from a trustee to a shareholder of a corporate beneficiary will not be treated as a deemed dividend if the loan is repaid before the earlier of the due date for lodgement or the date of lodgement of the trust's income tax return for the year in which the loan is made.

Part 2 in Schedule 9 to this Bill amends Division 7A of the ITAA 1936 to allow a loan from a private company to be repaid or put on a commercial footing before the earlier of the due date for lodgement and the date of lodgement of the private company's income tax return for the income year in which the loan is made in order to avoid the loan being treated as a deemed dividend.

Date of effect: The amendments in Part 1 in Schedule 9 will apply to loans made on or after 12 December 2002.

The amendments in Part 2 of Schedule 9 will apply to loans made in the 2004-05 year of income or a later year of income.

Proposal announced: The changes included in Part 1 of Schedule 9 have not been previously announced as they correct a minor defect in Subdivision EA of Division 7A of the ITAA 1936.

The changes included in Part 2 of Schedule 9 were announced in the 2004-05 Budget.

Financial impact: Nil.

Compliance cost impact: Nil.

Technical corrections and amendments

Schedule 10 to this Bill makes minor corrections and amendments to the taxation laws. These corrections and amendments are part of the Government's ongoing commitment to improve the quality of the taxation laws. They fix errors such as duplications of definitions, missing asterisks from defined terms, incorrect numbering and referencing and outdated guide material.

Date of effect: These corrections and amendments generally commence on Royal Assent. However, some amendments will apply retrospectively for the reasons set out in Chapter 10.

Proposal announced: These corrections and amendments have not been announced.

Financial impact: Nil.

Compliance cost impact: Nil.

Minor amendment to the refundable film tax offset

Schedule 11 to this Bill amends the income tax law to allow revocation of unused provisional certificates issued under Division 10BA of the *Income Tax Assessment Act 1936* in respect of certain film projects. This will enable those projects to then apply for the tax offset for large scale films contained in Division 376 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Date of effect: These amendments apply to any eligible expenditure incurred, whether before or after commencement of this Bill. Effectively, expenditure incurred on films completed on or after 4 September 2001 may be eligible under Division 376 of the ITAA 1997.

Proposal announced: This measure was announced in the former Minister for Revenue and Assistant Treasurer's Press Release No. C080/03 of 15 August 2003.

Financial impact: The financial impact of the amendment is expected to be negligible.

Compliance cost impact: This measure is expected to have a minimal impact on compliance costs.

Chapter 1
The 25 per cent entrepreneurs' tax offset

Outline of chapter

1.1 Schedule 1 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to provide a 25 per cent entrepreneurs' tax offset on the income tax liability of a taxpayer that is attributable to business income from certain small businesses in the simplified tax system (STS).

1.2 This Schedule also makes a consequential amendment to the *Taxation Administration Act 1953* to exclude the 25 per cent entrepreneurs' tax offset from the calculation of the rate of pay as you go (PAYG) instalments.

Context of amendments

1.3 In the 2004 election policy statement *Promoting an Enterprise Culture*, the Government announced a number of measures designed to foster the entrepreneurial spirit of small businesses. The Government stated that it would provide further incentive and encouragement to small businesses – particularly those that set up and operate from home – through the introduction of a tax offset for entrepreneurs. This proposal is targeted at very small, micro and home-based businesses that are in the STS.

1.4 The STS, which commenced on 1 July 2001, was introduced as a result of recommendations in the Ralph *Review of Business Taxation* to reduce the disproportionate tax compliance burden that falls on small business. This aim was achieved by providing eligible small businesses with simpler depreciation rules than under the uniform capital allowances regime, a cash basis for recognising income and deductible expenses (see Chapter 2 for changes to this component), and simple trading stock rules. The rules relating to the STS are contained in Division 328 of the ITAA 1997.

Summary of new law

1.5 The ITAA 1997 is amended to allow a 25 per cent entrepreneurs' tax offset on the income tax liability of a taxpayer that is attributable to business income from certain small businesses in the STS.

Comparison of key features of new law and current law

New law	***Current law***
Small businesses in the STS which have an annual turnover of $50,000 or less will be eligible for a tax offset of 25 per cent of their income tax liability in respect of their business income. The tax offset will be phased-out when the annual turnover is greater than $50,000 and less than $75,000.	No equivalent.

Detailed explanation of new law

1.6 Subdivision 61-J is inserted in Division 61 of the ITAA 1997 to allow a 25 per cent entrepreneurs' tax offset on the income tax liability of a taxpayer that is attributable to business income from certain small businesses in the STS. ***[Schedule 1, item 5, Subdivision 61-J]***

1.7 The offset is available either to:

- the STS taxpayer in the case of an individual or company operating as an STS taxpayer;
- the partners of a partnership that is an STS taxpayer; or
- the trustee or beneficiaries of a trust that is an STS taxpayer, depending on who is liable for tax on the trust income.

[Schedule 1, item 5, section 61-500]

1.8 Under section 328-365 of the ITAA 1997, an entity is eligible to be an STS taxpayer for an income year if:

- it carries on a business during that year;
- the STS average turnover of the business and related businesses for the year is less than $1 million net of goods and services tax (GST) credits; and
- the business and related businesses have depreciating assets with values less than $3 million at the end of that year.

1.9 The amount of the tax offset varies depending on the amount of STS group turnover of the STS taxpayer. Where the STS group turnover of the STS taxpayer is $50,000 or less, the offset is calculated as 25 per cent of the income tax liability attributable to the STS income. The offset phases out when STS group turnover is greater than $50,000 and less than $75,000. ***[Schedule 1, item 5, section 61-500]***

1.10 'STS group turnover' has the meaning as given by section 328-375. The grouping provisions in section 328-380 also apply for the purposes of the 25 per cent entrepreneurs' tax offset to prevent businesses that fail the turnover test from subdividing in order to access the tax benefit provided by the 25 per cent entrepreneurs' tax offset. (Additional explanation of the STS grouping rules and turnover can be found in Taxation Ruling TR 2002/6 and Taxation Ruling TR 2002/11.)

1.11 An entity's ***STS group turnover*** for an income year is defined in section 328-375 as the sum of:

- the value of the business supplies made during the year by the entity; and
- the value of the business supplies of entities during the period it is grouped with those entities.

The STS group turnover is reduced by any supplies made between the entity and the grouped entities or between the grouped entities themselves.

1.12 A taxpayer may be eligible for more than one tax offset. For example, if a taxpayer is a sole trader who has elected into the STS and that taxpayer is also a partner in a partnership that has also elected into the STS, the taxpayer may be entitled to a tax offset in respect of their income as a sole trader and also in respect of their share of the STS income from the partnership ***[Schedule 1, item 5, section 61-500]***. However, if the sole trader and the partnership are grouped entities, the amount of STS group turnover is relevant to determining eligibility for an offset.

Net STS income and STS annual turnover

1.13 Regardless of whether the tax offset is available to the STS taxpayer, a partner, a trustee or a beneficiary, there must be an amount of net STS income before an entitlement to an offset arises. That is, the entity claiming the offset must have net STS income for the year. The entity eligible for the offset must have a share of that net income included in its assessable income in order to be eligible for an offset.

1.14 An entity's net STS income for an income year is the amount by which:

the entity's STS annual turnover for the year

exceeds

the sum of the entity's deductions attributable to the turnover,

where STS annual turnover for a year is the total of the value of the business supplies the entity made in the year. ***[Schedule 1, item 5, subsections 61-525(1) and (2)]***

1.15 The deductions attributable to the STS turnover are the allowable deductions that the entity can claim against its assessable income which specifically relate to that turnover.

Example 1.1

Fred is an STS taxpayer who sells home-made greeting cards via the Internet. Fred's STS annual turnover is $35,000 for the year. Fred runs his business from a home office in his house. Fred claims deductions for his business expenses such as the cost of the materials used in making the greeting cards, stationery, postage and the electricity expenses relating to the home office. These business expenses total $5,000.

Fred also has salary and wage income of $75,000 for the year. He is a member of a trade union and he subscribes to a professional journal. His work-related expenses total $1,200.

Fred also has a negatively geared share portfolio from which he receives $5,000 worth of dividends and has $6,000 of interest expenses related to borrowings to acquire the shares. Fred therefore makes a loss for taxation purposes of $1,000 from his share investments.

> Fred's net STS income for the year is the amount by which his STS annual turnover of $35,000 exceeds his deductions attributable to that turnover of $5,000. Therefore, his net STS income is $30,000.
>
> Fred's work-related expenses and the expenses relating to his share investments do not affect his STS annual turnover. The income from Fred's share investments is not included in his STS annual turnover, as the dividends do not constitute taxable supplies.

1.16 Value of the business supplies does not include supplies that constitute an insurance recovery or the principal component of a loan. These are disregarded when calculating turnover. ***[Schedule 1, item 5, subsection 61-525(4)]***

1.17 With respect to gambling supplies, the amount included in the calculation of STS annual turnover is the difference between the total amount wagered and total monetary prizes paid out. Total amounts wagered is the sum of the consideration for all gambling supplies that are attributable to that tax period. Total monetary prizes are the sum of prizes paid or payable in money (including casino chips) in that tax period. ***[Schedule 1, item 5, subsection 61-525(3)]***

1.18 The definition of 'STS annual turnover' is consistent with the broader definition of STS group turnover in section 328-375.

1.19 The turnover of a business reflects the ordinary activities of carrying on that business, such as the sale of goods and the provision of services, and also includes interest received on amounts deposited in business banking accounts. The turnover does not include items such as dividends, rental income where the rental activities do not form an ordinary part of the business or amounts resulting from realisation of an investment.

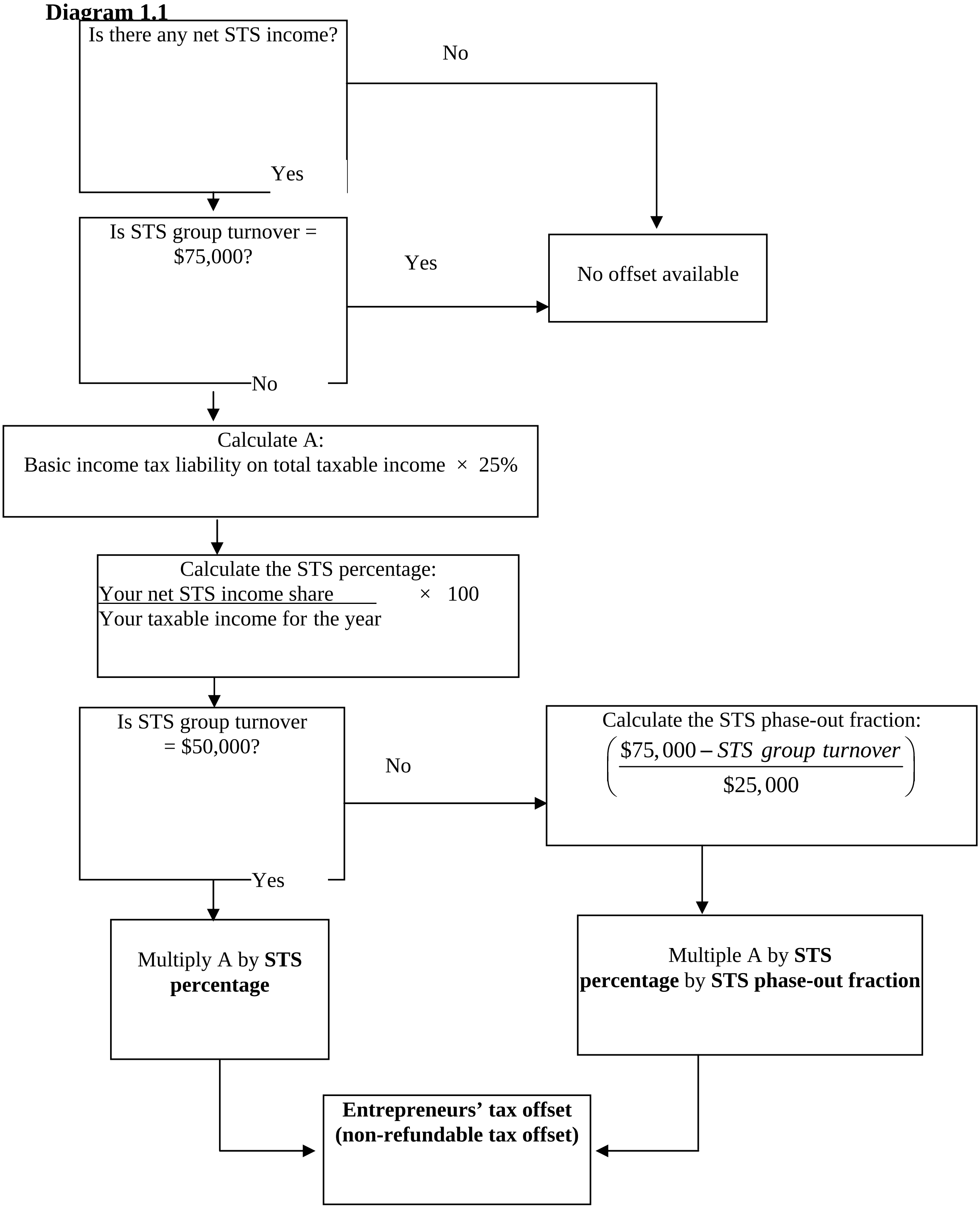
1.20 'Value of the business supplies' is based on the terms defined in the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) and is defined in section 995-1 of the ITAA 1997. The value of the business supplies an entity makes during an income year is the sum of the values of all the taxable supplies the entity made during the year in the ordinary course of carrying on a business (calculated exclusive of GST payable on supplies) and the prices of the other supplies made in the ordinary course of carrying on the business. Both 'price' and 'value' are defined in section 9-75 of the GST Act.

1.21 The GST Act explains the method of working out the value of a taxable supply. A 'taxable supply' is defined in section 9-5 of the GST Act and is one on which GST is payable. The value of a taxable supply is worked out as 10/11 of the price of the supply. This calculation excludes the GST payable on the supply (the other 1/11).

1.22 If the supply is not a taxable supply, the price of all the non-taxable supplies made during the year in the ordinary course of carrying on a business is added to the value of all taxable supplies. The price of a supply is generally the amount of money an entity pays for the supply. Supplies that are not taxable include those that are GST-free and input taxed for the purposes of the GST Act.

1.23 Diagram 1.1 illustrates how the offset will operate.

Diagram 1.1



Tax offset for an individual or a company

Eligibility for the offset

1.24 A taxpayer is entitled to a tax offset for an income year if the taxpayer:

- is an individual (operating as a sole trader) or a company;
- has elected to be an STS taxpayer for the year;
- has STS group turnover of less than $75,000 for the year; and
- has net STS income for the year.

[Schedule 1, item 5, subsection 61-505(1)]

Calculation of the offset

1.25 If the STS group turnover is $50,000 or less, the taxpayer is entitled to a tax offset of 25 per cent of their income tax liability that is attributable to STS income. If the STS group turnover is more than $50,000, the tax offset is phased out until it equals zero at turnover of $75,000. The offset is calculated using the following method:

Step 1: Calculate taxable income for the year.

Step 2: Calculate 25 per cent of the basic income tax liability for the year on the taxable income; that is, using the applicable tax rates and taking into account any special provisions that affect the calculation of the liability.

Note: the basic income tax liability does not take into account any tax offsets.

Step 3: Calculate the STS percentage, which cannot exceed 100 per cent, as:

$$\frac{\text{the taxpayer's net STS income for the year}}{\text{the taxpayer's taxable income for the year}} \times 100$$

Step 4: If the STS group turnover is $50,000 or less, multiply the step 2 amount by the STS percentage to determine the amount of the tax offset.

Step 5: If the STS group turnover is more than $50,000, calculate the STS phase-out fraction as:

$$\frac{\$75,000 \ - \ \text{the STS group turnover for the year}}{\$25,000}$$

The tax offset is calculated as:

step 2 amount × STS percentage × STS phase-out fraction

[Schedule 1, item 5, subsection 61-505(2)]

Example 1.2: Sole trader with other non-business income

Jenny runs a physiotherapy practice from her home and she is an STS taxpayer for the income year commencing 1 July 2006. The net income from her practice is $20,000 (i.e. $30,000 turnover less $10,000 business expenses). In addition, she has a part-time job as a shop assistant from which she receives salary and wages of $25,000.

Step 1: Jenny's taxable income for the year is $45,000.

Step 2: Basic income tax liability is $9,671.53
25 per cent of her basic income tax liability is:
25% × 9,671.53 = 2,417.88

Step 3: The STS percentage is: $\frac{20,000}{45,000} \times 100 = 44.44\%$

Step 4: Jenny's STS group turnover is $30,000; therefore, the tax offset is:

2,417.88 × 44.44% = 1,074.51

Step 5: Not applicable.

Therefore, Jenny's entrepreneurs' tax offset is $1,074.51.

Example 1.3: A company with a turnover between $50,000 and $75,000

Company A is an STS taxpayer for the income year commencing 1 July 2006. Company A has net STS income of $20,000 (i.e. annual turnover of $60,000 less expenses of $40,000) and no other source of income. Company B is a grouped entity of Company A, which has a turnover of $10,000, but is making a tax loss. The STS group turnover of the two companies is $70,000.

Step 1: Company A's taxable income is $20,000.

Step 2: Basic income tax liability is $6,000
(i.e. $20,000 × company tax rate of 30%)
25 per cent of the basic income tax liability is:
25% × 6,000 = 1,500

Step 3: The STS percentage is: $\frac{20,000}{20,000} \times 100 = 100\%$

Step 4: STS group turnover is greater than $50,000.

Step 5: The STS phase-out fraction is:

$$\frac{75,000 - 70,000}{25,000} = 0.2$$

The tax offset is:

1,500 × 100% × 0.2 = 300

Therefore, Company A is entitled to an entrepreneurs' tax offset of $300.

Tax offset for a partner in a partnership

Eligibility for the offset

1.26 A taxpayer is entitled to a tax offset for an income year if:

- the taxpayer is a partner in a partnership;
- the partnership is an STS taxpayer for the year;
- the partnership's STS group turnover is less than $75,000 for the year;
- the partnership has net STS income for the year; and
- a share of the partnership's net STS income is included in the taxpayer's assessable income for the year.

[Schedule 1, item 5, subsection 61-510(1)]

Calculation of the offset

1.27 If the partnership's STS group turnover is $50,000 or less, the partner is entitled to a tax offset of 25 per cent of their income tax liability that is attributable to their share of the partnership's net STS income. If the partnership's STS group turnover is more than $50,000, the tax offset available to the partner is phased out until it equals zero at turnover of $75,000. The offset is calculated using the following method:

Step 1: Calculate the partner's taxable income for the year.

Step 2: Calculate 25 per cent of the basic income tax liability for the year on the taxable income; that is, using the applicable tax rates and taking into account any special provisions that affect the calculation of the liability.

Note: the basic income tax liability does not take into account any tax offsets.

Step 3: Calculate the STS percentage, which cannot exceed 100 per cent, as:

$$\frac{\text{the partner's net STS income for the year}}{\text{the partner's taxable income for the year}} \times 100$$

Step 4: If the STS group turnover of the partnership is $50,000 or less, multiply the step 2 amount by the STS percentage to determine the amount of the tax offset available to the partner.

Step 5: If the partnership's STS group turnover is more than $50,000, calculate the STS phase-out fraction as:

$$\frac{75{,}000 \ - \ \text{the partnership's STS group turnover for the year}}{\$25{,}000}$$

The partner's tax offset is calculated as:

step 2 amount × STS percentage × STS phase-out fraction

[Schedule 1, item 5, subsection 61-510(2)]

Example 1.4: Partner in a partnership

Liz and Richard are equal partners in Partnership A. The partnership, a costume-making business, is an STS taxpayer for the income year commencing 1 July 2006. The net income of the partnership is $45,000 (i.e. $50,000 turnover less $5,000 business expenses). Liz also has a part-time job from which she receives salary and wages of $30,000.

Step 1: Liz's taxable income for the year is $52,500 (i.e. 50% of $45,000 + $30,000)

Step 2: Basic income liability is $11,921.53
25 per cent of her basic income tax liability is:
25% × 11,921.53 = 2,980.38

Step 3: The STS percentage is: $\frac{22{,}500}{52{,}500} \times 100 = 42.86\%$

Step 4: The partnership's STS group turnover is $50,000 or less; therefore, Liz's tax offset is:

2,980.38 × 42.86% = 1,277.39

Step 5: Not applicable.

Therefore, Liz's entrepreneurs' tax offset is $1,277.39.

Example 1.5: Partner and sole trader

Rick, Ingrid and Sam are equal partners in the partnership trading as Rick's Café. Rick's Café is an STS taxpayer for the income year commencing 1 July 2006. Rick's Café has net STS income of $45,000 (i.e. $60,000 turnover less $15,000 business expenses). Rick also has a consulting business, Consultations By Rick, which he operates as a sole trader and which is also an STS taxpayer. Consultations By Rick has net STS income of $40,000 (i.e. $50,000 turnover less $10,000 expenses). Rick also does some part-time work as a pilot from which he receives salary and wages of $25,000. Rick's Café and Consultations By Rick are not grouped entities for STS purposes.

Note: If Rick's Café and Consultations By Rick were grouped entities, there would be no entitlement to the offset because group turnover ($60,000 + $50,000) exceeds $75,000.

Rick's offset in relation to the partnership income

Step 1: Rick's taxable income for the year is $80,000 (i.e. 1/3 of $45,000 + $40,000 + $25,000)

Step 2: Basic income tax liability is $22,211.11
25 per cent of Rick's basic income tax liability is:
25% × 22,211.11 = 5,552.78

Step 3: The STS percentage is: $\frac{15{,}000}{80{,}000} \times 100 = 18.75\%$

Step 4: The STS group turnover of the partnership is greater than $50,000.

Step 5: The STS phase-out fraction is:

$$\frac{75{,}000 - 60{,}000}{25{,}000} = 0.6$$

Rick's tax offset in relation to his partnership income is:

5,552.78 × 18.75% × 0.6 = 624.69

Rick's offset in relation to his income as a sole trader

Step 1: Rick's taxable income for the year is $80,000 (i.e. 1/3 of $45,000 + $40,000 + $25,000)

Step 2: Basic income tax liability is $22,211.11
25 per cent of Rick's basic income tax liability is:
25% × 22,211.11 = 5,552.78

Step 3: The STS percentage is: $\frac{40,000}{80,000} \times 100 = 50\%$

Step 4: Rick's STS group turnover for his consulting business is $50,000 or less; therefore, Rick's tax offset in relation to his income from operating as a sole trader is:

5,552.78 × 50% = 2,776.39

Step 5: Not applicable.

Therefore in total, Rick is entitled to an entrepreneurs' tax offset of $3,401.08 (i.e. $624.69 + $2,776.39)

Tax offset for a trustee of a trust

Eligibility for the offset

1.28 A taxpayer is entitled to a tax offset for an income year if:

- the taxpayer is a trustee of a trust;
- the trust is an STS taxpayer for the year;
- the trust's STS group turnover for the year is less than $75,000;
- the trust has net STS income for the year; and
- the trustee is liable to be assessed under either section 98, 99 or 99A of the *Income Tax Assessment Act 1936* on a share of the trust's net STS income.

[Schedule 1, item 5, subsection 61-515(1)]

Calculation of the offset

1.29 If the trust's STS group turnover is $50,000 or less, the trustee is entitled to a tax offset of 25 per cent of its income tax liability that is attributable to its share of the trust's net STS income. If the trust's STS group turnover is more than $50,000, the tax offset available to the trustee is phased out until it equals zero at turnover of $75,000. The offset is calculated using the following method:

Step 1: Calculate the net income of the trust for the year.

Step 2: Calculate 25 per cent of the amount of tax that the trustee is liable to pay on that net income, ignoring any tax offsets.

Step 3: Calculate the STS percentage, which cannot exceed 100 per cent, as:

$$\frac{\text{the trustee's net STS income for the year}}{\text{the net income of the trust for the year}} \times 100$$

Step 4: If the STS group turnover of the trust is $50,000 or less, multiply the step 2 amount by the STS percentage to determine the amount of the tax offset available to the trustee.

Step 5: If the trust's STS group turnover is greater than $50,000, calculate the STS phase-out fraction as:

$$\frac{\$75{,}000 \ - \ \text{the trust's STS group turnover for the year}}{\$25{,}000}$$

The trustee's tax offset is calculated as:

step 2 amount × STS percentage × STS phase-out fraction.

[Schedule 1, item 5, subsection 61-515(2)]

Tax offset for a beneficiary of a trust

Eligibility for the offset

1.30 A taxpayer is entitled to a tax offset for an income year if:

- the taxpayer is a beneficiary of a trust;
- the trust is an STS taxpayer for the year;

- the trust's STS group turnover for the year is less than $75,000;
- the trust has net STS income for the year; and
- a share of the trust's net STS income is included in the beneficiary's assessable income for the year.

[Schedule 1, item 5, subsection 61-520(1)]

Calculation of the offset

1.31 If the trust's STS group turnover is $50,000 or less, the beneficiary is entitled to a tax offset of 25 per cent of its income tax liability that is attributable to its share of the trust's net STS income. If the trust's STS group turnover is more than $50,000, the tax offset available to the beneficiary is phased out until it equals zero at turnover of $75,000. The offset is calculated using the following method:

Step 1: Calculate the beneficiary's taxable income for the year.

Step 2: Calculate 25 per cent of the basic income tax liability for the year on the taxable income; that is, using the applicable tax rates and taking into account any special provisions that affect the calculation of the liability.

Note: the basic income tax liability does not take into account any tax offsets.

Step 3: Calculate the STS percentage, which cannot exceed 100 per cent, as:

$$\frac{\text{the beneficiary's net STS income for the year}}{\text{the beneficiary's taxable income for the year}} \times 100$$

Step 4: If the trust's STS group turnover is $50,000 or less, multiply the step 2 amount by the STS percentage to determine the amount of the tax offset available to the beneficiary.

Step 5: If the trust's STS group turnover is greater that $50,000, calculate the STS phase-out fraction as:

$$\frac{\$75{,}000 \ - \ \text{the trust's STS group turnover for the year}}{\$25{,}000} \times 100$$

The beneficiary's tax offset is calculated as:

step 2 amount × STS percentage × STS phase-out fraction

[Schedule 1, item 4, subsection 61-520(2)]

Application and transitional provisions

1.32 The amendments made to the ITAA 1997 to allow a 25 per cent entrepreneurs' tax offset apply to assessments for the first income year commencing on or after 1 July 2005 and later years. ***[Schedule 1, item 11]***

1.33 The amendment made to the *Taxation Administration Act 1953* applies in relation to the calculation of an entity's adjusted tax:

- for a base year that is the first income year starting on or after 1 July 2005 or a later income year; and
- in relation to a PAYG instalment period that includes or starts on the date of Royal Assent of this Bill.

[Schedule 1, item 13]

Consequential amendments

1.34 The following consequential amendments are made to the ITAA 1997 as a result of the introduction of the 25 per cent entrepreneurs' tax offset:

- the list of tax offsets in section 13-1 is updated to include references to the 25 per cent entrepreneurs' tax offset ***[Schedule 1, items 1 to 4]***;
- a note is included in section 328-5 to guide taxpayers to the new offset in Subdivision 61-J ***[Schedule 1, item 6]***;
- the notes in subsection 328-365(1) to the guide to Division 328 are amended as a result of the introduction of the new 25 per cent entrepreneurs' tax offset ***[Schedule 1, items 7 and 8]***; and
- definitions of 'net STS income' and 'STS annual turnover' are inserted in subsection 995-1(1) ***[Schedule 1, items 9 and 10]***.

1.35 An amendment is made to section 45-340 of the *Taxation Administration Act 1953*. The amendment ensures that the 25 per cent entrepreneurs' tax offset is not taken into consideration when determining the rate of PAYG instalments. The offset is excluded from the calculation because it is only available on assessment. ***[Schedule 1, item 12]***

1.36 If an entity anticipates that it will be entitled to the offset on assessment, the entity may vary its instalments during the year. However, the entity may be liable to general interest charge where a variation results in an underestimation of the instalments of more than 15 per cent.

1.37 The amendment made to the *Taxation Administration Act 1953* applies in relation to the calculation of an entity's adjusted tax:

- for a base year that is the first income year starting on or after 1 July 2005 or a later income year; and
- in relation to a PAYG instalment period that includes or starts on the date of Royal Assent of this bill.

[Schedule 1, item 13]

1.38 This ensures that the Commissioner of Taxation is not required to recalculate an instalment rate given to an entity prior to the commencement of the amendments in this Bill.

REGULATION IMPACT STATEMENT

Background

1.39 The STS, which commenced on 1 July 2001, was introduced as a result of recommendations in the Ralph *Review of Business Taxation* to reduce the disproportionate tax compliance burden that falls on small business. This aim was achieved by providing eligible small businesses with simpler depreciation rules than under the uniform capital allowance regime, a cash basis for recognising income and deductible expenses, and simple trading stock rules.

1.40 As part of their election commitments to promote an enterprise culture in Australia, the Government announced the introduction of a 25 per cent tax offset on the income tax liability attributable to business income for small businesses in the STS that have an annual turnover of $50,000 or less and will be fully phased out once annual turnover reaches $75,000.

Policy objective

1.41 The objectives of this measure are to provide encouragement for enterprising Australians in the early days of a small business, in particular to provide a greater benefit to businesses with greater productivity, and to provide incentive for the growth of small business especially the very small, micro and home-based businesses which are in the STS.

Implementation options for 25 per cent entrepreneurs' tax offset

1.42 As announced in the Government's 2004 election policy statement *Promoting an Enterprise Culture* a 25 per cent tax offset will be applied to the tax liability in relation to STS income.

Option 1 – 25 per cent entrepreneurs' tax offset using average tax rates

1.43 Under this method the 25 per cent tax offset would be applied to tax on total income and averaged by an STS percentage (which is equivalent to net STS income divided by total taxable income).

1.44 This overcomes the situation where a taxpayer with $6,000 or less of net STS income would not be entitled to the tax offset because of the effect of the tax-free threshold.

1.45 The 25 per cent entrepreneurs' tax offset has the following features:

- The tax offset will be available to small businesses that are in the STS and have an annual turnover of $50,000 or less:
  - the tax offset phases out for each $1 over $50,000 up to $75,000.
- 25 per cent tax offset on income tax liability in respect of net STS income.
- The tax offset will flow through to the individuals who operate their small business through a partnership or trust.
- The turnover test would be applied at the group level that is, the entity and its affiliates. The tax offset would apply at either the entity or recipient level depending on who is liable to tax on the income.

- Integrity measures required to prevent existing businesses above the turnover threshold from sub-dividing to access the discount.

Option 2 – 25 per cent entrepreneurs' tax offset using the top slice of income

1.46 Under this option the 25 per cent tax offset would be applied to the tax liability on net STS income on the assumption that the net STS income represents the top slice of taxable income.

1.47 This maximises the tax offset available to the taxpayer because the tax offset is applied to the tax liability based on the taxpayer's top marginal rate of tax.

Option 3 – 25 per cent entrepreneurs' tax offset using the bottom slice of income

1.48 This option would provide the 25 per cent tax offset on the tax liability on net STS income on the assumption that the net STS income represents the bottom slice of taxable income.

1.49 The disadvantage of this method is that, as the first $6,000 of income earned by an individual is not subject to tax, individual taxpayers who have less than $6,000 of net STS income will not receive any discount.

Impact group identification

1.50 Groups affected by the 25 per cent entrepreneurs' tax offset are STS taxpayers and non-STS taxpayers in receipt of gross STS income under $75,000, namely very small, micro and home-based businesses who are in the STS. It is estimated that more than 300,000 small and home-based businesses will be able to benefit from the 25 per cent tax offset.

Analysis of costs / benefits

Option 1 – 25 per cent entrepreneurs' tax offset using average tax rates

Benefits

1.51 This measure will deliver the 25 per cent tax offset as announced in the Government's election commitment.

1.52 The measure will provide a further source of capital that can be ploughed back into a business at its most vulnerable start-up and development stage.

1.53 The offset provided by this measure will be more valuable the more profitable the business. That is, businesses with lower expense ratios will obtain a greater benefit.

Costs

1.54 The disaggregation of business income and other income increases compliance costs of small businesses. Small businesses will be required to isolate their gross business income and their deductions incurred in gaining that income, and then calculate the net income after deductions.

Option 2 – 25 per cent entrepreneurs' tax offset using the top slice of income

Benefits

1.55 This option would provide the same benefits as option 1.

Costs

1.56 This option would require the taxpayer to calculate tax on total income then tax on total income less net STS income. The taxpayer would then need to calculate that difference and then calculate 25 per cent of that difference as the discount. Therefore, additional calculations would be required compared with option 1.

1.57 This option provides a greater benefit to people with large amounts of other non-business income and therefore is not as well targeted as option 1. For example, a person with $100,000 salary and wages and $10,000 net STS income would have the tax offset calculated using the top marginal tax rate of 47 per cent.

Option 3 – 25 per cent entrepreneurs' tax offset using the bottom slice of income

Benefits

1.58 This option would provide the same benefits as option 1.

Costs

1.59 This option would require the taxpayer to calculate the tax on net STS income first and then apply the 25 per cent tax offset to that amount of tax. The taxpayer would then reduce the tax on total income by the amount of the tax offset. Therefore, two calculations would be required. Where the net STS income was below $6,000 the taxpayer would not get any benefit owing to the operation of the tax-free threshold. Taxpayers with low levels of taxable income would benefit less under this option than either option 1 or 2.

Revenue cost

1.60 The financial cost to the revenue as a result of the introduction of a 25 per cent entrepreneurs' tax offset is expected to be as follows, based on average rates of tax:

2004-05	***2005-06***	***2006-07***	***2007-08***
Nil	Nil	-$400 million	-$390 million

Administration cost

1.61 It is estimated that the 25 per cent entrepreneurs' tax offset will have an impact on Australian Taxation Office (ATO) expenses of $7.3 million over four years from 2004-05 to 2007-08 to administer. The annual breakdown of this is:

2004-05	***2005-06***	***2006-07***	***2007-08***
$0.6 million	$1.9 million	$2.6 million	$2.2 million

Economic benefits

1.62 The 25 per cent entrepreneurs' tax offset will be an incentive for enterprising Australians to get a kick-start in the early days of a small business. These amendments will provide encouragement to small business growth.

Other issues – consultation

1.63 The Department of the Prime Minister and Cabinet and the ATO have been consulted on this issue. In view of the requirement to introduce legislation on 9 December 2004, there is not sufficient time to consult more widely.

Conclusion and recommended option

1.64 The design implementation using average tax rates (option 1) is the preferred approach. This approach will deliver the policy objective with reduced compliance costs to taxpayers and the ATO. The change will provide small business taxpayers with greater incentive for the growth of small business.

1.65 The other options have the potential to increase compliance costs for business taxpayers and would provide either a greater or reduced benefit to taxpayers. Options 2 and 3 are also not as well targeted as option 1. The top slice approach (option 2) provides a greater benefit to people with high levels of non-business income. The bottom slice approach (option 3) provides no benefit where net business income is less than $6,000. Many small businesses in the start-up phase will be in this situation.

1.66 The Treasury and the ATO will monitor this taxation measure, as part of the whole-of-taxation system on an ongoing basis.

Chapter 2
Extending the simplified tax system

Outline of chapter

2.1 Schedule 2 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to remove the requirement that taxpayers in the simplified tax system (STS) must use the STS accounting method (generally referred to as a cash basis of accounting).

Context of amendments

2.2 In the 2004 election policy statement *Promoting an Enterprise Culture*, the Government announced on 26 September 2004 a number of measures designed to foster the entrepreneurial spirit of small businesses. The Government announced that it would remove the restriction on small businesses in the STS to account for their ordinary income when received and general deductions when paid. This will enable businesses to utilise the most appropriate method of determining taxable income. The decision whether or not to enter the STS will no longer impact on the most appropriate method for a business to calculate its taxable income.

2.3 The STS was introduced on 1 July 2001 as an alternative method of determining taxable income for certain businesses with straightforward, uncomplicated financial affairs who choose to enter the STS. The STS modifies the current method of determining taxable income.

2.4 The STS has three main elements:

- Modified accounting arrangements for STS taxpayers which recognise most business income and deductions only when they are received or paid.
- A simplified trading stock regime where STS taxpayers do not have to account for changes in the value of trading stock or do stocktakes at the end of the income year in certain circumstances.
- A simplified depreciation regime under which depreciating assets costing less than $1,000 are written off immediately. Most other depreciating assets are pooled and enjoy an accelerated rate of depreciation.

2.5 Under the modified accounting method (generally referred to as cash accounting) in Subdivision 328-C, an STS taxpayer is not required to bring to account, at year end, income from sales for which payment has not been received (debtors). Similarly, business expenses owing (creditors), at year end, are not deductible until paid. However, there is no change to the accounting method used for statutory income and most specific deductions. This method requires certain adjustments to ordinary income, general deductions and deductions for tax-related expenses and repairs when a business starts (entry adjustment rules) or stops (exit adjustment rules) being an STS taxpayer.

2.6 The entry adjustment rules ensure that the transition *to* the cash accounting method does not result in business income and expenses being recognised twice or omitted. The exit adjustment rules ensure that the transition *from* the cash accounting method does not result in omission of business income and expenses.

Summary of new law

2.7 To be eligible for the concessions available under the STS businesses have to adopt modified accounting arrangements which recognise most business income and deductions only when they are received or paid. This denies access to the concessions available under the STS to those businesses whose most appropriate method of calculating taxable income is different.

2.8 Schedule 2 to this Bill will amend the STS rules to remove the requirement to recognise most business income and deductions only when they are received or paid. The amendment will allow small businesses to access the benefits of the STS whilst continuing to calculate their taxable income using the most appropriate method for their circumstances.

Comparison of key features of new law and current law

New law	***Current law***
Businesses will be able to calculate their taxable income using the most appropriate method for their circumstances. Assessable income is recognised when it is derived and allowable deductions are recognised when they are incurred. This is generally referred to as an accruals system.	Business income and deductions are recognised only when they are received or paid. This is generally referred to as a cash accounting system.

Detailed explanation of new law

2.9 Schedule 2 to this Bill amends Division 328 of the ITAA 1997 to remove the requirement that taxpayers in the STS must use a cash basis of accounting. Subdivision 328-C currently specifies the accounting method for STS taxpayers. This Subdivision is repealed with effect from the first income year commencing on or after 1 July 2005. ***[Schedule 2, item 9]***

Application and transitional provisions

2.10 The amendments apply to the first income year commencing on or after 1 July 2005. ***[Schedule 2, item 11]***

Income Tax (Transitional Provisions) Act 1997

Meaning of STS accounting method

2.11 The term ***STS accounting method*** is defined to mean the accounting method that was required to be used by STS taxpayers for the 2004-05 income year. This was generally referred to as the cash accounting method which is being repealed with effect from the first income year commencing on or after 1 July 2005. ***[Schedule 2, item 10, section 328-125]***

Continuing to use cash accounting

2.12 Transitional provisions will be introduced to enable businesses that have elected into the STS, prior to the first income year commencing on or after 1 July 2005, to continue to recognise most business income and deductions only when they are received or paid. This allows businesses who currently calculate their taxable income under the cash accounting method contained in the STS to continue to use that method. ***[Schedule 2, item 10, section 328-120]***

Ceasing to use cash accounting

2.13 Transitional provisions will also allow STS taxpayers to cease to use the cash accounting method. These provisions ensure that business income and expenses (that have not been recognised under the cash accounting method because they had not been received or paid) are recognised in the first year that a business, which is currently in the STS, ceases to use the cash accounting method (changeover years). ***[Schedule 2, item 10, section 328-115]***

Example 2.1: Remaining in the simplified tax system but ceasing to use the cash accounting method

Robert entered the STS in the 2003-04 income year.

Before entering the STS he recognised income in the year it was derived and claimed deductions in the year they were incurred (generally referred to as an accruals method).

Robert included amounts owing from customers as income derived in the 2002-03 income year.

He also claimed deductions for business expenses outstanding at the end of the 2002-03 income year.

The entry adjustment rule (see subsection 328-110(2) of the ITAA 1997) for ordinary income ensures that, when Robert entered the STS, amounts owing from a previous year were not recognised again when *received.*

The entry adjustment rule (see subsection 328-110(4) of the ITAA 1997) for deductions ensures that expenses outstanding from a previous year were not recognised again when *paid.*

Robert chooses to change back to his original method of calculating taxable income (the accruals method) in the 2009-10 income year. Robert remains in the STS.

While he was using a cash basis of accounting he had derived ordinary income for which payment had not been *received*. Robert did not include this amount as income as the cash accounting method does not recognise ordinary income until it is *received*.

While he was using a cash basis of accounting he had ordered business supplies but had not *paid* for them. Robert did not claim a deduction for this expense as the cash accounting method does not recognise general deductions until they have been *paid*.

The exit adjustment rule for ordinary income ensures that Robert includes in assessable income, amounts owing to him in the changeover year (2010-11 income year).

The exit adjustment rule for deductions ensures that he can deduct expenses owed by him in the changeover year (2010-11 income year).

Re-entry of business that previously elected to leave the STS

2.14 Under subsection 328-440(3) of the ITAA 1997, taxpayers who choose to leave the STS cannot re-enter for at least five years after the income year in which they left the STS. Transitional provisions will suspend this rule for five years from 1 July 2005 for taxpayers who have exited the STS prior to their first income year commencing on or after 1 July 2005. ***[Schedule 2, item 10, section 328-440]***

2.15 This will allow businesses, that left the STS because the cash accounting method was no longer appropriate to their circumstances, to re-enter the STS without having to wait five years.

2.16 The five year rule will recommence for exits from the STS after the taxpayer's first income year commencing on or after 1 July 2005.

Consequential amendments

2.17 Consequential amendments are made to the following provisions to remove references to the cash accounting method in the STS:

- The note to subsection 6-5(4) of the ITAA 1997 which refers to the STS cash accounting regime is repealed ***[Schedule 2, item 1]***.
- The note to subsection 8-1(3) of the ITAA 1997 which refers to the application of the cash accounting regime to deductions is repealed and the note renumbered ***[Schedule 2, items 2 and 3]***.
- The note to subsection 70-15(3) of the ITAA 1997 which refers to the timing of deductions for trading stock is repealed and the note renumbered ***[Schedule 2, items 4 and 5]***.
- Section 328-5 of the ITAA 1997, which explains what the Division (STS) is about, is amended to remove the reference to the cash accounting system ***[Schedule 2, items 6 and 7]***.
- Section 328-10 of the ITAA 1997, which provides a map to Division 328 (the STS), is repealed ***[Schedule 2, item 8]***.

Chapter 3
Roll-over of income taxing point for shareholders in employee share schemes

Outline of chapter

3.1 Schedule 3 to this bill amends the *Income Tax Assessment Act 1936* (ITAA 1936) to allow taxpayers who have deferred the income tax liability on a discount received on shares or rights acquired under an employee share scheme (ESS) to roll-over any taxing point that would otherwise occur because of a corporate restructure.

Context of amendments

3.2 Employees may defer their income tax liability arising from a discount on shares or rights acquired under an ESS. The deferral can be for up to 10 years, unless a ‘cessation time’ occurs. At that time, employees must include any discount they have received in their assessable income for that income year. Currently, a corporate restructure may give rise to a cessation time by triggering a disposal of the shares or rights or by breaking the employment relationship between an employee and the company that originally granted the shares or rights.

3.3 In response to the House of Representatives report *Shared Endeavours: An inquiry into employee share ownership in Australia* (the Nelson Report), the Government announced that, from 1 July 2004, employees who have deferred their ESS income tax liability would be able to roll-over their income taxing point in the event of a corporate restructure. The amendments in Schedule 3 will allow employees to roll-over an income taxing point in the event of a corporate restructure, subject to certain conditions, including continuity of employment in the restructured entity or group.

Summary of new law

3.4 This amendment would allow employees who have deferred their ESS income tax liability to roll-over their income taxing point in the event of a corporate restructure such as a takeover, merger or demerger that gives rise to a cessation time.

3.5 The roll-over relief from the taxing point is available for shares or rights provided to the employee in the new company or companies that match the original shares or rights prior to the restructure, if after the restructure:

- the shares or rights are held in a company in which the taxpayer is employed; and
- the shares or rights in the restructured entity meet certain qualifying conditions under Division 13A. These conditions are explained in paragraphs 3.42 to 3.45.

[Schedule 3, item 11, section 139DQ]

3.6 The new shares or rights are treated as a continuation of the old shares or rights for roll-over purposes provided they are held in the company in which the employee is employed after the restructure.

3.7 The deferral period will continue to run from the acquisition of the shares or rights in the old company, and the maximum deferral period will still be 10 years.

Comparison of key features of new law and current law

New law	***Current law***
In the event of a corporate restructure that gives rise to a cessation time, employees who have deferred their ESS income tax liability can roll-over the income taxing point to the extent that, after the restructure, the shares or rights are held in an entity which employs them if the shares or rights meet the qualifying conditions. The deferral period will run from the date of acquisition of the original shares or rights, with the maximum period of deferral being 10 years.	A corporate restructure, such as a takeover or demerger, may result in the employee having to dispose of their shares or rights and no longer being employed by the entity which granted them the shares or rights. This could give rise to a cessation time and so trigger a taxing point for the deferred ESS income tax liability.

Detailed explanation of new law

Background

3.8 Division 13A of the ITAA 1936 provides that, where a discount is given in relation to a share or right acquired by an employee under an ESS, that discount is included in the employee's assessable income in the income year in which the share or right was acquired (section 139B of the ITAA 1936). The discount represents the difference between the market value of a share or right and what the employee paid to acquire it. However, in relation to a 'qualifying share or right' (section 139CD of ITAA 1936), the employee can defer tax on that discount for up to 10 years.

3.9 While taxpayers may defer their income tax liability for up to 10 years, certain events – 'cessation times' under sections 139CA and 139CB – can trigger a taxing point for a taxpayer, which requires the discount to be included in assessable income in the year that the cessation time occurs. A cessation time includes when the employee disposes of the shares or rights or when the employee ceases to be employed in the entity that issued the shares or rights.

3.10 A corporate restructure may cause a cessation time under sections 139CA and 139CB because some or all of the shares or rights held in the old company may be disposed of and replaced with shares or rights in new companies or because the employee may become employed by a different company. This can trigger a taxing point that would require the employee to include the value of the discount in their assessable income in the income year in which the corporate restructure occurs.

Roll-over of the taxing point

3.11 A taxpayer who has deferred an income tax liability on a discount provided as part of acquiring shares or rights under an ESS will be able to roll-over a taxing point subject to certain conditions being met (refer to paragraphs 3.42 to 3.45), provided that:

- a cessation time is caused by a takeover or corporate restructure;
- the employee receives matching shares or rights in the new company (or group) to replace shares or rights in the old company (or group) as a result of the takeover or restructure; and
- the employee works for the new company (or group) after the takeover or restructure.

[Schedule 3, item 11, section 139DQ]

3.12 The roll-over relief will not apply to cessation times that occur outside of corporate restructures. A taxing point will still arise when an employee's employment ceases with the employer or when the shares or rights are disposed of, for reasons other than a corporate restructure or when the maximum 10 year deferral period expires, whichever event occurs first. For shares or rights with restrictions preventing their disposal and conditions resulting in forfeiture, a taxing point will still arise when the disposal restrictions expire or the 10 year maximum tax deferral period from the date the rights or shares were acquired expire, whichever event occurs first.

3.13 The roll-over works by treating the shares or rights in the new company that match the shares or rights in the old company as a continuation of the shares or rights in the old company that they are matching, and treating the employment in the new company as a continuation of the employment in the old company.

Matching shares or rights

3.14 The roll-over relief is limited to shares or rights that can reasonably be regarded as matching the shares or rights in the old company. Matching shares or rights are the replacement shares or rights provided to put the employee in the same position financially after the corporate restructure as before it. Matching shares or rights should be no more than that which is required to place the employee in the same position financially as if the restructure had not occurred. The roll-over relief is limited to matching shares so that the taxpayer does not receive any additional benefit as a result of the restructure than he or she would otherwise have received. ***[Schedule 3, item 11, subsection 139DQ(1)]***

3.15 To be eligible for the roll-over relief, it must be possible to identify the shares or rights that the employee holds as a result of the restructure and they must reasonably match the employee's original holding of shares or rights immediately before the restructure.

Example AA: Matching the value of shares

Fred acquired 100 shares at a discount under an ESS in Company A in 1999 and deferred his tax liability on the discount. In 2004, Company A shares are valued at $0.50 per share. Following an announcement of a takeover by Company B, the price of Company A shares increases to $1. Company B buys out all shares in Company A. Fred's shares are replaced by 200 Company B shares valued at $0.50 per share. Following the restructure, Fred is employed by Company B. The shares in Company B are matching for the purposes of the roll-over, as they have the same value as the original shares in Company A. (This example assumes no shifting in value from non-ESS shares to ESS shares.)

3.16 While the taxpayer should not receive any additional benefit, there need not be a one to one ratio between the old and the new shares or rights in order for them to be matching, provided that the value of the new shares or rights relative to the old shares or rights remains unchanged.

Example 3.1

> Stanley acquires 200 shares under an ESS in Streetcar Pty Ltd. Busline Pty Ltd then buys out all shares in Streetcar Pty Ltd on the basis of two shares in Busline Pty Ltd for each share held in Streetcar Pty Ltd. As a result of the takeover, Stanley is issued 500 shares in Busline Pty Ltd. He receives 400 shares in exchange for his 200 shares and a further 100 shares by way of an employee bonus. The matching shares are the 400 shares in Busline Pty Ltd. The additional 100 shares that Stanley received are over and above what is required to put him in the same position financially after the restructure as before it. The 400 shares Stanley holds in Busline Pty Ltd are matching for the purpose of accessing the roll-over relief, as these shares have the same value as the old shares. (This example assumes no shifting in value from non-ESS shares to ESS shares.)

3.17 To be matching, the market value of the original shares or rights immediately before the restructure (or a reasonable estimate of the market value of the shares or rights) should be the same or equivalent to the value of the replacement shares or rights as a result of the restructure.

Example 3.2

> Marian acquires 1,000 shares in Pebbles Inc as part of an ESS. Immediately prior to a takeover by Granite Pty Ltd, the shares have a market value of $1 per share. Granite Pty Ltd acquires all shares in Pebbles Inc and gives shareholders two shares in Granite Pty Ltd for one share in Pebbles Inc. As replacement for her shares in Pebbles Inc, Marian was given 1,600 shares in Granite Pty Ltd and $800 in cash. The market value of the replacement share package after the restructure exceeds the value of her old shares by $600. The $600 was by way of an employee bonus. The 1,600 shares in Granite Pty Ltd and only $200 (of the $800) 'match' the original shares, as they are similar in value to the shares held by Marian prior to the takeover. Marian has acquired interests as a result of the restructure that exceed the value of her old shares worth $600. (This example assumes no shifting in value from non-ESS shares to ESS shares.)

3.18 The replacement of old shares or rights with an equivalent combination of new shares and cash is considered to be matching. Where some additional benefit is received as part of the replacement of the shares and rights in the old company following a restructure, the additional benefit is not matching. However, a cessation time will arise to the extent that the old shares or rights are replaced by cash that is matching, as roll-over relief only applies to matching shares or rights that are treated as a continuation of the shares or rights in the old company. ***[Schedule 3, item 11, subsection 139DQ(2)]***

3.19 To be regarded as reasonably matching, the attributes of the shares or rights immediately before the restructure need to be the same, or substantially the same, immediately after the restructure. Attributes include whether it is a share or a right. The replacement of shares for rights, or vice versa, following a restructure would not qualify for roll-over relief as the essential characteristic of the employee's interests (shares or rights) provided after the restructure would have substantially changed.

3.20 The tax treatment of non-matching shares or rights immediately after a corporate restructure will be determined on the basis of the application of the existing law and will depend on the circumstances in each case.

Continuation of shares and rights

3.21 Treating the matching shares or rights as a continuation of the shares or rights in the old company means that the replacement of shares or rights is not treated as a disposal of the shares or rights in the old company or as an acquisition of shares or rights in the new company. ***[Schedule 3, item 11, subsection 139DQ(1)]***

Example AA: Continuation of shares or rights

Using the scenario in *Example AA* above, following the restructure, Fred is employed by Company B. As Fred also holds replacement shares in Company B that match the value of the shares in Company A, the replacement shares he gets in Company B are deemed to be a continuation of the shares in Company A for the purpose of the roll-over.

Example 3.3

Keith acquires 500 shares in Deco Corp Ltd as part of an ESS. Subsequently, Luci Pty Ltd acquires all the shares in Deco Corp Ltd. Keith remains employed by Luci Pty Ltd. As part of the takeover, all of Keith’s shares in Deco Corp Ltd are replaced by 500 shares in Luci Pty Ltd. If they reasonably match the original Deco Corp Ltd shares, the 500 Luci Pty Ltd shares Keith holds are treated as a continuation of the original shares for the purposes of the roll-over relief.

3.22 Treating the matching shares or rights as a continuation of the shares or rights in the old company means that the characteristics of the old shares or rights are mirrored in the matching shares or rights.

3.23 Where a taxpayer holds shares or rights in the old company that were acquired at different times, the matching shares or rights are also held to be acquired at those different times. The 10 year maximum deferral period will continue to run from the date the original shares or rights were acquired.

Example 3.4

Rob acquires 100 shares in Island Pty Ltd under an ESS in the year 2000 and acquires a further 100 shares in 2002. Friday Pty Ltd acquires all the shares in Island Pty Ltd and gives all shareholders one share in Friday Pty Ltd for each share held in Island Pty Ltd. Rob now holds 200 shares in Friday Pty Ltd, 100 of which will face a maximum cessation time by 2010 and 100 of which will face a maximum cessation time by 2012.

3.24 Currently, a cessation time arises at the time of acquisition for shares acquired under an ESS that do not impose restrictions preventing the taxpayer from disposing of the share before a particular time. Matching shares or rights received by the taxpayer as part of the corporate restructure may be the same shares or rights granted to all shareholders and so may not impose such restrictions. However, the replacement of shares or rights with restrictions, with shares or rights without restrictions following a restructure is considered matching. By treating the matching shares as a continuation of the shares in the old company, the matching shares will not be treated as an acquisition of shares that do not impose restrictions and so no cessation time will arise. ***[Schedule 3, items 3 and 4]***

Example 3.5

Olive acquires 100 shares in Twist Pty Ltd in the year 2005, that impose a restriction that they cannot be sold until 2008. In 2006 all the shares in Twist Pty Ltd are bought by Beadle Pty Ltd and Olive's 100 restricted shares in Twist Pty Ltd are replaced by 100 unrestricted shares in Beadle Pty Ltd. Olive is employed by Beadle Pty Ltd following the restructure. As the shares in Beadle Pty Ltd match the shares in Twist Pty Ltd, the acquisition by Olive of unrestricted shares will not give rise to an immediate taxing point and she can continue to defer her income taxing point until no later than 2015.

Continuation of employment

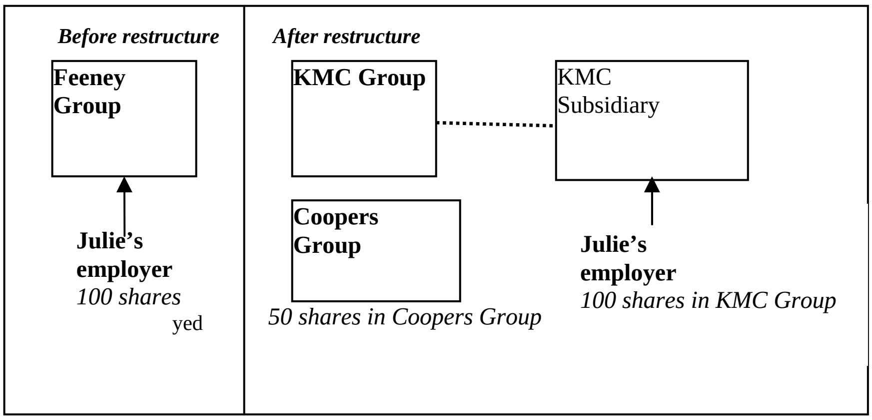
3.25 The roll-over also provides for a continuation of employment. In a takeover situation, the employee is regarded as having continued their employment in the old company if, following the restructure, they are employed by the new company, a subsidiary of the new company, a holding company of the new company or a subsidiary of the holding company of the new company. ***[Schedule 3, item 11, subsection 139DQ(3)]***

Example AA: Continuation of employment

Using *Example AA* above, following the restructure, as Fred is employed by Company B and gets replacement shares in Company B, Fred's employment with Company B is deemed as a continuation of his employment with Company A.

Example 3.6

Julie acquires 100 shares under an ESS in Feeney group. Following a restructure, Feeney group is demerged into KMC group and Coopers group; Julie is employed by a subsidiary of KMC group. As a result of the restructure, one share in Feeney group will be exchanged for one share in KMC group and half a share in Coopers group.
The 100 shares Julie acquires in KMC group and 50 shares in Coopers group are deemed to be matching shares for the 100 shares in Feeney group. However, the 100 shares in KMC group are treated as a continuation of the same proportion of the shares in the Feeney Group, for which Julie can obtain a roll-over relief, as her employment with KMC group is considered as a continuation of her employment with Feeney group. For the 50 Coopers group shares that Julie holds that match the shares in the Feeney group, an income taxing point for the same proportion of shares in the Feeney group arises. A cessation time will occur because there is no continuation of employment with the Coopers Group.



When is the roll-over available?

3.26 The roll-over is available to a taxpayer who has acquired shares or rights under an ESS but has deferred being taxed on the discount, and who faces a taxing point solely as a result of a restructure of the entity in which the taxpayer is employed.

3.27 Not all corporate restructures give rise to a taxing point. If there is no disposal of shares or change in the company in which the employees are employed then no cessation time will arise.

3.28 If no cessation time arises as a result of a restructure, then the roll-over does not apply. These roll-over provisions will apply only to those taxpayers for whom a cessation time under sections 139CA and 139CB would arise were it not for this measure.

3.29 The roll-over will also apply to shares acquired by the taxpayer as a result of exercising a right acquired under an ESS where the shares contain restrictions that prevent the taxpayer from disposing of the share or impose a condition that could result in the taxpayer forfeiting the ownership of the share. The law currently provides that the cessation time for such shares occurs at the time when the last restriction or condition ceases to have effect. This amendment ensures that shares acquired in this way are held to be acquired under an ESS for the purposes of the application of the roll-over.

3.30 Where the exercise of a right results in the issue of restricted shares, a cessation time will arise for these shares at the time of a restructure. Where replacement shares are issued in respect of these shares following the restructure, this amendment ensures that the roll-over relief will apply. The roll-over relief will not apply to unrestricted shares that result from the exercise of a right, as a cessation time will already have occurred prior to the restructure. ***[Schedule 3, items 5 to 7]***

Example 3.7

> Scott holds 100 rights, acquired at a discount, in Nether Pty Ltd under an ESS, which he exercised and, as a result, he holds shares with restrictions. Following a takeover of Nether Pty Ltd by Ball Pty Ltd, Scott's shares are replaced by shares in Ball Pty Ltd – his new employer. The replacement shares Scott is issued are deemed to be a continuation of the old shares for the purposes of the roll-over relief.

3.31 However, the law also provides that a cessation time will occur either when the last restriction or condition ceases to have effect, or when the 10 year period starting from when the taxpayer acquired the right expires, whichever event occurs first.

3.32 The roll-over is also available where, following a restructure, shares or rights with restrictions are replaced by shares or rights with or without restrictions. In that case, a taxing point arises when the maximum 10 year deferral period from the date when the original shares were acquired in the old company, expires. The cessation time for the replacement shares or rights is a maximum of up to 10 years after acquisition of the original shares or rights.

3.33 The roll-over does not apply to shares or rights acquired under an ESS that are not qualifying shares for the purposes of Division 13A of the ITAA 1936. The roll-over also does not apply to shares or rights acquired under an ESS where the employee has elected to bring the discount to tax in the year that the shares or rights were acquired.

3.34 The roll-over does not apply to cessation times triggered by actions other than corporate restructures, such as a voluntary disposal of shares or rights. This includes situations where a partial takeover offer is made and the employee voluntarily accepts the offer and disposes of their shares or rights.

What kind of corporate restructure can give rise to the roll-over?

Takeover or merger

3.35 In a takeover (or merger) scenario, an employee of the old company becomes an employee of the new or restructured company and the employee's shares or rights in the former company are replaced by shares or rights in the new company. Roll-over relief in a takeover scenario will only apply where 100 per cent of the old company's shares and rights are acquired by the new company. In the case of a partial takeover, the taxpayer has a choice in whether or not to dispose of their shares or rights and their employment in the old company is not severed. In this case, a cessation time may arise but roll-over is not available or appropriate. ***[Schedule 3, item 14, section 139GCB; item 11, section 139DQ]***

Example AA: Takeover or merger

Using the scenario in *Example AA* above, as all the shares in Company A were subsequently bought by Company B and Fred's shares in Company A were replaced by shares in Company B (his new employer) as a result of the takeover, and assuming that the other qualifying conditions are met, Fred can roll-over his taxing point for a maximum period of 10 years ending in 2009.

Example 3.8

Ron acquired shares at a discount under an ESS in the year 2000 in Q Holdings Pty Ltd and deferred his tax liability on the discount. Subsequently 51 per cent of the shares in Q Holdings Pty Ltd are bought by P Holdings Pty Ltd. Ron continues to hold his shares in Q Holdings Pty Ltd and is employed by Q Holdings Pty Ltd so no cessation time arises and no roll-over is necessary.

Example 3.9

Evan acquired 800 shares at a discount under an ESS in Rid Pty Ltd and deferred his tax liability on the discount. Subsequently 51 per cent of the shares in Rid Pty Ltd are bought by CCF Pty Ltd. Evan decides to sell 300 shares and is employed by Rid Pty Ltd. A cessation time arises for these 300 shares as the disposal of the shares was not the result of a corporate restructure for the purposes of the roll-over relief. The roll-over is not available because it is only a partial takeover.

Other corporate restructures

3.36 This measure also applies to any other change in ownership, or change in the structure of ownership, of a company or group of companies where some or all of the shares or rights in one company or group of companies are replaced by shares or rights in another company or group of companies. This can include demergers. ***[Schedule 3, item 14, section 139GCC; item 11, section 139DQ]***

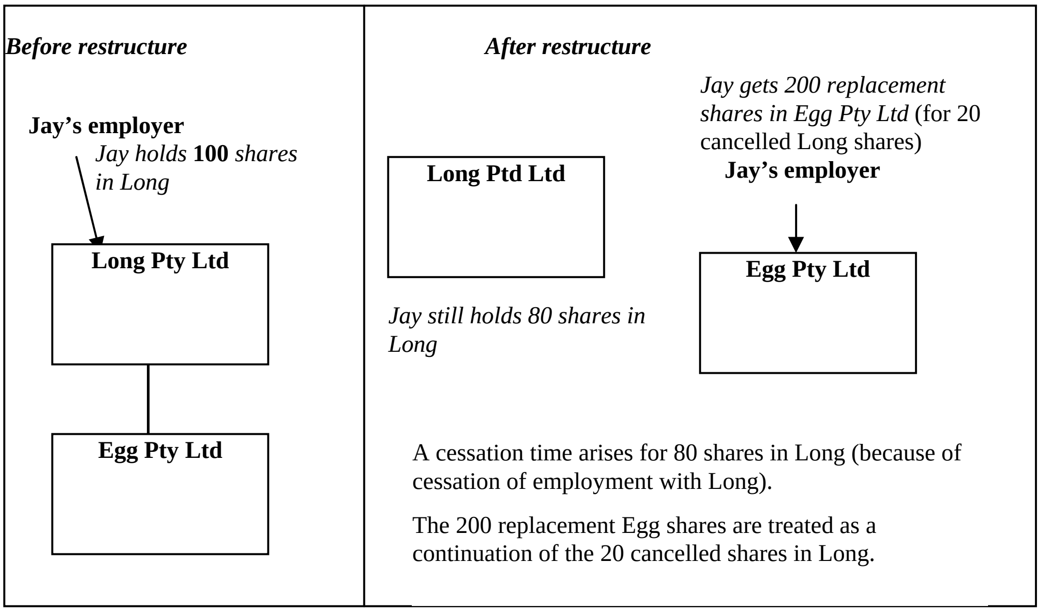
3.37 The amendments to Division 13A only apply if the employee's ownership of shares or rights in the old company ceases as a result of a takeover or restructure.

3.38 Generally, roll-over relief is not available in a demerger because none of the shares or rights in the old company cease to be owned by the employee. After the demerger, the employee will still hold all these shares or rights plus additional shares or rights acquired in the demerged entity. Accordingly, roll-over relief is not available.

3.39 However, roll-over relief may apply to a demerger where the employee is issued matching shares or rights in the demerged entity to replace some of their shares or rights in the old company, provided the employee is also employed by the demerged entity after the demerger.

Example 3.10

Jay is employed by Long Pty Ltd, and holds 100 shares in Long Pty Ltd. In 2008, the group demerges so that Egg Pty Ltd is no longer a subsidiary of Long Pty Ltd. Jay is employed in Egg Pty Ltd after the restructure. As part of the restructure, 20 shares of Jay's 100 shares in Long Pty Ltd are cancelled and replaced by 200 shares in Egg Pty Ltd. As Jay is no longer employed by Long Pty Ltd, an income taxing point is triggered for the 80 shares held in Long Pty Ltd. Assuming that the replacement shares are reasonably matching, roll-over relief will be available because Jay has received replacement shares in Egg Pty Ltd as a result of the restructure. These replacement shares are deemed to be a continuation of the shares in Long Pty Ltd and his employment with Egg Pty Ltd is deemed a continuation of employment with Long Pty Ltd.



Other conditions that must be met for roll-over relief to apply

3.40 The roll-over will be available for matching shares or rights to the extent that the matching shares or rights are held in the entity in which the taxpayer is employed following the corporate restructure and the matching shares and rights in the restructured entity meet the qualifying conditions (section 139DR). Where the restructure does not result in the employee being employed by a new entity, roll-over relief is not available. ***[Schedule 3, item 14, sections 139GCB and 139GCC; item 11, section 139DQ]***

3.41 An employing entity can include:

- the restructured company;
- a holding company of the restructured company;
- a subsidiary of the restructured company or a subsidiary of the holding company of a restructured company.

[Schedule 3, item 11, subsection 139DR(2)]

3.42 The other conditions are that:

- immediately before the takeover or restructure, the taxpayer held shares or rights in the old company under an ESS;
- the matching shares are ordinary shares and matching rights are rights to acquire ordinary shares; and
- at the time the taxpayer acquires the matching shares or rights, the taxpayer does not hold a legal or beneficial interest in more than 5 per cent of the shares of the new company and is not in a position to cast (or control the casting of) more than 5 per cent of the maximum number of votes that may be cast at a general meeting of the new company.

[Schedule 3, item 11, section 139DR]

3.43 In relation to the third dot point in paragraph 3.42, if the employee's total shares or rights in a restructured entity, consisting of shares or rights acquired privately and as part of an ESS, exceeds 5 per cent of the shares in the new company, roll-over relief will not apply.

3.44 A further condition to access the deferral of an income taxing point under Division 13A is that, at the time the shares were acquired, at least 75 per cent of permanent employees of the employer were (or at some earlier time had been) entitled to acquire shares or rights under the scheme. This condition ensures that participation in the ESS is offered widely to the employees. This condition is not applicable to a corporate restructure, where an offer is made to all shareholders, not as part of an offer to employees to participate in an ESS. This condition has therefore not been attached to the conditions that must be met to access the roll-over.

3.45 These conditions mirror those in section 139CD and ensure that the intention of Division 13A of encouraging participation in an ESS as a way of aligning the interests of employees and employers is maintained.

3.46 The roll-over is only available to the extent that shares or rights are held in the entity that employs the taxpayer following the corporate restructure. Shares or rights that the taxpayer receives as part of the restructure, in a company other than the company in which the taxpayer is employed, are not subject to the roll-over. This ensures that the employer-employee relationship that underpins an ESS continues. ***[Schedule 3, item 11, section 139DQ; item 14, sections 139GCB and 139GCC]***

3.47 In a restructure other than a takeover or merger, the employee may be employed in one of the companies involved in the restructure and have shares or rights in that company and in other companies or group of companies (e.g. a subsidiary). The roll-over will only apply to the shares or rights in the old company to which the matching shares or rights relate, to the extent that the matching shares are issued by the new entity that employs the employee following the restructure. (See Example 3.10.) ***[Schedule 3, item 11, section 139DQ; item 14, section 139GCC]***

Apportionment of consideration paid for the original shares and rights following a corporate restructure

3.48 Any consideration the taxpayer paid for the original shares or rights should be spread among the matching shares or rights in proportion to their market values immediately after the corporate restructure. This allows the calculation of the discount that is to be brought to tax to be calculated for those shares that will not be subject to the roll-over and those that will. ***[Schedule 3, item 11, section 139DS; item 12]***

Example 3.11

Ian acquired 1,000 shares at a discount under an ESS in Acme Inc for which he paid $1 per share and the shares have a market value of $2 per share immediately before a corporate restructure. After the restructure, Acme Inc shares are worth $1.60 only and Ian also receives 400 shares in a subsidiary of the restructured entity valued at $1 per share. As the value of Acme Inc shares has fallen, in calculating the value of the discount to be brought to tax, the consideration Ian paid for the shares should also fall by a proportionate value, that is $0.80 a share. Hence the total consideration paid for Acme Inc shares is $800 (= $0.80 × 1,000 shares).

The total consideration attributable to the 400 new shares in the subsidiary is $200 or $0.50 per share ($200/400 = $0.50). The $0.50 would be relevant in calculating the discount to be brought to tax for the additional shares Ian received as part of the restructure.

3.49 Similarly, where an employee acquired different issues of shares or rights at different prices, the calculation of the discount that is to be brought to tax should reflect an average of the different prices paid in acquiring the different issues of shares or rights.

Example 3.12

> Heather acquired 500 ESS shares in 1995 at a discount of $3 per share and 500 shares in the year 2000 at a discount of $5 per share. The consideration paid for both share issues total $4,000. The company that employs Heather is taken over by Rip Sol Pty Ltd. As a result of the restructure, Heather received 1,000 replacement shares. In 2005, a cessation time arises for the shares she acquired in 1995. At a market value of $8 per share, Heather would be required to bring a discount of $2,000 to tax ($8 *less* the average price paid for each share of $4 per share × 500 shares). In the year 2010, a cessation time will arise for the shares acquired in 2000.

Synchronisation between Division 13A and Subdivision 130-D

3.50 Subdivision 130-D of the ITAA 1997 is concerned with the interaction between the employee share provisions and the capital gains tax (CGT) rules. At present, Subdivision 130-D is concerned only with the CGT consequences of an employee acquiring shares or rights under an ESS at a discount. The amendments will extend the scope of Subdivision 130-D (and in particular that of subsection 130-80(1)) to apply also to new or replacement shares or rights acquired as part of a corporate restructure. ***[Schedule 3, item 17]***

3.51 The amendments also recognise that there can be a corporate restructure resulting in a Division 13A roll-over without resulting in a CGT roll-over. The amendments provide that any capital gain or loss from the restructure is disregarded. This ensures that there is no double counting on eventual disposal of the new or replacement shares or rights. ***[Schedule 3, item 18]***

3.52 Subject to certain conditions, section 130-90 deals with the circumstances where a capital gain or loss made by the trustee when the employee becomes absolutely entitled to a share or right held in the trust is disregarded. This amendment will extend the concession under subsection 130-90 to disregard a capital gain or loss made by the trustee with respect to new or replacement shares or rights acquired as part of a corporate restructure. ***[Schedule 3, items 20 and 21]***

3.53 For the purposes of roll-over relief, an amendment to subsection 139C(4) treats shares acquired from the exercise of rights as being acquired under an ESS. Where a corporate restructure occurs and these shares are replaced with shares in the new company, the replacement shares will be treated as a continuation of the shares in the old company and are taken to be acquired under an ESS. As a result of the interaction of the amendments to subsection 139C(4) with the current definition of 'employee share scheme' in section 995-1 of the ITAA 1997, the replacement shares will be treated as being acquired under an ESS as defined. Accordingly, it is not necessary to amend the CGT provisions to treat the shares acquired from the exercise of rights as being acquired under an ESS. ***[Schedule 3, item 17]***

Application and transitional provisions

3.54 The changes made by Schedule 3 apply to shares or rights that have been acquired as a result of corporate restructures that happen on or after 1 July 2004. ***[Schedule 3, item 22]***

Consequential amendments

3.55 An amendment is required to substitute the reference to the *Corporations Act 2001* in place of the 'Corporations Law' in section 139GC. ***[Schedule 3, item 13]***

3.56 This amendment is added to the table of contents in section 139A of the ITAA 1936. ***[Schedule 3, item 1]***

3.57 This amendment is included in sections 139CA, 139CB and 139CC of the ITAA 1936. ***[Schedule 3, items 4 to 8]***

3.58 Section 139C(4) of the ITAA 1936 is modified by inclusion of the amendment. ***[Schedule 3, item 2]***

3.59 The meaning of '100% takeover', subsidiary and restructure in the amendment are included in the index of definitions in section 139GH of the ITAA 1936. ***[Schedule 3, items 15 and 16]***

3.60 Definitions of 'restructure' and '100% takeover' are added to Division G of the ITAA 1936. ***[Schedule 3, item 14, sections 139GCB and 139GCC]***

3.61 Section 139DD allows an adjustment to a tax assessment and the benefit of a tax refund where tax has been paid on ESS rights, but the rights subsequently lapse without exercise. This amendment ensures that section 139DD will apply to replacement rights that meet the requirements of section 139DQ. ***[Schedule 3, items 9 and 10]***

REGULATION IMPACT STATEMENT

Background

3.62 In March 1999, the Minister for Employment, Workplace Relations and Small Business, the Hon Peter Reith MP, requested that the House of Representatives Standing Committee on Employment, Education and Workplace Relations inquire into and report on: 'The extent to which employee share ownership schemes have been established in Australian enterprises and the resultant effects on workplace relations and productivity in enterprises and the economy.'

3.63 As a result of this inquiry, the Nelson report was released by the Committee in October 2000, supporting increased access to employee share ownership plans. The report made 45 recommendations that focused on ways in which ESS could be taken up by eligible workers and adopted by businesses, irrespective of their size or type.

3.64 Under the current taxation law, an employee may defer an income taxing point on a discount received as part of an ESS for up to 10 years. However, a taxing point will arise before 10 years if a cessation event occurs. A change of employment constitutes a cessation point and a corporate restructure can trigger a change in employment.

Policy objective

3.65 The Government's objective is to improve the attractiveness to employees of ESS participation in order to support the development of ESS as a means to further align the interests of employees and employers. The Government seeks to achieve this by ensuring that certain taxation concessions currently available to holders of ESS will continue to benefit employees in the event of a corporate restructure.

Implementation Options

3.66 In response to the Nelson Report, the Government announced that, from 1 July 2004, employees who have deferred their ESS income tax liability would be able to roll-over their income taxing point in the event of a corporate restructure. This will provide roll-over for taxation liabilities that arise as a result of an ESS cessation time that occurs when an employee experiences a change of employer owing to a corporate restructure.

3.67 Under this option, roll-over relief would be provided where the employee's employment and the ESS in which they participate remain substantially the same following the restructure. Employees would need to remain employed by the restructured entity and the conditions that apply to the ESS shares that they hold in the new entity will need to satisfy the Division 13A qualifying conditions.

3.68 There are no other implementation options that are consistent with both the policy intent and integrity of the Division 13A concessions.

Assessment of impacts

Impact group identification

3.69 The groups that would be affected by this measure are employees who participate in ESS and have deferred the income tax liability that arises as a result of their ESS benefits and who may face a cessation time as a result of corporate restructure.

3.70 It is estimated that a small proportion of the estimated 65,000 taxpayers who have deferred their ESS liability may be affected. This depends on the extent and nature of corporate restructure activity in any given year.

Analysis of costs

Compliance costs

3.71 The compliance costs associated with this measure are expected to be minimal as the measure provides a potential concession for employers and employees and does not impose any additional compliance requirements on employers or employees.

3.72 However, some minimal costs may arise for employers as they may wish to provide information to employees regarding the tax implications on their ESS holdings in the event of a corporate restructure or seek advice on whether the relief is available. Employees may also incur some costs in confirming the tax liability of their ESS holdings in the event of a corporate restructure.

3.73 Costs for employees and employers would include seeking advice on whether or not relief is available for participants. They could seek this advice from a variety of sources including tax agents and the Australian Taxation Office (ATO).

Administration costs

3.74 The ATO would need to make changes to material prepared for taxpayers, tax practitioners and industry for education about the taxation arrangements that apply to ESS. ATO staff would also need to provide advice to taxpayers on the new arrangements, including as part of Private Binding Rulings.

Revenue costs

3.75 The cost to revenue of this measure is unquantifiable but expected to be small.

Analysis of benefits

3.76 As a result of the proposal, individuals who would otherwise face an ESS income tax liability arising from a corporate restructure may be able to defer such a liability. As a result these individuals may be encouraged to participate in schemes without concern that a tax liability will arise as a result of a restructure.

3.77 In addition, this will address the potential inequity whereby other shareholders may be eligible for capital gains tax roll-over in the event of a restructure but ESS shareholders may face an income tax liability.

Consultation

3.78 The House of Representatives Standing Committee on Employment, Education and Workplace Relations had consulted extensively on issues relating to ESS. They held public hearings across Australia and received more than 50 submissions from Government, unions, multi-national organisations, industry associations and Australian companies of all sizes.

3.79 Draft legislation and the explanatory memorandum to implement this measure were released on a confidential basis to CPA Australia, the Institute of Chartered Accountants in Australia, Taxpayers Australia, Australian Employee Ownership Association, the Australian Ownership Group, Ernst and Young, Pricewaterhouse Coopers and the National Australia Bank.

3.80 Stakeholders generally supported the proposed measure and considered it workable. Suggested changes to the legislation were minor and related mainly to providing more clarity around the application of the roll-over concession in different corporate restructure scenarios. These changes have been incorporated in the current legislation. In addition, various elements of the proposal (e.g. how matching shares or rights are determined for the purposes of the roll-over relief) were simplified following consultation with industry representatives.

Conclusion

3.81 The implementation option discussed above is the only one that achieves the outcome of providing relief from an ESS taxation liability without compromising the policy intent and integrity of the ESS tax concessions.

3.82 Compliance costs are considered to be relatively small, mainly relating to the information requirements of employers and employees regarding whether relief would be available to them in their individual circumstances.

3.83 Benefits of allowing roll-over for ESS tax liabilities include encouragement to participate in schemes without concerns that a corporate restructure may trigger an unexpected tax liability. The roll-over also provides equity of treatment between other shareholders.

3.84 The Treasury and the ATO will monitor this taxation measure, as part of the whole taxation system, on an ongoing basis.

Chapter 4
Fringe benefits tax exemption thresholds for long service award benefits

Outline of chapter

4.1 Schedule 4 to this Bill amends the *Fringe Benefits Tax Assessment Act 1986* (FBTAA 1986) to increase the fringe benefits tax (FBT) exemption thresholds for long service award benefits.

Context of amendments

4.2 A long service award benefit is a fringe benefit provided by an employer to an employee in respect of the employee's employment in recognition of the employee's period of service of not less than 15 years.

4.3 Long service award benefits granted in recognition of 15 years or more of service are exempt from FBT if the value of the benefit does not exceed a specified maximum amount, or threshold.

4.4 The current exemption thresholds are:

- $500 for 15 years' service; and
- $50 for each year more than 15 years that is being recognised.

4.5 Thus the current exemption threshold is $500 where the period of service being recognised by the award is 15 years. If the award recognises a period of service greater than 15 years, the exemption threshold increases by $50 for each additional year.

Summary of new law

4.6 This amendment increases the exemption thresholds from $500 to $1,000 for 15 years' service, and from $50 to $100 for each additional year of service.

Comparison of key features of new law and current law

New law	*Current law*
Long service award benefits are exempt from FBT where the value of the benefit does not exceed $1,000 for 15 years' service and $100 for each additional year of service.	Long service award benefits are exempt from FBT where the value of the benefit does not exceed $500 for 15 years' service and $50 for each additional year of service.

Detailed explanation of new law

4.7 The benefit is exempt provided that the value of the benefit is not more than $1,000 plus $100 for each year of service 15 years or more that is being recognised. ***[Schedule 4, item 1, paragraph 58Q(1)(c) (formula)]***

Example 4.1

Peter & Friends Pty Ltd provides a long service award benefit to an employee, Paul, in recognition of Paul's 20 years' service. Peter & Friends Pty Ltd is exempt from FBT on the value of Paul's benefit, provided that the value of the benefit does not exceed $1,500.

The exemption threshold is calculated as $1,000 for Paul's 15 years' service, plus $100 for each year 15 years or more that is being recognised:

$$\$1,000 + (\$100 \times (20 - 15))$$

4.8 Where the employer provides a subsequent benefit, the benefit is exempt provided that the value of the benefit is not more than $100 per annum for each year of service in excess of the years of service for which a benefit was previously provided. ***[Schedule 4, item 2, paragraph 58Q(1)(d) (formula)]***

Example 4.2

Peter & Friends Pty Ltd is also providing a long service award benefit to another employee, Mary, in recognition of Mary's 25 years' service. Five years ago, Mary received a long service award benefit for her first 20 years of service. Peter & Friends Pty Ltd is exempt from FBT on the value of Mary's benefit, recognising her last five years of service, provided that the value of the benefit does not exceed $500.

The exemption threshold is calculated as $100 for each year of Mary's additional 5 years' service being recognised since her previous award:

$$\$100 \times (25 - 20)$$

Application and transitional provisions

4.9 This amendment applies for the FBT year beginning on 1 April 2005 and later FBT years. ***[Schedule 4, item 3]***

Chapter 5
Petroleum exploration incentive

Outline of chapter

5.1 Schedule 5 to this Bill amends the *Petroleum Resource Rent Tax Assessment Act 1987* (PRRTAA 1987) to allow petroleum exploration companies conducting exploration work in designated frontier areas to receive an uplift on expenditure incurred. Under this measure, the Minister responsible for the *Petroleum (Submerged Lands) Act 1967* can allocate up to 20 per cent of the annual offshore petroleum acreage release areas as designated frontier areas. For a person conducting exploration in a designated frontier area, exploration expenditure in the original period of the exploration permit is uplifted to 150 per cent, provided the exploration expenditure is not incurred in evaluating or delineating a petroleum discovery that has already been made.

5.2 This chapter discusses the amendments to the PRRTAA 1987 which enable the relevant Minister to specify designated frontier areas, and also the amendments that provide the uplift on deductions for eligible exploration expenditure incurred in those areas.

Context of amendments

5.3 Concerns about Australia's declining oil reserves have been raised by the petroleum industry as well as in the House of Representatives Standing Committee on Industry and Resources' 2003 report into impediments to increasing investment in minerals and petroleum exploration in Australia (*Exploring Australia's Future)*. While Australia has some 40 offshore basins that display signs of petroleum potential, most of these areas have remained unexplored. They are often in deep water and distant from existing infrastructure, thus making them relatively high-cost and high-risk undertakings for petroleum exploration companies. These amendments are designed to encourage petroleum exploration companies to explore in designated parts of these areas, which are systematically chosen as part of the administration of exploration under the *Petroleum (Submerged Lands) Act 1967*. This, in turn, increases the probability of discovering a new petroleum province in Australia's offshore waters.

Summary of new law

5.4 This Bill will allow:

- the relevant Minister to designate up to 20 per cent of the annual offshore petroleum acreage release areas from 2004 to 2008 as designated frontier areas; and
- an initial uplift to 150 per cent to be applied to exploration expenditure which is incurred in the original period of an exploration permit of a designated frontier area if the exploration expenditure is not incurred in evaluating or delineating a petroleum pool which has been discovered.

5.5 The policy rationale is to encourage petroleum exploration in Australia's selected offshore areas in order to increase the chances of a new petroleum province being discovered. As exploration in frontier areas is often a high-cost and high-risk undertaking, an incentive is necessary to encourage exploration in these areas. Under the current provisions of the PRRTAA 1987, exploration expenditure is deductible against assessable receipts from petroleum production. Under the new law, 150 per cent of eligible exploration expenditure incurred in a designated frontier area will be deductible against the petroleum company's assessable receipts from petroleum production. Therefore, the 150 per cent uplift on eligible exploration expenditure will reduce petroleum resource rent tax payable.

5.6 Under the current law, undeducted exploration expenditure is augmented at a rate reflecting the period between the expenditure being incurred and when it is able to be deducted. The augmentation is at the annual rate of the long-term bond rate plus 15 percentage points or at the gross domestic product (GDP) factor rate depending on the time between when the expenditure was incurred and the time it is deducted. Under the new law, once an amount becomes uplifted frontier expenditure and is uplifted to 150 per cent of what it would otherwise be, it retains the same access to augmentation as all other exploration expenditure provided in the Schedule to the PRRTAA 1987. That is, the initial uplift is maintained as time passes and further augmentation applies to the uplifted amount.

5.7 New definitions, including 'designated frontier area' and 'designated frontier expenditure', are introduced to describe the amounts eligible for the 150 per cent uplift as well as amounts which have been uplifted. The meaning of 'incurred exploration expenditure' amount is also amended in the PRRTAA 1987 to ensure the uplifted expenditure (rather than what the expenditure would otherwise be) is the basis for transfer, augmentation and deduction against assessable receipts.

5.8 This Bill will also correct the machinery by which taxpayers may seek to review an objection decision on a transfer or revocation of transfer of exploration expenditure by the Commissioner of Taxation (Commissioner). The present provision was not corrected when the machinery for review of objections in taxation matters was relocated to Part IVC of the *Taxation Administration Act 1953*. Consequently, in relation to the Commissioner's transfer or revocation of transfer of exploration expenditure, there has been no effective machinery for review of any objection by the taxpayer since that relocation.

Comparison of key features of new law and current law

New law	***Current law***
The Minister responsible for administering the *Petroleum (Submerged Lands) Act 1967* may designate up to 20 per cent of an offshore petroleum acreage release areas as designated frontier areas.	No equivalent.
Exploration expenditure conducted in the original period of an exploration permit for a designated frontier area, which is not incurred in evaluating or delineating a discovered petroleum pool, is uplifted to 150 per cent. This uplifted amount is deductible for the purpose of the petroleum resource rent tax.	Exploration expenditure is deductible for the purpose of the petroleum resource rent tax without any initial uplift.
The uplifted amount of undeducted frontier expenditure is carried forward and augmented at a rate reflecting the period between the expenditure being incurred and when it is deducted.	Undeducted exploration expenditure is carried forward and augmented at a rate reflecting the period between the expenditure being incurred and when it is deducted.

Detailed explanation of new law

5.9 To encourage petroleum exploration in remote offshore frontier areas, the new law allows the Minister administering the *Petroleum (Submerged Lands) Act 1967* to specify designated frontier areas as part of an offshore petroleum acreage release. Such a release invites applications for exploration permits in relation to the released acreage. In calculating petroleum resource rent tax, an initial uplift to 150 per cent is applied to exploration expenditure incurred in the original period of an exploration permit of a designated frontier area, provided it is not exploration expenditure incurred in evaluating or delineating a petroleum pool which has been discovered already. The original period of an exploration permit is generally for six years. Once uplifted, this amount is effectively treated through the rest of the PRRTAA 1987 like any other exploration expenditure incurred. This includes the same access to augmentation and transferability as provided under the Schedule for other exploration expenditure.

5.10 Exploration expenditure in the original period of an exploration permit of a designated frontier area incurred in evaluating or delineating a discovered petroleum pool, while not eligible for the 150 per cent uplift, remains deductible for the purpose of the petroleum resource rent tax. This includes the same access to augmentation and transferability as provided under the Schedule for other exploration expenditure.

Designated frontier area

5.11 The term 'designated frontier area' is introduced under the new law to define the area within which exploration expenditure must relate to in order to qualify for a 150 per cent uplift ***[Schedule 5, item 1, new definition of 'designated frontier area' in section 2]***. This new term combines the existing concept of an exploration permit with new powers provided to the Minister responsible for the *Petroleum (Submerged Lands) Act 1967* to specify frontier areas.

5.12 A 'designated frontier' area is an area which must fit two criteria. Firstly, it must be an 'exploration permit area' as defined under the *Petroleum (Submerged Lands) Act 1967*. The permit area defines the boundaries within which a person may explore for petroleum. Secondly, it must be an area specified either under section 36A or specified in an instrument made under the powers of section 36B.

Designated frontier expenditure

5.13 The term 'designated frontier expenditure' in the new law defines the type of expenditure which is eligible for the 150 per cent uplift. To be classified as designated frontier expenditure, the exploration expenditure incurred must meet the following three criteria ***[Schedule 5, item 2, section 2, new definition of 'designated frontier expenditure']***:

- it must relate to a designated frontier area;

- it must be incurred during the original period of the exploration permit which ends when the permit ceases to be in force or when it is first renewed; and

- it must not be incurred in evaluating or delineating a petroleum pool which has been discovered.

The definition of a 'petroleum pool' is found in the *Petroleum (Submerged Lands) Act 1967*.

5.14 These amendments give effect to the policy intention of finding new petroleum pools. This is achieved by confining the uplift to exploration work conducted in relation to an area after it has been designated as a frontier area and which is not expenditure incurred in evaluating or delineating a petroleum discovery.

5.15 Eligibility for the 150 per cent uplift depends on the purpose or intention of the exploration expenditure. If the purpose or intention of exploration expenditure is not evaluating or delineating a previously discovered petroleum pool, it will qualify for the 150 per cent uplift. Further, the outcome of the exploration activity does not change its eligibility for the 150 per cent uplift. That is, exploration expenditure on evaluating or delineating a petroleum discovery does not qualify for the 150 per cent uplift even if it happens to discover something new. Alternatively, exploration expenditure that is not evaluating or delineating an existing petroleum discovery qualifies for the 150 per cent uplift even if the results turn out to find something about an existing discovery.

5.16 Exploration expenditure in a designated frontier area associated with work programme commitments made by petroleum exploration companies under the work programme bidding system would normally qualify for the 150 per cent uplift because work on evaluating or delineating of a discovered petroleum pool is not normally included in, or accepted as meeting, work commitments. The work programme bidding system is the basis used for awarding exploration permits under the *Petroleum (Submerged Lands) Act 1967*.

5.17 Taking these considerations into account, petroleum exploration companies are expected to have the relevant information to determine whether or not particular exploration expenditure qualifies for the 150 per cent uplift.

Designated frontier areas for 2004

5.18 The designated frontier areas for 2004 are T04-5, W04-2, W04-4, W04-15, W04-16 and NT04-3 ***[Schedule 5, item 4, section 36A]***. These areas are designated by the proposed law because they are selected from areas for which applications for exploration permits had already been invited in the 2004 releases of acreage.

5.19 Exploration expenditure incurred in these permit areas is increased to 150 per cent if the amounts incurred meet the criteria set out under the definition of designated frontier expenditure (see paragraph 5.13).

Designated frontier areas for 2005 to 2008

5.20 Under the new law, the Minister responsible for the *Petroleum (Submerged Lands) Act 1967* is given the power to designate up to (and including) 20 per cent of the offshore petroleum acreage release areas in each of the years from 2005 to 2008 as designated frontier areas ***[Schedule 5, item 4, section 36B]***. For example, if there are a total of 20 potential exploration permit areas in the annual offshore petroleum acreage release, the Minister may designate up to (and including) four of these areas as designated frontier areas. The Minister specifies a designated frontier area and publishes the specifying instrument in the *Gazette*. The term ***potential exploration permit area*** is defined as an area released under an offshore petroleum acreage release, but for which exploration permits have not yet been awarded. The process for inviting applications and awarding exploration permits is provided under Division 2 of Part III of the *Petroleum (Submerged Lands) Act 1967*.

5.21 As indicated in the 11 May 2004 Joint Press Release by the Treasurer and Minister for Industry, Tourism and Resources, when specifying designated frontier areas, the relevant Minister is likely to favour those areas which are at least 100 kilometres from a commercialised oil discovery and not adjacent to an area designated in the previous year’s acreage release.

5.22 The Minister cannot specify designated frontier areas for a calendar year after 2008 ***[Schedule 5, item 4, section 36B]***. While designated frontier areas already specified under sections 36A and 36B will remain in effect, no new designated frontier areas can be specified after this date. However, this provision does not prevent the Minister from readvertising designated frontier areas already specified under section 36A or 36B after the 2008 calendar year, for instance because no permits have been issued.

5.23 Exploration expenditure incurred in the permit areas which are designated frontier areas is increased to 150 per cent if the amounts incurred meet the criteria set out under the definition of designated frontier expenditure (see paragraph 5.13).

Uplifted frontier expenditure

5.24 Amendments to the PRRTAA 1987 enable the definition of certain exploration permits as ‘designated frontier areas’. An exploration amount incurred in relation to these areas and which also meets the criteria set out in the definition of ‘designated frontier expenditure’ is uplifted by 150 per cent to become ‘uplifted frontier expenditure’ ***[Schedule 5, item 4, section 36C]***. This ‘uplifted frontier expenditure’ is then used in the Schedule to the PRRTAA 1987 as a component of the ‘incurred exploration expenditure amount’ from which exploration expenditure deductions against assessable receipts from petroleum production are worked out, with augmentation and transfer as applicable.

Review of the Commissioner’s transfer and revocation of transfer of exploration expenditure

5.25 Exploration expenditure must be transferred by taxpayers so far as it can be used up in the year of tax, under either section 45A or section 45B, and in a required order. Where taxpayers fail to make the required transfers, the Commissioner may transfer the expenditure (or in some circumstances revoke the transfer) under section 45C. The taxpayer must be notified by the Commissioner, and may object against the transfer or revocation. Subsection 45C(9) allowed 60 days to object in writing, and subsection 45C(10) applied the standard machinery for review of objections; but when that machinery was transferred from Part VII to Part IVC of the *Taxation Administration Act 1953* no consequential amendment was made. The amendments substitute specific authority to taxpayers to object in accordance with the relocated machinery provisions, carrying standard consequent review and appeal rights. ***[Schedule 5, item 5, subsection 45C(9); item 6, subsection 45C(10)]***

Application and transitional provisions

5.26 The amendments providing the uplift will apply in respect of any eligible exploration expenditure incurred (whether before or after the commencement of this Schedule) that is ‘designated frontier expenditure’. Such exploration expenditure may have been incurred where the eligible exploration or recovery area is a ‘designated frontier area’ under new section 36A, for periods after each applicable gazettal (i.e. 30 March, 14 April or 5 May 2004, depending on the area concerned), even though the amendments are made after those dates and after the exploration expenditure is incurred. ***[Schedule 5, item 17, clause 1]***

5.27 The amendments ensuring the standard machinery for objections apply to every objection (even if made before the amendment) that has not been finally determined or otherwise disposed of when the amendment is made ***[Schedule 5, item 17, clause 2]***. This means that all existing objections in relation to transfer of exploration expenditure will get the benefit of a formal objection and review process, if they have not been disposed of, not just new objections.

Consequential amendments

Incurred exploration expenditure amount

5.28 The term 'incurred exploration expenditure amount' is defined in Clause 1 of the Schedule to the PRRTAA 1987. The term is used under the current law to work out under the Schedule the deductible expenditure in relation to a project that is Class 2 augmented bond rate exploration expenditure (under section 35A of the PRRTAA 1987) and Class 2 GDP factor expenditure (under section 35B of the PRRTAA 1987) that is deductible expenditure based on amounts of exploration expenditure actually incurred on or after 1 July 1990. The term is also used in the Schedule to work out what of that expenditure is transferable and so required to be transferred, either between projects of the same taxpayer under section 45A of the PRRTAA 1987 or between projects of group companies under section 45B of the PRRTAA 1987, or where a required transfer under those sections is not made, is transferred by the Commissioner under section 45C of the PRRTAA 1987.

5.29 The present definition of the term is divided into separate paragraphs for petroleum projects that are not combined projects and for petroleum projects that are combined projects.

5.30 The new law substitutes a new definition of 'incurred exploration expenditure amount' in relation to petroleum projects that are not combined projects ***[Schedule 5, item 7, definition of 'incurred exploration expenditure amount' in clause 1 of the Schedule to the PRRTAA 1987]*** and inserts a new definition in relation to petroleum projects that are combined projects ***[Schedule 5, item 8, definition of 'incurred exploration expenditure amount' in clause 1 of the Schedule to the PRRTAA 1987]***. The effect of the revised definition is to replace the former starting point in working out deductible and transferable expenditure under the Schedule. The former starting point was exploration expenditure actually incurred by the taxpayer, and any incurred exploration expenditure amount taken to have been incurred by the taxpayer because the taxpayer acquired either the whole or a part of another person's entitlement to derive assessable receipts of the project after the acquisition.

5.31 The new starting point excludes from these amounts the designated frontier expenditure (i.e. the amount to which uplift applies) and adds to these amounts the uplifted frontier expenditure incurred for petroleum resource rent tax purposes (the initially uplifted amount). This amendment ensures that in calculating amounts under the Schedule to the PRRTAA 1987 in relation to exploration expenditure incurred on or after 1 July 1990, which are transferable, non-transferable, or eligible for augmentation according to the Schedule, that the amount uplifted to 150 per cent is the starting point for the calculations.

5.32 For the purposes of Parts 2 and 3 of the Schedule to the PRRTAA 1987, the new definitions of 'incurred exploration expenditure amount' are sufficient to ensure the correct application of the amounts initially uplifted to 150 per cent in place of the amounts so uplifted. Those Parts deal with what is taken to be expenditure incurred in relation to a project against receipts of which the expenditure is absorbed once there is a production licence for that project.

Non-transferable expenditure

5.33 In the current law, Part 4 of the Schedule is used in determining whether there is transferable expenditure in relation to a petroleum project for which there is not yet a production licence. That is, this Part is not concerned with working out under section 35A or 35B what exploration expenditure has been incurred in relation to the project – unlike Parts 2 and 3. As part of this calculation, clause 15 describes what expenditure is non-transferable. To account for the introduction of a new type of expenditure, 'uplifted frontier expenditure', the new law includes amendments to include the uplifted amount in calculating what exploration expenditure can be transferred.

5.34 Subclause 15(1) of the Schedule describes the case where the sum of exploration expenditure and other deductible expenditure for the petroleum project is exceeded by its assessable receipts, and there is therefore no transferable amount. Under the new law, amendments to paragraph 15(1)(a) and subclause 15(1) ensure that the exploration expenditure in the calculation includes the amount of the uplift by including uplifted frontier expenditure and excluding designated frontier expenditure ***[Schedule 5, item 9, paragraph 15(1)(a) of the Schedule to the PRRTAA 1987]***, and that the resulting non-transferable amount excludes designated frontier expenditure and includes uplifted frontier expenditure incurred ***[Schedule 5, item 10, subclause 15(1) of the Schedule to the PRRTAA 1987].***

5.35 In subclause 15(2), as the amount of transferable exploration expenditure must actually be incurred by that person (i.e. it cannot have been acquired through purchase of another taxpayer's interest in assessable receipts of the project), so the amendment to paragraph 15(2)(b) ensures that the Schedule includes the uplifted frontier expenditure actually incurred by that person (while excluding the corresponding designated frontier expenditure) ***[Schedule 5, item 11, paragraph 15(2)(b) of the Schedule to the PRRTAA 1987]***. In the case that all expenditure actually incurred in relation to the project exceeds assessable receipts, subclause 15(2) ensures that only the excess of the uplifted exploration expenditure over the assessable receipts is available to be transferred ***[Schedule 5, item 12, subclause 15(2) of the Schedule to the PRRTAA 1987]***. The amount of uplifted exploration expenditure matched by receipts is non-transferable.

5.36 Amendments to paragraphs 15(3)(b) and 15(4)(c) ensure that the exploration expenditure including the uplift, that is, including uplifted frontier expenditure and excluding designated frontier expenditure, is subject to the same ordering rules as formerly applied to exploration expenditure under the Schedule ***[Schedule 5, items 13 and 14, paragraph 15(3)(b) and 15(4)(c) of the Schedule to the PRRTAA 1987]***. As there are now three subparagraphs to paragraph 15(4)(c), the reference in paragraph 15(4)(d) is amended to be to the whole of paragraph (c) and not just subparagraphs (i) and (ii) ***[Schedule 5, item 15, paragraph 15(4)(d) of the Schedule to the PRRTAA 1987]***.

Amounts to be worked out

5.37 The amendment to paragraph 16(c) is to ensure that in the working out of the amount of notional exploration expenditure in relation to a notional project, uplifted frontier expenditure is included (and the corresponding designated frontier expenditure is excluded). Therefore, this amendment prevents double counting. ***[Schedule 5, item 16, paragraph 16(c) of the Schedule to the PRRTAA 1987]***

REGULATION IMPACT STATEMENT

Policy objective

5.38 The policy objective of this measure is to encourage petroleum exploration in Australia's remote offshore areas in order to discover a new petroleum province.

5.39 While Australia has some 40 offshore basins that display signs of petroleum potential, most of these areas have remained unexplored because they are often in deepwater and distant from existing infrastructure. This makes petroleum exploration in some of these basins relatively high-cost and high-risk. In contrast, offshore petroleum exploration in areas around existing discoveries is less risky and may be less expensive. The proposed taxation incentive is designed to encourage petroleum exploration companies to explore in selected new offshore areas, thereby increasing the probability of discovering a new petroleum province in Australia's offshore waters.

Implementation options

5.40 Two implementation options have been identified for achieving the policy objective. Both options lower the cost of petroleum exploration in remote offshore areas by increasing deductible expenditure against a petroleum resource rent tax liability. Both options require amendments to the PRRTAA 1987.

Option 1

5.41 Option 1 consists of amending the PRRTAA 1987 to add two new features which have the effect of reducing exploration costs in remote offshore areas. Firstly, the proposed amendments enable the Minister responsible for the *Petroleum (Submerged Lands) Act 1967* to designate up to 20 per cent of the total number of annual petroleum offshore acreage release areas as a designated frontier area. This will enable the Government to target the offshore areas displaying signs of petroleum potential but have remained under-explored.

5.42 Secondly, exploration expenditure incurred in the original period of an exploration permit granted in a designated frontier area is uplifted 150 per cent. The original period of an exploration permit is generally for six years.

5.43 Exploration work conducted during the original period of the exploration permit may include searching for new petroleum reserves as well as evaluating or delineating a petroleum discovery already made. Under option 1, exploration expenditure directed at evaluating or delineating a petroleum pool already discovered is excluded from the 150 per cent uplift.

Option 2

5.44 Under option 2, the relevant Minister would also designate up to 20 per cent of the annual offshore petroleum acreage release areas as designated frontier areas. However, under this option, the 150 per cent uplift would apply to all exploration expenditure conducted in the original period of the exploration permit in a designated frontier area even if the expenditure was on evaluating or delineating a petroleum pool once it had been discovered.

Assessment of impacts

Impact group identification

5.45 Both implementation options presented above will impact upon petroleum exploration companies willing to conduct exploration in the designated frontier areas. There are over 60 companies ranging from very large, multinational oil companies to small, independent companies which currently hold interests in exploration permits in Australian offshore areas.

Analysis of costs / benefits

Assessment of benefits

5.46 Both options 1 and 2 reduce the costs of exploration in designated frontier areas by uplifting to 150 per cent certain expenditure incurred in these areas. Exploration in designated frontier areas is a relatively high-risk and high-cost undertaking for petroleum companies as these areas are often in deep water and distant from existing infrastructure. Implementing option 1 or 2 effectively means that for every $1 spent, the petroleum exploration company can deduct $1.50 against its petroleum resource rent tax liabilities.

5.47 Consequently, both options 1 and 2 are expected to encourage petroleum exploration in previously unexplored areas. Further, an uplift on exploration expenditure may encourage existing petroleum explorers in Australia to refocus their efforts in Australia, as well as to attract new explorers into the Australian offshore area. The Australian community also shares in the benefits either directly through new investment and increased employment opportunities, or indirectly through better knowledge of our potential petroleum resources and any additional taxation revenue generated from developing petroleum discoveries. The exact level of benefits is uncertain, but both options 1 and 2 are expected to provide a positive benefit to all petroleum exploration companies deciding to explore in designated frontier areas and to the Australian community more generally.

5.48 Option 2 has a greater potential tax advantage for petroleum companies exploring in designated frontier areas because it includes a wider range of exploration expenditure to be uplifted than under option 1. That is, under option 2 petroleum exploration companies are allowed to uplift *all* exploration expenditure incurred in the original period of an exploration permit in a designated frontier area, whereas under option 1, petroleum exploration companies are only able to uplift exploration expenditure in the original period of the exploration permit if the exploration expenditure is not incurred evaluating or delineating a petroleum pool previously discovered. Option 1 is anticipated to provide a tax advantage for work that is aimed at finding new petroleum pools.

Assessment of costs

Compliance costs

5.49 Compliance costs are expected to be slightly higher under option 1 relative to option 2. This is due to the need under option 1 to determine whether or not certain exploration expenditure is incurred in evaluating or delineating a petroleum discovery. For example, a company may drill at point A to determine whether there is a petroleum pool at this location. This type of exploration qualifies for the 150 per cent uplift regardless of whether or not a petroleum pool is discovered. Assuming a new petroleum pool is discovered at point A, a petroleum company may subsequently decide to drill at point B to evaluate or delineate the petroleum pool discovered at point A. In this case, the expenditure incurred drilling the well at point B is not eligible for the 150 per cent uplift. Alternatively, the company may instead decide to drill at point C not to evaluate or delineate the petroleum pool discovered at point A, but to determine whether there is a different petroleum pool accessible at point C. In this case, the expenditure incurred in drilling the well at point C is eligible for the 150 per cent uplift. Separating these two cases apart may involve some additional compliance costs.

5.50 While the level and extent of the total compliance cost increase from the proposed amendments are unclear, this cost is expected to be insignificant. This is because the identification of the expenditures as exploration expenditure for petroleum resource rent tax purposes involves essentially the same compliance costs in establishing the distinction between exploration expenditure in evaluating or delineating a discovery already made, and other exploration expenditure. The small number of petroleum resource rent tax taxpayers would have a good understanding of the character of their exploration expenditure in the limited number of designated frontier areas likely to be explored each year.

Administrative costs

5.51 In general, both options are likely to have no material additional administrative costs for the Australian Taxation Office (ATO) relative to the costs of administering the current law.

5.52 However, option 1, relative to option 2, may involve slightly higher administrative costs. This is because option 1 applies to certain exploration expenditure whereas option 2 applies to all exploration expenditure. The possibility of slightly higher administrative costs stem from the need for the ATO to determine whether certain exploration expenditure is eligible for the 150 per cent uplift.

5.53 The level and extent of the additional administrative costs identified in paragraph 5.52 are unclear, but are likely to be negligible compared with existing costs associated with administering the PRRTAA 1987.

Government revenue

5.54 The options are expected to have a minor impact on the Government's revenue. Specifically, option 1 is estimated to cost $17 million over the period from 2004-05 to 2007-08. Option 2 is expected to have a slightly higher revenue cost relative to option 1 because a wider range of expenditure will be eligible for the uplift.

Consultation

5.55 This policy arises from concerns about Australia's declining oil reserves raised by the petroleum industry as well as by the House of Representatives Standing Committee on Industry and Resources' 2003 report into impediments to increasing investment in minerals and petroleum exploration in Australia (*Exploring Australia's Future*). The policy options were developed in consultation with the Department of Industry, Tourism and Resources; Geoscience Australia; and the ATO.

5.56 A draft of Schedule 5 was also provided to representatives of the peak petroleum industry body, the Australian Petroleum Production and Exploration Association, for comment prior to its finalisation.

5.57 In their feedback, industry representatives stressed the importance of petroleum exploration companies having the certainty of knowing whether expenditure will receive the 150 per cent uplift before it is incurred. This concern is addressed in this Schedule to the Bill and the explanatory memorandum. In this regard, in almost all instances, exploration expenditures associated with work programme commitments under the work programme bidding system are likely to qualify for the 150 per cent uplift. This is due to the fact that exploration work on evaluating or delineating a petroleum discovery is not normally included in, or accepted as meeting, work commitments. The work programme bidding system is the basis used for awarding exploration permits under the *Petroleum (Submerged Lands) Act 1967*. Moreover, the treatment of petroleum companies' exploration expenditure depends on what the expenditure is for, not what it achieves. Taking these considerations into account, petroleum exploration companies are expected to have the relevant information to determine whether or not particular exploration expenditure qualifies for the 150 per cent uplift.

Conclusion and recommended option

5.58 Both options 1 and 2 are likely to stimulate petroleum exploration in Australia's offshore frontier areas. Option 1 is preferred because it more directly targets the taxation concession at encouraging exploration expenditure rather than evaluating or delineating a known petroleum discovery. A taxation concession is not required to encourage exploration expenditure targeted at evaluating or delineating an existing petroleum discovery.

5.59 The Treasury; the Department of Industry, Tourism and Resources; and the ATO will monitor this taxation measure on an ongoing basis.

Chapter 6
Consolidation – providing greater flexibility

Outline of chapter

6.1 Schedule 6 to this Bill:

- ensures that certain liabilities taken into account when an entity leaves a consolidated group that correspond to liabilities brought into a consolidated group with a joining entity have the same value at the leaving time that the liabilities had at the joining time;

- ensures that there is no double reduction in working out step 3 of the allocable cost amount (ACA) on entry;

- ensures that when debts which have had a connection with a consolidated group are written off, the claimant can claim a bad debt deduction; and

- clarifies the taxation consequences for life insurance companies and general insurance companies that join or leave a consolidated group.

6.2 All references to legislative provisions in this chapter are references to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise stated.

6.3 Unless otherwise stated a reference in the chapter to a consolidated group should be read as including a multiple entry consolidated group.

Context of amendments

6.4 A number of modifications are being made to the consolidation regime to provide greater flexibility, further clarify certain aspects of the regime and ensure that it interacts appropriately with other areas of the income tax law.

Summary of new law

Value of certain liabilities when an entity leaves a consolidated group

6.5 Part 2 of Schedule 6 to this Bill ensures that certain liabilities taken into account when an entity leaves a consolidated group (in working out the head company's cost for membership interests in the leaving entity) that correspond to liabilities brought into a consolidated group with a joining entity have the same value at the leaving time that the liabilities had at the joining time.

Ensuring no double reduction in step 3 of the allocable cost amount calculation on entry

6.6 Part 3 of Schedule 6 to this Bill ensures that there is no double reduction in working out step 3 of the ACA where an entity joins a consolidated group by removing the requirement to reduce accrued undistributed profits to the extent that they have recouped particular sorts of losses.

Bad debts

6.7 Part 4 of Schedule 6 to this Bill inserts bad debt rules to ensure that an entity can deduct a bad debt that has been for a period owed to a member of a consolidated group, and has for another period been owed to an entity that was not a member of that group.

Life insurance companies

6.8 Part 5 of Schedule 6 to this Bill will clarify the taxation consequences for life insurance companies that join or leave a consolidated group by ensuring that:

- no taxation distortions arise when risk policy liabilities are transferred to or from the head company when a life insurance company joins or leaves a consolidated group;

- any complying superannuation class tax losses and net capital losses from virtual pooled superannuation trust assets held by a life insurance company that joins a consolidated group are transferred to the head company and retain their character;

- losses held by a subsidiary of a life insurance company that joins a consolidated group where all the membership interests of the subsidiary are virtual pooled superannuation trust assets can, provided certain conditions are satisfied, be transferred to the head company and will become either:
  - complying superannuation class tax losses of the head company; or
  - net capital losses from virtual pooled superannuation trust assets of the head company;
- losses held by a subsidiary of a life insurance company that joins a consolidated group where all the membership interests of the subsidiary are segregated exempt assets cannot be transferred to the head company;
- franking surpluses held at the joining time in the franking account of a subsidiary of a life insurance company that is a member of the consolidated group are applied to the benefit of the head company in a way that is consistent with the outcome that would arise if the group did not consolidate;
- the head company will be taxed appropriately if it has excess assets in its segregated exempt assets because another member of the consolidated group holds an immediate annuity contract with a life insurance company that is a member of the group; and
- the tax cost setting rules that apply when a life insurance company leaves a consolidated group are modified to specify the value of certain assets and the value of policyholder liabilities.

General insurance companies

6.9 Part 5 of Schedule 6 to this Bill will also clarify the taxation consequences for general insurance companies that join or leave a consolidated group by ensuring that:

- if a general insurance company that has demutualised joins a consolidated group, the goodwill asset of the company is a retained cost base asset for tax cost setting purposes; and
- no taxation distortions arise when outstanding claims liabilities and unearned premiums are transferred to or from

the head company when a general insurance company joins or leaves a consolidated group.

Comparison of key features of new law and current law

New law	*Current law*
Value of certain liabilities when an entity leaves a consolidated group	
Under step 4 of the ACA calculation, when an entity leaves a consolidated group with the same liability that was brought into the consolidated group by a joining entity, the amount that is taken into account for the liability owed by the leaving entity is the same as the value of the liability at the *joining* time.	Under step 4 of the ACA calculation, when an entity leaves a consolidated group the amount that is taken into account for liabilities owed by the leaving entity is the value of the liability at the *leaving* time.
Ensuring no double reduction in step 3 of the allocable cost amount calculation on entry	
Under step 3 of the ACA calculation, when an entity joins a consolidated group the amount that is added for undistributed taxed profits is *not* reduced by profits that recouped a loss.	A profit that recouped a loss may result in a double reduction in the amount included under step 3 of the ACA calculation when an entity joins a consolidated group.
Bad debts	
Bad debt rules are inserted to ensure that when debts which have had a connection with a consolidated group are written off the claimant can claim a bad debt deduction.	No equivalent.

<table>
<tr><th>New law</th><th>Current law</th></tr>
<tr><td colspan="2">Life insurance companies</td></tr>
<tr><td>If a life insurance company joins a consolidated group, the head company’s opening value of risk policy liabilities will include the value of those liabilities used by the joining life insurance company just before the joining time.

If a life insurance company leaves a consolidated group:
• the head company’s closing value of risk policy liabilities will include the leaving life insurance company’s value of those liabilities just before the leaving time; and
• the leaving life insurance company’s opening value of risk policy liabilities will be equal to the value of those liabilities used by the head company just before the leaving time.</td><td>If a life insurance company joins or leaves a consolidated group, then distortions may arise because the head company uses a different value of risk policy liabilities than the joining or leaving life insurance company.</td></tr>
<tr><td>Complying superannuation class tax losses and net capital losses from virtual pooled superannuation trust assets held by a life insurance company that joins a consolidated group can be transferred to the head company and will retain their character.</td><td>Complying superannuation class tax losses and net capital losses from virtual pooled superannuation trust assets held by a life insurance company that joins a consolidated group can be transferred to the head company only if certain conditions are satisfied.</td></tr>
</table>

New law	***Current law***
Life insurance companies	
Losses held by a subsidiary of a life insurance company that joins a consolidated group where all the membership interests of the subsidiary are virtual pooled superannuation trust assets can, provided certain conditions are satisfied, be transferred to the head company. The losses transferred will become either: • complying superannuation class tax losses of the head company; or • net capital losses from virtual pooled superannuation trust assets of the head company.	Losses held by a subsidiary of a life insurance company that joins a consolidated group where all the membership interests of the subsidiary are virtual pooled superannuation trust assets, are subject to the normal consolidation loss transfer rules. The losses transferred do not become complying superannuation class tax losses of the head company.
Losses held by a subsidiary of a life insurance company that joins a consolidated group where all the membership interests of the subsidiary are segregated exempt assets cannot be transferred to the head company.	Losses held by a subsidiary of a life insurance company that joins a consolidated group where all the membership interests of the subsidiary are segregated exempt assets are subject to the normal consolidation loss transfer rules.
To the extent that they relate to shareholders, franking surpluses held at the joining time in the franking account of a subsidiary of a life insurance company that is a member of the consolidated group will be credited to the head company's franking account. To the extent that they relate to policyholders, the franking surpluses will be cancelled or will be available as a refundable tax offset.	Franking surpluses held at the joining time in the franking account of a subsidiary of a life insurance company that is a member of the consolidated group are credited to the head company's franking account.

<table>
<tr><th>New law</th><th>Current law</th></tr>
<tr><td colspan="2">Life insurance companies</td></tr>
<tr><td>If the head company has excess assets in its segregated exempt assets because another member of the consolidated group holds an immediate annuity contract with a life insurance company that is a member of the group, then the head company’s assessable income will include:
the income component of the transfer value of excess assets transferred; and
the income component of any annuity payments made between the joining time and the time that the excess assets are transferred.</td><td>If the head company has excess assets in its segregated exempt assets because another member of the consolidated group holds an immediate annuity contract with a life insurance company that is a member of the group, then the head company’s assessable income includes the whole transfer value of excess assets transferred.</td></tr>
<tr><td>The tax cost setting rules that apply when a life insurance company leaves the consolidated group will be modified to specify the value of certain assets and the value of policyholder liabilities.</td><td>The ordinary tax cost setting rules will apply when a life insurance company leaves a consolidated group.</td></tr>
<tr><td colspan="2">General insurance companies</td></tr>
<tr><td>If a general insurance company that has demutualised joins a consolidated group, the goodwill asset of the company will be a retained cost base asset for tax cost setting purposes.</td><td>The goodwill asset of a general insurance company that joins a consolidated group is a reset cost base asset for tax cost setting purposes.</td></tr>
</table>

New law	***Current law***
General insurance companies	
If a general insurance company joins a consolidated group, the head company's opening value of outstanding claims liabilities and the unearned premium reserve will reflect the values used by the joining general insurance company just before the joining time. If a general insurance company leaves a consolidated group: • the head company's closing value of outstanding claims liabilities and the unearned premium reserve will include the leaving general insurance company's value of those liabilities and the reserve just before the leaving time; and • the leaving general insurance company's opening value of outstanding claims liabilities and the unearned premium reserve will be equal to the values used by the head company just before the leaving time.	If a general insurance company joins or leaves a consolidated group, then distortions may arise because the head company uses a different value of outstanding claims liabilities and the unearned premium reserve than the joining or leaving general insurance company.

Detailed explanation of new law

Value of certain liabilities when an entity leaves a consolidated group

6.10 Liabilities that were brought into a group by a joining entity may leave a consolidated group with an entity when it ceases to be a member of the group. The amount of the liability that is taken into account in calculations the cost for membership interests in the leaving entity is worked out by adding up all of the entity's liabilities at the leaving time that, in accordance with accounting standards or statements of accounting concepts made by the Australian Accounting Standards Board, can or must be identified in the entity's statement of financial position.

6.11 Part 2 of Schedule 6 to this Bill ensures that where the same liability (i.e. excluding any new liabilities) that was brought into a consolidated group leaves, the value of that liability should be the same at both the joining time and the leaving time. An example of a liability that may vary in amount is an accounting provision for damages under a legal case.

6.12 If the value of the liability in these circumstances was allowed to be different, then the change in the value of that liability would not have been recognised under the consolidation cost setting rules. The problem occurs because the amount of the liability at the joining time is used in setting the cost for tax purposes of the joining entity's assets.

6.13 On entry, liabilities are added in working out the ACA of an entity that joins a consolidated group under step 2 (sections 705-70, 705-75, 705-80 and 705-85). On exit, liabilities are subtracted in working out the ACA to be used in setting the cost for membership interests in an entity that leaves a consolidated group under step 4 (section 711-45).

6.14 Where a liability of a joining entity that is taken into account at step 2 of the ACA calculation is discharged for a different amount after the joining time (and this change would have resulted in a variation to the original ACA), a capital gain or loss will arise under section 104-530 (CGT event L7). If the joining entity had not joined the group then the change in the amount of the liability would be reflected in the value of membership interests in the leaving entity and therefore would have affected the owner's gain or loss when it disposed of those membership interests.

6.15 The purpose of the alignment in the value of particular liabilities on exit with their value on entry is to ensure that there is a consistent outcome with what would have occurred if the relevant liability had been discharged and CGT event L7 had been triggered.

Example 6.1

Assume the amount of a liability taken into account at step 2 of working out the ACA on joining was $100 and the same liability had a value for the purposes of step 4 of working out the ACA for a leaving entity at the leaving time of $150. The increase in the amount of the liability would have the effect of reducing the tax cost for the membership interests in the leaving entity (thereby potentially increasing the amount of a capital gain or reducing the amount of a capital loss on the disposal of those interests).

If the liability had not left with the leaving entity but had been discharged by the consolidated group instead for $150 then the consolidated group would have received a capital loss of $50 (under CGT event L7). Only taking into account the amount of the liability that was taken into account at the joining time ensures that no capital gain or loss arises from the difference in the amount of the liability between the joining and the leaving times.

6.16 An adjustment to the amount of a liability for the purposes of working out the ACA when an entity leaves a consolidated group will occur where:

- a liability is taken into account in working out the ACA for an entity that leaves a consolidated group under subsections 711-45(1) to (7) ***[Schedule 6, item 2, paragraph 711-45(8)(a)]***;

- that liability was a liability of an entity that became a subsidiary member of a consolidated group (not necessarily the same entity as the leaving entity) that was taken into account in working out the ACA for the subsidiary member in accordance with Division 705 ***[Schedule 6, item 2, paragraph 711-45(8)(a)]***;

- the amount of the liability that was taken into account on entry (called the 'entry amount') is different from the amount taken into account on exit (called the 'exit amount') in applying one of subsections 711-45(1) to (7) ***[Schedule 6, item 2, paragraph 711-45(8)(b)]***; and

- the ACA for the subsidiary member on joining would have been different if the amount of the liability at the leaving time had been taken into account in working out the ACA for the subsidiary member at the joining time ***[Schedule 6, item 2, paragraph 711-45(8)(c)]***.

6.17 Then the amount of the liability that is taken into account in working out the ACA for an entity that leaves is taken to be the amount that was taken into account on entry. As discussed below, this replacement amount becomes the starting point for applying section 711-45. The amount that is taken into account under step 4 on exit may be modified by particular subsections of section 711-45 (after the application of subsection 711-45(8)). ***[Schedule 6, item 2, subsection 711-45(8)]***

Liability at exit must be the same liability as on entry

6.18 The adjustment only applies where the liability at the leaving time is the same as the liability at the joining time. Consequently, no adjustment is made to the extent that the liability is different as a result of, for example, a partial repayment of the liability or an increase in the amount of a liability that accrued after the joining time. The reference to "a leaving entity's liability … was taken into account" in paragraph 711-45(8)(b) means that the liability on entry has to be the same liability as the liability that is in existence at the leaving time. ***[Schedule 6, item 2, paragraph 711-45(8)(a)]***

Liability must have been taken into account in working out the allocable cost amount for an entity that joined

6.19 The adjustment only applies to liabilities that were taken into account in working out the ACA for an entity that joined the consolidated group. Consequently, no adjustment will apply to liabilities that were brought into a group by the head company or an entity that was a chosen transitional entity. ***[Schedule 6, item 2, paragraph 711-45(8)(a)]***

There must be a difference between the entry amount and the exit amount

6.20 No adjustment is made where there is no difference between the amount of the liability that was taken into account in working out the allocable amount on entry and the amount of that liability that is taken into account where an entity leaves a consolidated group. This is because, in these circumstances, there is no change in the amount of the liability that has affected the tax cost set for assets of a joining entity. For example, subsection 705-80(1) (which adjusts the amount of a liability for unrealised gains and losses) may have applied in working out the amount of the liability on entry and consequently there may not be a difference if the amount of the liability on exit was substituted for the amount on entry. ***[Schedule 6, item 2, paragraph 711-45(8)(b)]***

The change in the liability would have changed the amount of the allocable cost amount for the joining entity

6.21 No adjustment is made if the change in the liability would *not* have resulted in a change in the ACA for the joining entity if the changed amount of the liability had been used. This is because the change in the amount of the liability would not have affected the amount of the ACA and consequently the amount allocated to the assets. ***[Schedule 6, item 2, paragraph 711-45(8)(c)]***

6.22 This condition is consistent with the operation of CGT event L7 (in particular paragraph 104-530(3)(c)). This outcome may arise because not every change in the amount of a liability between the joining time and the time the liability leaves with an entity that exits a group will affect the ACA calculation. This is because the ACA calculation factors in future tax effects for the liability, and after taking those into account, there may be no net change in the ACA.

The replacement amount becomes the starting point for applying section 711-45

6.23 Subsection 711-45(8) adjusts the amount of the liability that is used as the starting point for the application of any of the other subsections in section 711-45. For example:

- in applying subsection 711-45(4), it is necessary to work out the market value of the asset that corresponds to the liability on the assumption that the amount of that liability is equal to the entry amount;
- in applying subsection 711-45(5), the payment necessary to discharge the liability will be a reference to the payment necessary to discharge that liability on the assumption that its amount were equal to the entry amount; and
- in applying subsection 711-45(6), the entry amount of the liability rather than its exit amount will be used as the step 4 amount to which the market values mentioned in subsection (6) are added.

[Schedule 6, item 2, subsection 711-45(8)]

Ensuring no double reduction in step 3 of the allocable cost amount calculation on entry

6.24 Part 3 of Schedule 6 to this Bill ensures that a single economic loss does not result in a double reduction in working out step 3 of the ACA calculation (section 705-90). Prior to this amendment, a single economic loss may have inappropriately reduced the step 3 amount twice. First, by reducing the amount of available profits that are taken into account under subsection 705-90(2) where the economic loss has been recognised as an accounting loss. Secondly, under paragraph 705-90(6)(b) which would reduce the available profits to the extent they have been sheltered from income tax because of a loss of a sort stated in subsection 701-1(4) that is recognising the same economic loss.

6.25 Step 3 of the ACA calculation provides that undistributed frankable profits accruing to direct or indirect membership interests that the consolidated group held continuously in a joining entity are to be added when working out the joining entity's ACA. This amount is known as the joining entity's 'step 3 amount'. The purpose of the step is, consistent with the imputation system, to prevent double taxation by allowing a consolidated group a cost for retained taxed profits that accrued to membership interests during the period when the consolidated group held the membership interests.

6.26 The calculation of the step 3 amount commences with accounting profits as determined under subsection 705-90(2). This amount is limited under subsection 705-90(3) by reference to the balance of the entity's franking account. The subsection 705-90(3) amount operates as a cap after identifying the undistributed owned profits that accrued to the joined group to be counted under paragraph 705-90(6)(a). Prior to this amendment, the paragraph 705-90(6)(a) amount would then be reduced under paragraph 705-90(6)(b) to the extent that the undistributed profits recouped tax losses that accrued to the group.

6.27 As a result of the running balance nature of the calculation of the undistributed profits for accounting purposes, the amount sought to be excluded by paragraph 705-90(6)(b) may already have been reduced by a corresponding accounting expense or loss for the purposes of determining the subsection 705-90(2) starting amount of undistributed profits.

6.28 Consequently, to remove the potential for a double reduction, subsection 705-90(6) has been replaced by the words formerly contained in paragraph 705-90(6)(a). The requirement previously contained in paragraph 70590(6)(b) that the step 3 amount be reduced to the extent that the undistributed profits recouped losses that accrued to the group is repealed. ***[Schedule 6, item 3, subsection 705-90(6)]***

6.29 Following the repeal of paragraph 705-90(6)(b), an amendment is made to paragraph 701-30(2)(a) of the *Income Tax (Transitional Provisions) Act 1997* to remove the reference to paragraph 705-90(6)(b). ***[Schedule 6, item 4, paragraph 701-30(2)(a)]***

Bad debts

6.30 Part 4 of Schedule 6 to this Bill amends the consolidation regime to determine when an entity (called the claimant) that is or has been a member of a consolidated group can deduct against its assessable income a debt, or part of a debt, that has been written off.

6.31 Broadly, to be entitled to deduct a bad debt the claimant (and any entity that has for a period been owed the debt) must satisfy certain conditions. These conditions ensure that each entity that has been owed the debt for a period between when the debt was incurred and when it is written off, could have deducted the debt at the end of its holding period. ***[Schedule 6, item 5, section 709-210]***

6.32 The rules that are used to determine if a debt is deductible for each entity are the general deduction provisions of sections 8-1 and 25-35, subject to certain modifications.

6.33 Section 25-35 contains the rules that specifically allow a deduction for bad debts. The general rules about deductions in Division 8 apply in conjunction with section 25-35. Both of these rules are not specific to any particular type of entity. Further rules that regulate deducting debts which go bad within a company are in Subdivisions 165-C and 166-C. These rules ensure that there has not been a significant change in ownership or control of the entity from when the debt was incurred to when it seeks a deduction for the bad debt. If there is such a change, the company must satisfy the same business test. Similar rules in relation to trusts are contained in Schedule 2F to the *Income Tax Assessment Act 1936* (ITAA 1936).

6.34 The consolidation bad debt rules ensure that each entity which has been owed the debt and that has been related to a consolidated group is tested when the claimant writes off the debt.

6.35 The standard continuity of ownership test and same business test principles are modified by the amendments in this Bill to make allowance for the different entity types that may be owed a debt within the consolidated group context. For example, these amendments allow deductions for debts that may have first been incurred by a trust which later becomes a subsidiary member of a consolidated group, and then leaves the group with a company, before being written off by that entity. Modified tests are required because the different types of entity that may form consolidated groups would fail the standard continuity of ownership and same business test tests because their membership interests are not readily comparable.

6.36 Each period that an entity is owed a debt is called a ‘debt test period’. For example, from the previous paragraph, from the time that the trust incurred the debt to when it joined the consolidated group would be one debt test period. Similarly, the time that the debt was within the group would be another debt test period. Although the debt may legally always be owed to the same entity, under the single entity principle, for tax purposes, the debt is taken to be owed to a head company as long as the creditor is part of the consolidated group.

6.37 In order for the consolidation bad debt rules to apply, the debt must have been owed to an entity that was a member of a consolidated group for one debt test period, and owed to an entity (which could be the same entity) for a different debt test period while that entity was not a member of that group. Also, the claimant entity must have been owed the debt for one of the debt test periods and must have written off the debt. ***[Schedule 6, item 5, subsection 709-205(2)]***

6.38 For the purposes of determining the debt test periods, the entry and exit history rules in sections 701-5 and 701-45 respectively are ignored. This prevents these rules applying to look through each entity back to when the debt was first incurred. This would be inappropriate because it would effectively create a single debt test period. ***[Schedule 6, item 5, subsection 709-205(3)]***

6.39 The consolidation bad debt rules do not apply merely because a debt is assigned to or from a member of a consolidated group ***[Schedule 6, item 5, subsection 709-205(4)]***. This is because when the debt is assigned it is taken to be a new debt in the hands of the assignee, whose debt test period would start at the date of assignment. If the assignee subsequently joined or left a consolidated group, the consolidation bad debt rules would not apply to the assignor if the assignor was never part of that consolidated group (i.e. the consolidated group the assignee has joined or left, whatever the case may be). Similarly, if the debt is assigned from one entity to another, the head entity of the second entity would not be required to apply the consolidation bad debt rules when it writes off the debt, as the previous creditor was never a member of the second consolidated group.

Limit on deduction for bad debts

6.40 The ability to claim a deduction for a bad debt is limited to claimants who can show that for each debt test period the entity that was owed the debt would have been able to deduct a bad debt under section 8-1 or 25-35 if the debt was written off in the debt test income year.

6.41 In considering if a deduction is available under section 25-35, subsection 25-35(5) is ignored as it applies the tests contained in that subsection without modification. These tests would be inappropriate for consolidated groups. ***[Schedule 6, item 5, subsections 709-215(1) and (2)]***

6.42 In determining if the debt is deductible throughout the debt test income year, modified ownership test provisions inserted by this Bill operate in a similar way to the standard continuity of ownership and same business test provisions for companies, trusts and other entities. ***[Schedule 6, item 5, paragraph 709-215(2)(b)]***

6.43 To avoid the complication of splitting income years, certain provisions that deal with debts which are incurred and written off in the same income year (and at the end of an income year) are not applied in determining if a debt is deductible. ***[Schedule 6, item 5, paragraph 709-215(2)(c)]***

6.44 Each entity that was taken for tax purposes to be owed the debt for a debt test period will have a debt test income year. The 'debt test income year' starts and ends at different times depending on whether the entity that is owed the debt for that debt test period is the claimant and whether the debt test period ends before or after the claimant has written off the debt. The relevant times are set out in the table in subsection 709-215(3). ***[Schedule 6, item 5, subsection 709-215(3)]***

6.45 Each entity will have to test whether it could have deducted the debt if it had been written off in the debt test income year. For companies, this will involve satisfying a modified continuity of ownership or same business test. For trusts, this will mean satisfying the relevant test in Schedule 2F to the ITAA 1936 as modified.

6.46 In order to show that it can claim a deduction for the duration of the debt test income year, companies must be able to either satisfy the modified continuity of ownership or same business test for that year. The first step in satisfying the modified continuity of ownership is to set up the relevant continuity periods that are used to establish the ownership test period. That is, we need to define the first and second continuity periods (the ownership test period starts at the start of the first continuity period and ends at the end of the second continuity period).

Tests for companies

6.47 Once the ownership test period has been established (by setting the first and second debt test periods) the same business test parameters must also be defined. For the purposes of applying the same business test, the second continuity period differs from the second continuity period used for continuity of ownership purposes. This is because for continuity of ownership purposes, the second continuity period needs to include ownership changes that occur when an entity joins a consolidated group. Accordingly for continuity of ownership purposes, in certain circumstances the second continuity period ends just after the end of the debt test period (i.e. just after joining).

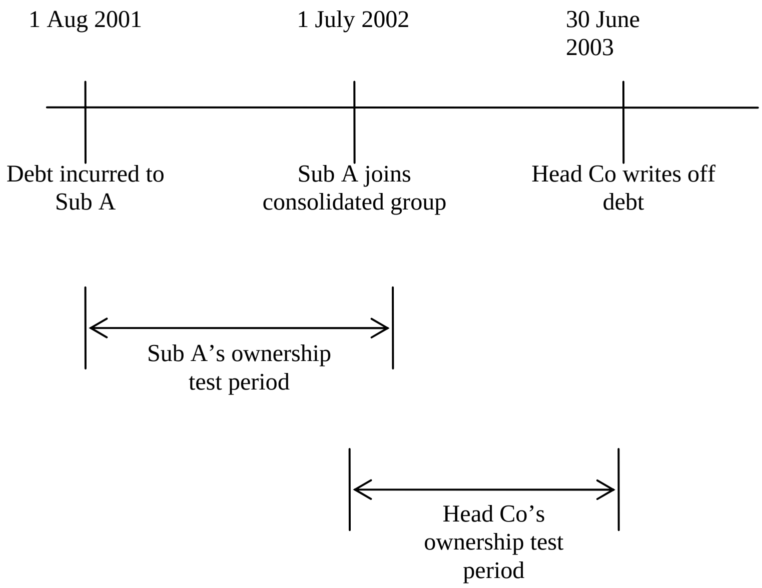
6.48 In order for continuity of ownership changes that may occur when an entity leaves a consolidated group to be included in the ownership test period, the first continuity period is set so that it starts just before the start of the debt test period. That is, just before the entity leaves the group and starts to be owed the debt. ***[Schedule 6, item 5, subsection 709-215(4) item 2 in the table]***

6.49 For same business test purposes, the second continuity period will be the debt test income year, as set by subsection 709-215(3). This effectively becomes the same business test period.

6.50 The relevant start and end times for continuity periods for continuity of ownership and same business test are set by reference to both the debt test income year and the table in subsection 709-215(4). ***[Schedule 6, item 5, subsection 709-215(4)***

6.51 An explanation of these periods and how they operate within the continuity of ownership and same business test framework can be found in Examples 6.2 and 6.3.

Example 6.2: Subsidiary member incurs a debt and joins a consolidated group which then writes off the debt



In this example there are two debt test periods, one for Sub A (1 August 2001 to 30 June 2002) and one for Head Co (1 July 2002 to 30 June 2003).

In order for Head Co to be able to claim a bad debt deduction, both Sub A and Head Co will need to satisfy the modified continuity of ownership test or, failing that, the same business test for the relevant periods.

Testing of Sub A – debt test period 1

Sub A must satisfy the modified continuity of ownership or same business test on the assumption that the debt was written off in the debt test income year. The debt test income year in this case is determined by subitem 2(a) in the table in subsection 709-215(3). That is, it starts either 12 months before the end of the debt test period (1 July 2001) or the start of the debt test period (1 August 2001).

Accordingly, Sub A's debt test income year begins on 1 August 2001. Sub A's debt test income year ends at the end of the debt test period (i.e. 30 June 2002).

In order to apply the modified continuity of ownership and same business test to Sub A we must also determine Sub A's first and second continuity periods. In this example, Sub A joined the consolidated group on 1 July 2002 and, prior to this occurring, Sub A was never part of another consolidated group. As a result, item 3 in the table in subsection 709-215(4) applies to set the first continuity period, which starts at the start of the debt test period (i.e. 1 August 2001) and ends at the start of the debt test income year, which is also 1 August 2001.

Subparagraphs 709-215(4)(b)(i) and (ii) set Sub A's second continuity period to begin at the start of the debt test income year (1 August 2001) and end just after Sub A joins the consolidated group (i.e. just after 1 July 2002). (See item 3 in the table in subsection 709-215(4).) The end time is set at just after Sub A joins to ensure that any changes in ownership that occurred on 1 July 2002 are taken into account.

For the purposes of applying the continuity of ownership test, Sub A's ownership test period will run from the start of the first continuity period (1 August 2001) until the end of the second continuity period (just after 1 July 2002).

If, during this time Sub A fails to satisfy the continuity of ownership test, it will need to satisfy the same business test in order for Head Co. to remain eligible for a bad debt deduction. For same business test purposes, the second continuity period is the debt test income year. The 'test time' for the purposes of applying subsection 165-126(2) is the later of the first time that Sub A cannot show it meets the continuity of ownership test or the time just after the start of the debt test period (1 August 2001).

Making the test time the later of these two times ensures that the business of Sub A prior to the debt being incurred is not tested. Without this requirement, if there was a change in ownership on the same day as when the debt was incurred, the test time would be on that day and the business that would be tested for same business test would be the business carried on *immediately* before the test time, which would be prior to the debt being incurred.

Testing of Head Co – debt test period 2

Head Co will also need to satisfy continuity of ownership or same business test for its debt test period in order for it to claim a deduction for the bad debt.

Head Co's debt test income year is set by item 1 in the table in subsection 709-215(3) as Head Co is the entity writing off the debt. Head Co's debt test income year will start on 1 July 2002 and end on 30 June 2003 (being the start and end of the income year in which the write off occurs). If Sub A had joined the group part way through Head Co's income year (e.g. on 1 January 2003), then Head Co's debt test income year would have started at this later time.

In order to apply the continuity of ownership and same business tests to Head Co, we must also determine Head Co's first and second continuity periods. As Head Co is the claimant and is writing the debt off, item 1 in the table in subsection 709-215(4) applies to set Head Co's first continuity period. Head Co's first continuity period starts at the start of the debt test period (1 July 2002) and ends at the start of the debt test income year, which is also 1 July 2002.

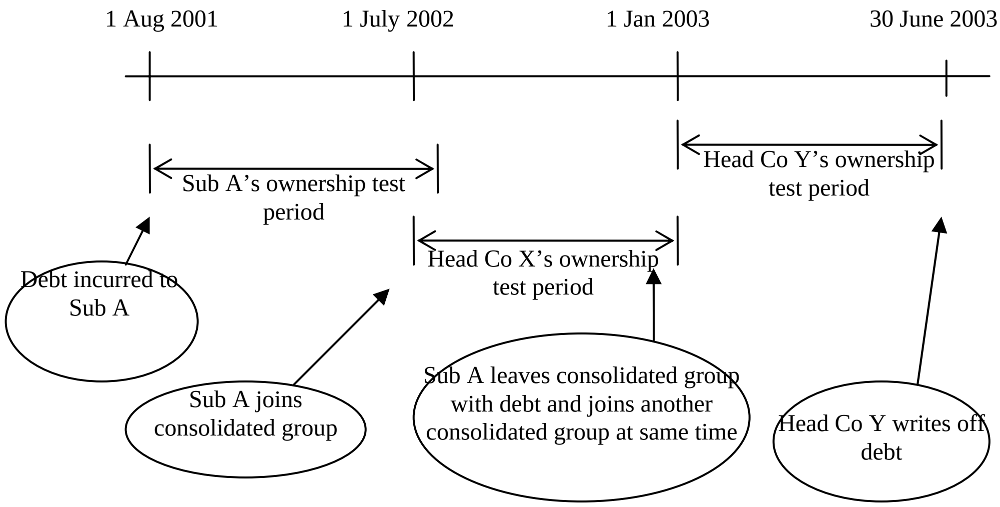
Head Co's second continuity period for the continuity of ownership test purposes begins at the start of the debt test income year (1 July 2002) and ends at the end of the income year in which the write-off occurs (i.e. 30 June 2003).

Therefore, for the purposes of applying the continuity of ownership test, Head Co's ownership test period will run from the start of the first continuity period (1 July 2002) until the end of the second continuity period (30 June 2003).

If, during Head Co's ownership test period, Head Co fails to satisfy the continuity of ownership test, it would have to satisfy the same business test in order to claim a deduction for the bad debt. For same business test purposes, the second continuity period is the debt test income year. The 'test time' for the purposes of applying subsection 165-126(2) is the later of the first time Head Co cannot satisfy the continuity of ownership test or the time just after the start of the debt test period (1 July 2002).

Making the test time the later of these two times ensures that the business of Head Co prior to the debt being owed to it is not tested. Without this requirement, if there was a change in ownership in Head Co on the same day as the debt began to be owed to Head Co, the test time would be on that day and the business that would be tested for same business test would be the business carried on *immediately* before the test time, which would be prior to the debt being owed to Head Co.

Example 6.3: The subsidiary member leaves a consolidated group and joins another consolidated group (and takes the debt with it) or the head company ceases to be the head company (but does not join another consolidated group)



In this example there are three separate debt test periods:

- one when the debt was owed to Sub A (debt test period 1);
- one when the debt was owed to Head Co X (debt test period 2); and
- one when the debt was owed to Head Co Y (debt test period 3).

In order for Head Co Y (the claimant) to be able to deduct the debt, each of the entities that have been owed the debt during each of the debt test periods must satisfy the modified continuity of ownership and same business tests.

Testing of Sub A – debt test period 1

Sub A's debt test period is from 1 August 2001 to 30 June 2002, as it is owed the debt for this period. Applying subitem 2(a) in the table in subsection 709-215(3), Sub A's debt test income year starts at the start of the debt test period (1 August 2001) and ends at the end of the debt test period (30 June 2002).

As Sub A is not writing off the debt and did not begin to be owed the debt because it ceased to be a member of a consolidated group, item 3 in the table in subsection 709-215(4) will apply to set Sub A's first continuity period. This begins at the start of the debt test period (1 August 2001) and ends at the start of the debt test income year (which is also 1 August 2001).

For the purposes of applying the continuity of ownership test, Sub A's second continuity period begins at the start of the debt test income year (1 August 2001) and ends just after the end of the debt test period (which is just after 1 July 2002). Accordingly, for continuity of ownership test purposes, Sub A's ownership test period starts at 1 August 2001 and ends on 2 July 2002.

If Sub A failed the continuity of ownership test during the ownership test period the same business test would apply. For the purposes of applying the same business test, Sub A's second continuity period is the debt test income year, which is 1 August 2001 to 30 June 2002. Subsection 709-215(6) would apply to set the test time as the later of the first time that Sub A cannot satisfy the continuity of ownership test or the time just after the start of the debt test period (1 August 2001).

Testing of Head Co X – debt test period 2

Head Co X's debt test period runs from 1 July 2002 until 31 December 2002 (the time the debt is taken for tax purposes to be owed to Head Co X). Again, subitem 2(a) in the table in subsection 709-215(3) is relevant in determining Head Co X's debt test income year. This begins at the later of 12 months before the end of the debt test period (i.e. 31 December 2001) and the start of the debt test period (1 July 2002). Accordingly, Head Co X's debt test income year begins on 1 July 2002. Head Co X's debt test income year ends at the end of the debt test period, which is 31 December 2002.

As Head Co X is not the claimant and its debt test period ends when Sub A joins another consolidated group, item 4 in the table in subsection 709-215(4) will apply to set the start of Head Co X's first continuity period, which begins at the start of the debt test period (1 July 2002). Head Co X's first continuity period ends at the start of the debt test income year, which is also 1 July 2002.

Head Co X's second continuity period begins at the start of the debt test income year (1 July 2002) and ends at the end of the debt test period (31 December 2002). Accordingly, Head Co X's ownership test period runs from 1 July 2002 (start of the first continuity period) and ends on 31 December 2002 (the end of second continuity period for the continuity of ownership test).

If the same business test must be applied, Head Co X's second continuity period is the debt test income year (1 July 2002 to 31 December 2002).

Testing of Head Co Y– debt test period 3

Head Co Y's debt test period runs from 1 January 2003 until 30 June 2003 (the time the debt is taken for tax purposes to be owed to Head Co Y). Item 1 in the table in subsection 709-215(3) determines Head Co Y's debt test income year as Head Co Y is the claimant and is writing off the debt. Head Co Y's debt test income year begins at the later of the start of the income year in which the write off time occurs (1 July 2002) and the start of the debt test period (1 January 2003). Accordingly, Head Co Y's debt test income year begins on 1 January 2003 and ends at the end of the income year in which the write off time occurs.

As Head Co Y is the claimant and it is the head company of a consolidated group at the write off time, item 1 in the table in subsection 709-215(4) will apply to set Head Co Y's first continuity period. This begins at the start of the debt test period (1 January 2003) and ends at the start of the debt test income year, which is also 1 January 2003.

For the purposes of applying the continuity of ownership test, Head Co Y's second continuity period begins at the start of the debt test income year (1 January 2003) and, applying item 1 in the table in subsection 709-215(4), ends at the end of the income year in which the write off time occurs (30 June 2003). Accordingly, Head Co Y's ownership test period runs from 1 January 2003 (start of the first continuity period) and ends on 30 June 2003 (the end of the second continuity period for the continuity of ownership test).

If the same business test is applied, Head Co Y's second continuity period is the debt test income year, which as discussed above, runs from 1 January 2003 to 30 June 2003.

Tests for trusts

6.52 Where the entity being tested under the consolidation bad debt rules is a trust, the trust must satisfy the modified tests in Schedule 2F to the ITAA 1936. That is, the trust must be able to satisfy the modified rules in Schedule 2F as if the debt was written off in the debt test income year. The consolidation bad debt rules modify the rules in Schedule 2F by modifying the relevant 'test period'. ***[Schedule 6, item 5, subsection 709-215(4)]***

6.53 Effectively, the modified test period for the purposes of the provisions in subsection 709-215(2) is set by reference to the table in subsection 709-215(4). Note that when applying the consolidation bad debt provisions to trusts, the test period is determined only by reference to the table in subsection 709-215(4) and not by reference to both tables in subsections 709-215(3) and (4) as is the case for companies. ***[Schedule 6, item 5, subsection 709-215(5)]***

6.54 To avoid comparing the business of a head company under the same business test with a time that is prior to when the head company was owed the debt, the timing of subsection 165-126(2) is modified to specify a test time that is just after the start of the head company's debt test period. ***[Schedule 6, item 5, subsection 709-215(6)]***

6.55 Similarly, in the case of a subsidiary joining a consolidated group, the subsidiary's debt test period ends as a result of the subsidiary joining the same business test will apply as though the subsidiary was carrying on the same business that it conducted just prior to when the debt test period ended (i.e. just before it joined the group). ***[Schedule 6, item 5, subsection 709-215(7)]***

Life insurance companies

6.56 Subdivision 713-L of the ITAA 1997 contains special rules that apply when a life insurance company joins or leaves a consolidated group. Part 5 of Schedule 6 to this Bill will further clarify the taxation consequences for life insurance companies that join or leave a consolidated group.

6.57 When a life insurance company joins a consolidated group, the amendments:

- clarify the nature of the membership interests in wholly-owned subsidiaries that can be members of the same consolidated group;

- ensure that the head company's opening value of risk policy liabilities reflects the joining life insurance company's value of those liabilities;

- allow complying superannuation classes losses held by the joining life insurance company and, provided that certain conditions are satisfied, losses held by certain subsidiaries of the joining life insurance company to become either:

  – complying superannuation classes losses of the head company; or

  – net capital losses from virtual pooled superannuation trust assets of the head company;

- prevent losses held by other subsidiaries of the joining life insurance company from being transferred to the head company;

- ensure that franking surpluses held by subsidiaries of the joining life insurance company are applied to the head company in a neutral way; and

- ensure that amounts in relation to annuities held with the joining life insurance company by another member of the consolidated group are taxed in a neutral way.

6.58 When a life insurance company leaves a consolidated group, the amendments:

- ensure that the head company's closing value of risk policy liabilities reflects the leaving life insurance company's value of those liabilities;

- clarify that complying superannuation class losses held by the head company at the leaving time can be transferred to the leaving life insurance company in certain circumstances; and

- modify the tax cost setting rules for the leaving life insurance company.

Wholly-owned subsidiaries that can be members of the same consolidated group as a joining life insurance company

6.59 A consolidated group generally consists of the head company and all of its subsidiaries (sections 703-10 and 703-15). Section 713-510 modifies this principle for consolidated groups that include life insurance company members. That section specifies the circumstances in which a wholly-owned subsidiary of a life insurance company can be a member of the same consolidated group as the life insurance company.

6.60 The amendments modify section 713-510 to clarify the operation of the section to an entity that is a wholly-owned subsidiary of the joining life insurance company where the membership interests in the subsidiary are held indirectly.

Certain wholly-owned subsidiaries cannot be members of the same consolidated group

6.61 The amendments clarify that a wholly-owned subsidiary of a life insurance company cannot be a member of the same consolidated group as the life insurance company if the life insurance company owns, either directly or indirectly through one or more interposed entities, all the membership interests in the entity and either:

- some, but not all, of the key interests are virtual pooled superannuation trust assets of the life insurance company; or
- some, but not all, of the key interests are segregated exempt assets of the life insurance company.

[Schedule 6, item 21, paragraph 713-510(1)(a)]

6.62 In addition, a subsidiary of a life insurance company cannot be a member of the same consolidated group as the life insurance company if the life insurance company owns, either directly or indirectly through one or more interposed entities, only some of the membership interests in the entity and any of the key interests are virtual pooled superannuation trust assets or segregated exempt assets of the life insurance company. ***[Schedule 6, item 21, paragraph 713-510(1)(b)]***

6.63 The key interests are the membership interests the life insurance company owns directly in the entity or in an interposed entity. ***[Schedule 6, item 21, subsection 713-510(3)]***

Certain wholly-owned subsidiaries cannot continue to be members of the same consolidated group

6.64 An entity cannot continue to be a subsidiary member of a consolidated group of which a life insurance company is a member if the life insurance company owns, either directly or indirectly through one or more interposed entities, all the membership interests in the entity and, had the entity not been a subsidiary member of the group, either:

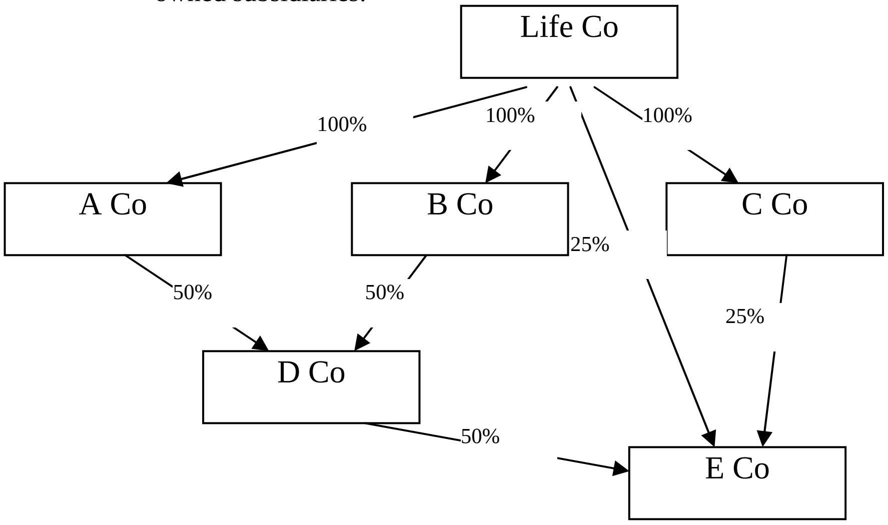
- some, but not all, of the key interests would be pooled superannuation trust assets of the life insurance company; or
- some, but not all, of the key interests would be segregated exempt assets of the life insurance company.

[Schedule 6, item 21, paragraph 713-510(2)(a)]

6.65 In addition, an entity cannot continue to be a subsidiary member of a consolidated group of which a life insurance company is a member if the life insurance company owns, either directly or indirectly through one or more interposed entities, only some of the membership interests in the entity and, had the entity not been a subsidiary member of the group, any of the key interests would be virtual pooled superannuation trust assets or segregated exempt assets of the life insurance company. ***[Schedule 6, item 21, paragraph 713-510(2)(b)]***

Example 6.4

Life Co joins a consolidated group and has the following wholly-owned subsidiaries:



All of the membership interests held directly by Life Co in A Co, B Co, C Co and E Co are virtual pooled superannuation trust assets.

A Co, B Co and C Co can be members of the same consolidated group as Life Co because all of their membership interests are key interests held directly by Life Co and are virtual pooled superannuation trust assets.

D Co can be a member of the same consolidated group as Life Co because all of its membership interests are held indirectly by Life Co through more than one interposed entity (i.e. A Co and B Co) and all the key interests in those interposed entities are virtual pooled superannuation trust assets of Life Co.

E Co can be a member of the same consolidated group as Life Co because:

- 25 per cent of its membership interests are key interests held directly by Life Co and are virtual pooled superannuation trust assets;
- 25 per cent of its membership interests are held indirectly by Life Co through an interposed entity (i.e. C Co) and all the key interests in that interposed entity are virtual pooled superannuation trust assets of Life Co; and
- 50 per cent of its membership interests are held indirectly by Life Co through more than one interposed entity and all the key

interests in two of those interposed entities (i.e. A Co and B Co) are virtual pooled superannuation trust assets of Life Co.

Risk policy liabilities when a life insurance company joins a consolidated group

6.66 Movements in the value of a life insurance company's net risk component of life insurance policies are reflected in the calculation of the company's taxable income. The company must compare the value of its net risk component of life insurance policies at the end of an income year with the value of the net risk component of those policies at the end of the previous income year:

- Paragraph 320-15(1)(h) includes in the company's assessable income the amount of any decrease in the value of the net risk component of life insurance policies over the income year.

- Section 320-85 allows the company to deduct the amount of any increases in the value of the net risk component of life insurance policies over the income year.

6.67 The amendments clarify that, for the income year in which a life insurance company joins a consolidated group, the head company's opening value of the net risk component of life insurance policies reflects the joining life insurance company's value of the net risk component of life insurance policies at the joining time. ***[Schedule 6, item 21, section 713-511]***

The head company does not already carry on life insurance business

6.68 Therefore, if the head company does not already carry on life insurance business because no other member of the consolidated group is a life insurance company, the head company's opening value of the net risk component of life insurance policies for the income year in which joining time occurs will be equal to the joining life insurance company's value of the net risk component of life insurance policies at the joining time.

Example 6.5

The value of the net risk component of life insurance policies of a life insurance company as at 30 June 2004 is $150 million. The company joins a consolidated group on 1 January 2005. At that time the value of the net risk component of those policies is $165 million.

If no other member of the consolidated group is a life insurance company, the head company's opening value of the net risk component of life insurance policies for the income year in which 1 January 2005 occurs will be $165 million.

The head company already carries on life insurance business

6.69 If the head company already carries on life insurance business at the joining time because, for example, another member of the group is a life insurance company, the head company's opening value of the net risk component of life insurance policies for the income year in which joining time occurs will be the sum of:

- the head company's value of the net risk component of life insurance policies at the end of the income year prior to the income year in which the joining time occurs; and
- the joining life insurance company's value of the net risk component of life insurance policies at the joining time.

Example 6.6

If in Example 6.5 another member of the consolidated group is a life insurance company, the head company's opening value of the net risk component of life insurance policies for the income year in which 1 January 2005 occurs will reflect the joining life insurance company's value of the net risk component of life insurance policies at the joining time.

Therefore, if the head company's closing value of the net risk component of life insurance policies as at 30 June 2004 was $90 million, its opening value of the net risk component of life insurance policies for the income year in which 1 January 2005 occurs will be $255 million (i.e. $90 million + $165 million).

Complying superannuation classes losses held by the joining life insurance company

6.70 The taxable income of life insurance companies is divided into the complying superannuation class (which is taxed at a rate of 15 per cent) and the ordinary class (which is taxed at a rate of 30 per cent).

6.71 Life insurance companies are required to segregate assets (virtual pooled superannuation trust assets) that support complying superannuation policies (section 320-170). Income derived on virtual pooled superannuation trust assets is included in the complying superannuation class of taxable income (section 320-137). Tax losses of the complying superannuation class are quarantined so that they can only be applied against the complying superannuation class of taxable income (section 320-141).

6.72 Similarly, net capital losses relating to virtual pooled superannuation trust assets are effectively quarantined so that they can only be used to reduce future capital gains from virtual pooled superannuation trust assets (section 320-125).

Complying superannuation class losses transferred to the head company

6.73 Generally, losses held by a joining entity can be transferred to the head company only if the rules in Division 707 are satisfied. Those rules broadly ensure that tax losses can be transferred to the head company only if the joining entity could have deducted or applied those losses in the period immediately before the transfer, assuming it had sufficient income or gains of the relevant kind.

6.74 The rules in Division 707 will not apply to any tax losses of the complying superannuation class and net capital losses relating to virtual pooled superannuation trust assets of a life insurance company that joins a consolidated group. ***[Schedule 6, item 25, subsection 713-530(4)]***

6.75 Rather:

- any tax losses of the complying superannuation class held by a life insurance company that joins a consolidated group will be regarded as being tax losses of the complying superannuation class made by the head company for the income year in which the joining time occurs and will be able to be utilised by the head company in that income year; and
- any net capital losses from virtual pooled superannuation trust assets held by a life insurance company that joins a consolidated group will be regarded as being net capital losses from virtual pooled superannuation trust assets made by the head company for the income year in which the joining time occurs and will be able to be utilised by the head company in that income year.

[Schedule 6, item 25, subsections 713-530(1) to (3)]

Step 5 of the allocable cost amount

6.76 Step 5 in the table in section 705-60 reduces a joining entity's ACA by certain losses that have not been utilised by the joining entity and that accrued to the joined group before the joining time (section 705-100). A loss is taken to have accrued to the joined group before the joining time if, assuming that as it arose it was instead profit that was accruing, a distribution of that profit would have been a distribution made to the joined group out of profits that accrued to the joined group before the joining time (subsection 705-90(8)).

6.77 If tax losses of the complying superannuation class and net capital losses relating to virtual pooled superannuation trust assets were instead profits, those profits would be allocated to virtual pooled superannuation trust policyholders (and therefore would not be available as a distribution to the joined group). Therefore, step 5 in the table in section 705-60 does not apply to a joining life insurance company’s tax losses of the complying superannuation class and net capital losses relating to virtual pooled superannuation trust assets.

Step 6 of the allocable cost amount

6.78 Step 6 in the table in section 705-60 reduces a joining entity’s ACA by an amount that reflects losses that are transferred to the joined group under Subdivision 707-A. As the rules in Division 707 will not apply to any tax losses of the complying superannuation class and net capital losses relating to virtual pooled superannuation trust assets of a life insurance company that joins a consolidated group, step 6 will not apply to reduce the joining life insurance company’s ACA by an amount that reflects the losses transferred.

6.79 This outcome is appropriate because tax losses of the complying superannuation class and net capital losses relating to virtual pooled superannuation trust assets are already reflected in the value of virtual pooled superannuation trust liabilities that is taken into account for determining a joining life insurance company’s ACA.

Losses held by certain life insurance subsidiaries

6.80 A consolidated group generally consists of the head company and all of its subsidiaries (sections 703-10 and 703-15). As outlined in paragraphs 6.59 to 6.65, section 713-510 modifies this principle for consolidated groups that include life insurance company members.

6.81 Generally, subject to certain conditions, losses held by a joining entity are transferred to, and can be used by, the head company (Division 707). It is not appropriate to apply these rules to losses that economically belong to life insurance company policyholders. Therefore, to ensure that relevant policyholders are not disadvantaged, the rules in Division 707 will be modified in respect of losses held by life insurance subsidiaries where all of the membership interests are, directly or indirectly through one or more interposed entities, virtual pooled superannuation trust assets or segregated exempt assets of the joining life insurance company.

Modifications where the membership interests in the life insurance subsidiary are virtual pooled superannuation trust assets

6.82 The rules in Division 707 will be modified where:

- a life insurance company becomes a member of a consolidated group;
- at the same time, a subsidiary entity that is, either directly or indirectly through one or more interposed entities, wholly-owned by the joining life insurance company, joins the consolidated group; and
- all of the membership interests that the joining life insurance company owns directly in the life insurance subsidiary or in an interposed entity are virtual pooled superannuation trust assets of the joining life insurance company.

[Schedule 6, item 25, paragraphs 713-535(1)(a) to (c)]

6.83 In these circumstances, any tax losses or net capital losses held by the life insurance subsidiary at the joining time will be able to be transferred to the head company only if the rules in Subdivision 707-A are satisfied. That Subdivision ensures that losses of an entity that joins a consolidated group can be transferred to the head company at the joining time only if, broadly, the entity could have utilised the loss had the entity not become a member of the group.

6.84 If any tax losses or net capital losses held by the life insurance subsidiary at the joining time can be transferred to the head company under Subdivision 707-A, the rules in Subdivisions 707-B, 707-C and 707-D (which generally apply to specify how losses can be utilised) will not apply. ***[Schedule 6, item 25, subsection 713-535(3)]***

6.85 Rather:

- any tax losses of the life insurance subsidiary will be regarded as being tax losses of the complying superannuation class made by the head company for the income year in which the joining time occurs and will be able to be utilised by the head company in that income year; and
- any net capital losses of the life insurance subsidiary will be regarded as being net capital losses from virtual pooled superannuation trust assets made by the head company for the income year in which the joining time occurs and will be able to be utilised by the head company in that income year.

[Schedule 6, item 25, paragraph 713-535(1)(d) and subsection 713-535(2)]

Modifications where the membership interests in the life insurance subsidiary are segregated exempt assets

6.86 The rules in Division 707 will also be modified where:

- a life insurance company becomes a member of a consolidated group;
- at the same time, a subsidiary entity that is, either directly or indirectly through one or more interposed entities, wholly-owned by the joining life insurance company, joins the consolidated group; and
- all of the membership interests that the joining life insurance company owns directly in the life insurance subsidiary or in an interposed entity are segregated exempt assets of the joining life insurance company.

[Schedule 6, item 25, subsection 713-540(1)]

6.87 In these circumstances, any tax losses or net capital losses held by the life insurance subsidiary at the joining time cannot be utilised by the subsidiary for an income year after the joining time. ***[Schedule 6, item 25, subsection 713-540(2)]***

6.88 This will prevent the loss from being transferred to the head company under Subdivision 707-A and therefore prevents the loss from being utilised by the head company under Subdivisions 707-B, 707-C and 707-D. This outcome is appropriate because income from segregated exempt assets is non-assessable non-exempt income.

Life insurance subsidiaries affected by these modifications cannot be value donors

6.89 Subdivision 707-C of the ITAA 1997 generally limits the rate of utilisation of losses transferred to the head company by, broadly, specifying the available fraction that is worked out for a bundle of losses. One factor that is taken into account to work out the available fraction for a bundle of losses is the modified market value of a loss entity.

6.90 Subdivision 707-C of the *Income Tax (Transitional Provisions) Act 1997* contains transitional provisions that increase the available fraction by, broadly, allowing a loss entity to add the modified market value of another entity (referred to as a value donor) to its modified market value.

6.91 Consequential amendments ensure that a life insurance subsidiary whose losses become tax losses of the complying superannuation class or net capital losses from virtual pooled superannuation trust assets of the head company because of section 713-535 of the ITAA 1997 cannot be a value donor. ***[Schedule 6, item 29, subparagraph 707-325(1)(ea)(i) of the Income Tax (Transitional Provisions) Act 1997]***

6.92 Similarly, a life insurance subsidiary that is unable to utilise its losses because of section 713-540 of the ITAA 1997 cannot be a value donor. ***[Schedule 6, item 29, subparagraph 707-325(1)(ea)(ii) of the Income Tax (Transitional Provisions) Act 1997]***

Time for making choices not affected by utilisation of complying superannuation class losses

6.93 The application of various aspects of the transitional provisions in Subdivision 707-C of the *Income Tax (Transitional Provisions) Act 1997* is based on the head company making a number of choices. These choices must be made by the day on which the head company lodges its income tax return for the first income year in which it utilises transferred losses.

6.94 Consequential amendments will ensure that the time for making these choices is not affected if the head company utilises losses that become tax losses of the complying superannuation class or net capital losses from virtual pooled superannuation trust assets because of section 713-535 of the ITAA 1997. ***[Schedule 6, items 30 to 34, section 707-355 of the Income Tax (Transitional Provisions) Act 1997]***

Franking surpluses held by life insurance subsidiaries

6.95 Generally, if a joining entity's franking account is in surplus at the joining time, a debit equal to the amount of the surplus is made to the joining entity's franking account (paragraph 709-60(2)(a)) and a credit for that amount is made to the head company's franking account (paragraph 709-60(2)(b)).

6.96 Difficulties arise with this treatment for entities that are subsidiaries of life insurance companies because of the special rules that apply to life insurance companies under the simplified imputation system. Broadly, if a life insurance company receives a franked dividend, then the simplified imputation system applies so that:

- to the extent that the dividend relates to shareholders, the life insurance company is entitled to a credit to its franking account; and
- to the extent that the dividend relates to policyholders, the life insurance company is entitled to a refundable tax offset.

6.97 Modifications are required to ensure that the franking surplus is applied to the head company in a way that is consistent with the outcome that would arise if the group did not consolidate.

6.98 Therefore, paragraph 709-60(2)(b) will not apply if:

- a life insurance company becomes a member of a consolidated group;
- at the same time, a subsidiary entity that is, either directly or indirectly through one or more interposed entities, wholly or partly owned by the joining life insurance company joins the consolidated group; and
- the life insurance subsidiary has a surplus in its franking account just before the joining time.

[Schedule 6, item 25, subsections 713-545(1) and (2)]

6.99 Rather, a franking credit will be made to the head company's franking account in respect of part of the franking surplus and the head company may be entitled to an immediate refundable tax offset for some or all of the remaining franking surplus.

Credit to the head company's franking account

6.100 If the life insurance subsidiary has a franking surplus, a franking credit will be made to the head company's franking account. The amount of the credit will be the amount of franking credit that would arise in the life insurance company's franking account under item 5 in the table in subsection 219-15(2) if:

- the life insurance subsidiary made a franked distribution to the life insurance company just before the joining time; and
- the amount of the franking credit on the distribution was equal to the whole amount of the franking surplus.

[Schedule 6, item 25, subsections 713-545(3) and (4)]

6.101 That is, broadly, the amount of the franking credit that will be made to the head company's franking account will be that part of the deemed franked distribution to the life insurance company that would be attributable to shareholders.

Refundable tax offset

6.102 The head company may also be entitled to a refundable tax offset for the income year in which the joining time occurs. The amount of the tax offset will depend on the nature of the membership interests in the life insurance subsidiary. ***[Schedule 6, items 17 and 25, subsections 67-25(5) and 713-545(5)]***

Tax offset if membership interests are segregated exempt assets

6.103 If immediately before the joining time all the membership interests in the life insurance subsidiary are, directly or indirectly through one or more interposed entities, segregated exempt assets of the life insurance company, then the amount of the tax offset will be the amount of the surplus in the franking account reduced by the amount of the franking credit that is made to the head company's franking account as a consequence of the deemed franked distribution to the life insurance company. ***[Schedule 6, item 25, paragraph 713-545(5)(a)]***

Example 6.7

A Co is a wholly-owned subsidiary of a life insurance company that joins a consolidated group. All of the membership interests in A Co are segregated exempt assets of the life insurance company.

A Co has a franking surplus of $1,000 in its franking account immediately before the joining time. If A Co made a distribution to the life insurance company that included the whole of the franking surplus, no part of the distribution would be attributable to shareholders of the life insurance company.

Therefore, no part of A Co's franking surplus will be credited to the head company's franking account. However, the head company will be entitled to a refundable tax offset of $1,000.

Tax offset if membership interests are virtual pooled superannuation trust assets

6.104 If immediately before the joining time all the membership interests in the life insurance subsidiary are, directly or indirectly through one or more interposed entities, virtual pooled superannuation trust assets of the life insurance company, then the amount of the tax offset will be:

$$\left(\begin{array}{l}\text{the amount of the surplus in the franking account reduced}\\ \text{by the amount of the franking credit that is made to the head}\\ \text{company's franking account as a consequence of the deemed}\\ \text{franked distribution to the life insurance company}\end{array}\right)$$

$$\times$$

$$\left(\begin{array}{l}\text{the complying superannuation class tax rate (currently 15\%)}\\ \text{divided by the ordinary class tax rate (currently 30\%)}\end{array}\right)$$

[Schedule 6, item 25, paragraph 713-545(5)(b) and subsection 713-545(6)]

Example 6.8

B Co is a wholly-owned subsidiary of a life insurance company that joins a consolidated group. All of the membership interests in B Co are virtual pooled superannuation trust assets of the life insurance company.

B Co has a franking surplus of $1,200 in its franking account immediately before the joining time. If B Co made a distribution to the life insurance company that included the whole of the franking surplus, no part of the distribution would be attributable to shareholders of the life insurance company.

Therefore, no part of B Co’s franking surplus will be credited to the head company’s franking account. However, the head company will be entitled to a refundable tax offset of $600.

(i.e. $1,200 × 15% ÷ 30%)

No tax offset if membership interests are ordinary assets

6.105 If immediately before the joining time, all the membership interests in the life insurance subsidiary are assets other than segregated exempt assets or virtual pooled superannuation trust assets of the life insurance company, then the amount of the tax offset will be nil. ***[Schedule 6, item 25, paragraph 713-545(5)(c)]***

Example 6.9

> C Co is a wholly-owned subsidiary of a life insurance company that joins a consolidated group. All of the membership interests in C Co are assets other than segregated exempt assets or virtual pooled superannuation trust assets of the life insurance company.
>
> C Co has a franking surplus of $800 in its franking account immediately before the joining time. If C Co made a distribution to the life insurance company that included the whole of the franking surplus, no part of the distribution would be attributable to shareholders of the life insurance company.
>
> Therefore, no part of C Co's franking surplus will be credited to the head company's franking account. Nor will the head company be entitled to a refundable tax offset in respect of the franking surplus.

Sections 709-70 and 709-75 do not apply

6.106 Sections 709-70 and 709-75 clarify that if a credit or debit arise in the franking account of a subsidiary member of a consolidated group after the joining time, then that credit or debit arises in the head company's franking account.

6.107 Sections 709-70 and 709-75 will not apply to a life insurance subsidiary. However, if the life insurance subsidiary receives a franked distribution that would result in an amount being added to its franking account if it was not a member of a consolidated group, the single entity rule will ensure that the simplified imputation system will apply appropriately to the head company in respect of the franked distribution. ***[Schedule 6, item 25, section 713-550]***

Amounts in relation to annuities held with a life insurance company by another member of the consolidated group

6.108 A life insurance policy that provides for an immediate annuity is an exempt life insurance policy provided that the policy meets certain conditions. Assets supporting liabilities under exempt life insurance policies can be held in a life insurance company's segregated exempt assets. Income generated on segregated exempt assets is non-assessable non-exempt income.

6.109 When the life insurance company makes an annuity payment, the amount payable represents a discharge of liabilities and is paid directly from the life insurance company's segregated exempt assets. Therefore, the payment of an annuity does not cause any tax consequences to arise for the life insurance company.

6.110 In most cases, the holder of the annuity is taxed on the annuity payments received in accordance with subsection 27H(1) of the ITAA 1936. Subsection 27H(1) includes the annuity payments received, reduced by the deductible amount, in a taxpayer's assessable income. The deductible amount effectively represents the capital component of the annuity. Any unused deductible amount is referred to as the reduced purchase price.

6.111 However, if the annuity contract is not held by an individual, the annuity may be a qualifying security that is taxed under Division 16E of Part III of the ITAA 1936. If the annuity is a qualifying security, the holder of the annuity is taxed on an accruals basis – that is, the accrual amount (worked out under section 159GQ) is included in the holder's assessable income. If a qualifying security is transferred (as defined in section 159GP), a balancing adjustment is included in assessable income or allowed as a deduction (section 159GS). A qualifying security is transferred if, broadly, it is sold, assigned or disposed of in any way.

6.112 A difficulty arises with the operation of the current law if a life insurance company is a member of a consolidated group and another member of the group holds an immediate annuity policy with the life insurance company. In these circumstances, the single entity rule will apply so that liabilities under the policy will cease to be recognised as exempt life insurance policy liabilities. Consequently, the head company will have excess segregated exempt assets that, once identified, must be transferred from the segregated exempt assets (subsections 320-235(1) and 320-250(2)).

6.113 An anomaly arises because the whole of the transfer value of the assets (which will include a capital component of the annuity) will be included in the head company's assessable income under paragraph 320-15(1)(f). In addition, any annuity payments made between the joining time and the time excess assets are transferred from the segregated exempt assets will not be taxed appropriately.

Circumstances in which modifications will apply

6.114 To overcome these concerns, modifications will apply if:

- the fused entities – that is, a life insurance company and an entity (the policyholder) holding an immediate annuity policy – become members of the same consolidated group;
- the immediate annuity policy was issued by the life insurance company to the policyholder prior to that time (the fusion time); and
- the head company of the group determines the total transfer value of its segregated exempt assets and the amount of its exempt life insurance policy liabilities (either at the fusion time or at a subsequent time).

[Schedule 6, item 25, section 713-553]

Excess assets transferred from the segregated exempt assets

6.115 The first modification will apply if:

- the head company determines that it has excess segregated exempt assets as at the determination time;
- that excess is attributable to liabilities in respect of the policyholder's immediate annuity policy that, because of the single entity rule, are no longer recognised; and
- as a consequence, the head company transfers under subsection 320-235(1) or 320-250(2) assets having a transfer value equal to the excess from its segregated exempt assets.

[Schedule 6, item 25, subsection 713-555(1)]

6.116 In these circumstances, the operation of Division 320 will be modified so that paragraph 320-15(1)(f) (which includes the whole of the transfer value of the assets in assessable income) will not apply to the transfer. ***[Schedule 6, item 25, subsection 713-555(2)]***

6.117 Rather, if the immediate annuity policy is not a 'qualifying security' (as defined in Division 16E of Part III of the ITAA 1936), the head company's assessable income for the income year in which the company transfers the policy assets will include the income component, if any, of the amount transferred. The income component of the amount transferred is the total transfer value of the assets transferred reduced by the 'reduced purchase price' (as defined in subsection 27A(1) of the ITAA 1936, taking into account any annuity payments assessable under section 713-560 to the head company in the period between the fusion time and the determination time) of the annuity. ***[Schedule 6, item 25, subsection 713-555(3)]***

6.118 If the immediate annuity policy is a qualifying security, the head company will include in its assessable income, or will be able to deduct, the amount of the balancing adjustment worked out under section 159GS of the ITAA 1936 as if there had been a transfer of the qualifying security. Any amounts assessable or deductible under section 713-560 to the head company in the period between the fusion time and the determination time must be taken into account in working out the balancing adjustment. ***[Schedule 6, item 25, subsection 713-555(4)]***

Annuity payments made between the fusion time and the determination time

6.119 The second modification will apply if, when the fused entities are both members of the consolidated group, there is a period (the gap) between the fusion time and the earlier of:

- the determination time; or
- the time at which the policyholder ceases to be a member of the consolidated group.

[Schedule 6, item 25, subsection 713-560(1)]

6.120 In these circumstances, the operation of the single entity rule will be modified so that liabilities in relation to the immediate annuity policy continue to be recognised as exempt life insurance policy liabilities during the gap. This will ensure that, during the gap, assets in relation to the policy can continue to be held in the head company's segregated exempt assets. ***[Schedule 6, item 25, subsection 713-560(2)]***

6.121 In addition, the operation of Division 320 will be modified so that, during the gap, the head company can transfer assets from its segregated exempt assets to provide for immediate annuity payments that arise under the terms of the policy. Any fees and charges that arise in relation to the immediate annuity policy during the gap can continue to be transferred from the head company's segregated exempt assets under subsection 320-250(2). ***[Schedule 6, item 25, subsection 713-560(3)]***

6.122 If the head company transfers assets (other than money) from its segregated exempt assets under subsection 713-560(3), section 320-255 will apply to the asset in the same way as that section applies to an asset transferred under subsection 320 250(2). Consequently, for example, for capital gains tax purposes the cost base of the asset transferred will be reset at its market value at the time of transfer. ***[Schedule 6, item 25, paragraph 713-560(4)(a)]***

6.123 In addition, the head company will include in its assessable income, or will be able to deduct, the amount that would have been assessable or deductible to the policyholder if the fused entities were not members of the same consolidated group during the gap. ***[Schedule 6, item 25, paragraph 713-560(4)(b)]***

6.124 If the immediate annuity policy is not a qualifying security, the head company's assessable income will include the amount that is derived in the gap and would have been included in the policyholder's assessable income if the life insurance company and the policyholder were not members of the same consolidated group. That is, the head company's assessable income will include the transfer value of the assets transferred, reduced by the deductible amount in relation to the annuity worked out under section 27H of the ITAA 1936. ***[Schedule 6, item 25, subsection 713-560(5)]***

6.125 If the immediate annuity policy is a qualifying security, the head company will include in its assessable income, or will be able to deduct, the amount attributable to the gap that would have been assessable or deductible to the policyholder under section 159GQ of the ITAA 1936 if the life insurance company and the policyholder were not members of the same consolidated group. ***[Schedule 6, item 25, subsection 713-560(6)]***

Risk policy liabilities when a life insurance company leaves a consolidated group

6.126 As previously discussed, movements in the value of a life insurance company's net risk component of life insurance policies are reflected in the calculation of the company's taxable income. The company must compare the value of its net risk component of life insurance policies at the end of an income year with the value of the net risk component of those policies at the end of the previous income year:

- Paragraph 320-15(1)(h) includes in the company's assessable income the amount of any decrease in the value of the net risk component of life insurance policies over the income year.

- Section 320-85 allows the company to deduct the amount of any increases in the value of the net risk component of life insurance policies over the income year.

6.127 For the income year in which a life insurance company leaves a consolidated group:

- the head company's value of the net risk component of life insurance policies at the end of the income year in which the leaving time occurs reflects the leaving life insurance company's value of the net risk component of life insurance policies at the leaving time; and

- the leaving life insurance company's opening value of the net risk component of life insurance policies reflects the head company's value of the net risk component of those policies at the leaving time.

[Schedule 6, item 25, section 713-565]

The head company ceases to carry on life insurance business

6.128 Therefore, if the head company ceases to carry on life insurance business because no other member of the consolidated group is a life insurance company, the head company's value of the net risk component of life insurance policies as at the end of the income year in which leaving time occurs will be equal to the leaving life insurance company's value of the net risk component of life insurance policies at the leaving time.

6.129 For the subsequent income year, the head company's value of the net risk component of life insurance policies at the end of the income year in which the leaving time occurs will not include the leaving life insurance company's value of the net risk component of life insurance policies at the leaving time (and therefore will be nil).

Example 6.10

The value of the net risk component of life insurance policies of the head company of a consolidated group that has a life insurance company member as at 30 June 2007 is $135 million. The life insurance company leaves the consolidated group on 1 January 2008. At that time the value of the net risk component of those policies is $125 million.

If no other member of the consolidated group is a life insurance company:

- for the purpose of working out the amount that is assessable or deductible in the income year in which 1 January 2008 occurs:
  - the head company's value of the net risk component of life insurance policies as at the end of that income year will be $125 million; and
  - the leaving life insurance company's opening value of the net risk component of life insurance policies for that income year will be $125 million; and
- for the purpose of working out the amount that is assessable or deductible in the subsequent income year, the value of the head company's net risk component of life insurance policies as at the end of the income year in which 1 January 2008 occurs will be nil.

The head company continues to carry on life insurance business

6.130 If the head company continues to carry on life insurance business after the leaving time because, for example, another member of the group is a life insurance company, the head company's value of the net risk component of life insurance policies as at the end of the income year in which leaving time occurs will be the sum of:

- the head company's actual value of the net risk component of life insurance policies at the end of the income year in which the leaving time occurs; and
- the leaving life insurance company's value of the net risk component of life insurance policies at the leaving time.

6.131 For the subsequent income year, the head company's value of the net risk component of life insurance policies at the end of the income year in which the leaving time occurs will not include the leaving life insurance company's value of the net risk component of life insurance policies at the leaving time.

Example 6.11

If in Example 6.10 another member of the consolidated group is a life insurance company, the head company's closing value of the net risk component of life insurance policies for the income year in which 1 January 2008 occurs will reflect the leaving life insurance company's value of the net risk component of life insurance policies at the joining time. Therefore, if the head company's actual value of the net risk component of life insurance policies as at 30 June 2008 is $90 million:

- for the purpose of working out the amount that is assessable or deductible in the income year in which 1 January 2008 occurs:
  - the head company's value of the net risk component of life insurance policies as at the end of that income year will be $215 million (i.e. $90 million + $125 million); and
  - the leaving life insurance company's opening value of the net risk component of life insurance policies for that income year will be $125 million; and
- for the purpose of working out the amount that is assessable or deductible in the subsequent income year, the head company's value of the net risk component of life insurance policies as at the end of the income year in which 1 January 2008 occurs will be $90 million.

Complying superannuation class losses transferred to a leaving life insurance company

6.132 Currently, section 713-530 applies when a life insurance company leaves a consolidated group and, at the leaving time, no other member of the group is a life insurance company. In those circumstances, any tax losses of the complying superannuation class and net capital losses relating to virtual pooled superannuation trust assets held by the head company are transferred to the leaving life insurance company.

6.133 Due to structural changes to Subdivision 713-L, section 713-530 is relocated and renumbered (so that it becomes section 713-570). In addition, the section is modified to clarify that:

- the section applies to tax losses of the complying superannuation class and net capital losses relating to virtual pooled superannuation trust assets held by the head company at the leaving time; and

- for the purposes of income years ending after the leaving time:

  – the leaving life insurance company had made the loss for the income year in which the leaving time occurs and will be able to utilise the loss in that income year; and

  – the head company had not made the loss for the income year in which the leaving time occurs and therefore will not be able to utilise the loss in that income year.

[Schedule 6, item 25, section 713-570]

Modification of the tax cost setting rules when a life insurance company leaves the consolidated group

6.134 Subdivision 713-L modifies the tax cost setting rules in Division 705 for life insurance companies that join a consolidated group. The modifications:

- specify certain assets to be retained cost base assets (section 713-515); and

- specify the basis for valuing certain life insurance policy liabilities of joining life insurance companies (section 713-520).

6.135 When an entity leaves a consolidated group, it is necessary to work out the old group's ACA for the leaving entity (section 711-20). Modifications similar to those that apply to a life insurance company that joins a consolidated group will be made to the tax cost setting rules in Division 711 for life insurance companies that leave a consolidated group.

Terminating value of assets used to support policyholders

6.136 Step 1 of the old group's ACA relates to the terminating values of the assets that the leaving entity takes with it (section 711-25).

6.137 If the leaving entity is a life insurance company, the head company's terminating value for an asset will be modified for assets that are used to support policyholders. That is, for the purpose of applying section 711-25 to a life insurance company that leaves a consolidated group, the terminating value of an asset will be the asset's 'transfer value' (as defined in subsection 995-1(1)) at the leaving time if:

- the asset is a virtual pooled superannuation trust asset;
- the asset is a segregated exempt asset; or
- the asset is an asset held for the purpose of discharging liabilities under the net investment component of ordinary life insurance policies (other than policies that provide participating benefits or discretionary benefits under life insurance business carried on in Australia).

[Schedule 6, items 25 and 28, section 713-575 and the definition of 'terminating value' in subsection 995-1(1)]

Value of policyholder liabilities

6.138 Step 4 of the old group's ACA relates to liabilities owed by the leaving entity (section 711-45). The value of those liabilities under step 4 is generally the value that is used for accounting purposes.

6.139 If the leaving entity is a life insurance company, the basis of valuing the leaving entities policyholder liabilities will be modified so that it is consistent with the basis that is used for valuing those liabilities for other taxation purposes.

6.140 That is, for the purpose of applying section 711-45 to a leaving entity that is a life insurance company:

- the value of the virtual pooled superannuation trust liabilities of the leaving entity will be the amount worked out under section 320-190 at the leaving time;
- the value of the exempt life insurance policy liabilities of the leaving entity will be the amount worked out under section 320-245 at the leaving time;
- the value of liabilities under the net risk component of life insurance policies (for which the leaving entity will be able to claim a deduction under section 320-80 after it ceases to be a member of the consolidated group) will be the 'current termination value' (as defined in subsection 995-1(1)) of that

component of those policies at the leaving time as calculated by an actuary; and

- the value of liabilities under the net investment component of ordinary life insurance policies of the leaving entity will be the amount worked out under subsection 320-190(2) as if those liabilities were virtual pooled superannuation trust liabilities at the leaving time.

[Schedule 6, item 25, section 713-580]

Structural changes to Subdivision 713-L

6.141 As a consequence of new rules being inserted for life insurance companies that join or leave a consolidated group, Subdivision 713-L has been restructured. Some consequential amendments are made to reflect this restructuring and, where appropriate, to insert notes that refer to the new modifications. ***[Schedule 6, items 18 to 20 and 22 to 25, sections 320-175, 320-230, 713-515, 713-520, 713-525 and 713-585]***

General insurance companies

6.142 Part 5 of Schedule 6 will also clarify the taxation consequences for general insurance companies that join or leave a consolidated group. The special consolidation rules for general insurance companies will be inserted into new Subdivision 713-M and will apply from 1 July 2002. ***[Schedule 6, items 26 and 35, Subdivision 713-M of the ITAA 1997 and section 713-700 of the Income Tax (Transitional Provisions) Act 1997]***

6.143 When a general insurance company joins a consolidated group, the amendments:

- modify the tax cost setting rules to treat the goodwill asset of a general insurance company that has demutualised as a retained cost base asset;
- ensure that the head company's opening value of outstanding claims liabilities reflects the joining general insurance company's value of those liabilities; and
- ensure that the head company's opening value of its unearned premium reserve reflects the joining general insurance company's value of that reserve.

6.144 When a general insurance company leaves a consolidated group, the amendments:

- ensure that the head company's closing value of outstanding claims liabilities reflects the leaving general insurance company's value of those liabilities; and

- ensure that the head company's closing value of its unearned premium reserve reflects the leaving general insurance company's value of that reserve.

Goodwill asset of general insurance companies that have demutualised

6.145 Goodwill accruing to the group as a consequence of its ownership and control of the joining entity is generally a reset cost base asset that is deemed to have been purchased by the head company at the joining time. Consequently, the tax cost setting provisions will generally result in goodwill having a cost base broadly equal to its market value.

6.146 This general rule is modified for the goodwill asset of a joining entity that is a life insurance company that has demutualised. In these circumstances, the goodwill asset is treated as a retained cost base asset provided that the ownership of the company has not changed between the time of demutualisation and the time of joining a consolidated group (paragraph 713-515(1)(c)).

6.147 The rationale for this modification is that Division 9AA of Part III of the ITAA 1936 sets the cost base of demutualisation shares for taxation purposes. As Division 9AA applies to both life insurance companies and to general insurance companies, a similar modification needs to be made to the tax cost setting rules that apply when a general insurance company joins a consolidated group.

6.148 Consequently, the goodwill asset of a joining entity that is a general insurance company that has demutualised will be a retained cost base asset provided that the ownership of the company has not changed between the time immediately after the company demutualised and the time of joining a consolidated group. ***[Schedule 6, items 26 and 27, subsections 713-705(1) and (2) and the definition of 'retained cost base asset' in subsection 995-1(1)]***

6.149 The tax cost setting amount of a goodwill asset of a general insurance company that has demutualised will be the value of the company's goodwill worked out according to Australian accounting practice at the time of demutualisation. ***[Schedule 6, item 26, subsection 713-705(3)]***

Outstanding claims liabilities and unearned premium reserve when a general insurance company joins a consolidated group

6.150 Specific rules for taxing general insurance companies are contained in Division 321 in Schedule 2J to the ITAA 1936.

6.151 Division 321 ensures that movements in the value of a general insurance company's outstanding claims liabilities and unearned premium reserve are reflected in the calculation of the company's taxable income. The company must compare the value of its outstanding claims liabilities and unearned premium reserve at the end of an income year with the value of those liabilities and that reserve at the end of the previous income year:

- Sections 321-10 and 321-50 include in the company's assessable income the amount of any decreases in the value of the outstanding claims liabilities and unearned premium reserve over the income year.
- Sections 321-15 and 321-55 allow the company to deduct the amount of any increases in the value of the outstanding claims liabilities and unearned premium reserve over the income year.

6.152 The amendments clarify that, for the income year in which a general insurance company joins a consolidated group:

- the head company's opening value of outstanding claims liabilities reflects the joining general insurance company's value of those liabilities at the joining time; and
- the head company's opening value of its unearned premium reserve reflects the joining general insurance company's value of that reserve at the joining time.

[Schedule 6, item 26, sections 713-710 and 713-715]

The head company does not already carry on general insurance business

6.153 Therefore, if the head company is not already carrying on general insurance business because no other member of the consolidated group is a general insurance company:

- the head company's opening value of outstanding claims liabilities for the income year in which joining time occurs, will be equal to the joining general insurance company's value of those liabilities at the joining time; and

- the head company's opening value of its unearned premium reserve for the income year in which joining time occurs will be equal to the joining general insurance company's value of that reserve at the joining time.

Example 6.12

The value of the outstanding claims liabilities of a general insurance company as at 30 June 2004 is $190 million. The value of its unearned premium reserve at that time is $75 million.

The company joins a consolidated group on 1 January 2005. At that time the value of the outstanding claims liabilities is $205 million and the value of its unearned premium reserve is $60 million.

If no other member of the consolidated group is a general insurance company, for the income year in which 1 January 2005 occurs:

- the head company's opening value of the outstanding claims liabilities will be $205 million; and
- the head company's opening value of its unearned premium reserve will be $60 million.

The head company already carries on general insurance business

6.154 If the head company already carries on general insurance business at the joining time because, for example, another member of the group is a general insurance company:

- the head company's opening value of outstanding claims liabilities for the income year in which joining time occurs will be the sum of:
  - the head company's value of those liabilities at the end of the income year prior to the income year in which the joining time occurs; and
  - the joining general insurance company's value of those liabilities at the joining time; and
- the head company's opening value of its unearned premium reserve for the income year in which joining time occurs, will be the sum of:
  - the head company's value of that reserve at the end of the income year prior to the income year in which the joining time occurs; and

– the joining general insurance company's value of that reserve at the joining time.

Example 6.13

If in Example 6.12 another member of the consolidated group is a general insurance company, the head company's opening value of the outstanding claims liabilities and the unearned premium reserve for the income year in which 1 January 2005 occurs, will reflect the joining general insurance company's value of those liabilities and that reserve at the joining time. Therefore, for the income year in which 1 January 2005 occurs:

- if the head company's closing value of outstanding claims liabilities as at 30 June 2004 was $70 million, its opening value of those liabilities will be $275 million
  (i.e. $70 million + $205 million); and

- if the head company's closing value of its unearned premium reserve as at 30 June 2004 was $40 million, its opening value of that reserve will be $100 million
  (i.e. $40 million + $60 million).

Outstanding claims liabilities and unearned premium reserve when a general insurance company leaves a consolidated group

6.155 The amendments also clarify that, for the income year in which a general insurance company leaves a consolidated group:

- the head company's value of outstanding claims liabilities at the end of the income year in which the leaving time occurs, reflects the leaving general insurance company's value of those liabilities at the leaving time;

- the head company's value of the unearned premium reserve at the end of the income year in which the leaving time occurs, reflects the leaving general insurance company's value of that reserve at the leaving time;

- the leaving general insurance company's opening value of outstanding claims liabilities reflects the head company's value of those liabilities at the leaving time; and

- the leaving general insurance company's opening value of the unearned premium reserve reflects the head company's value of that reserve at the leaving time.

[Schedule 6, item 26, sections 713-710 and 713-720]

The head company ceases to carry on general insurance business

6.156 Therefore, if the head company ceases to carry on general insurance business because no other member of the consolidated group is a general insurance company:

- the head company's value of outstanding claims liabilities at the end of the income year in which leaving time occurs, will be equal to the leaving general insurance company's opening value of those liabilities for that income year; and
- the head company's value of its unearned premium reserve at the end of the income year in which leaving time occurs, will be equal to the leaving general insurance company's opening value of that reserve for that income year.

6.157 For the subsequent income year, the head company's value of outstanding claims liabilities at the end of the income year in which the leaving time occurs will not include the leaving general insurance company's value of those liabilities at the leaving time (and therefore will be nil). Similarly, the head company's value of its unearned premium reserve at the end of the income year in which the leaving time occurs will not include the leaving general insurance company's value of that reserve at the leaving time (and therefore will be nil).

Example 6.14

The value of the outstanding claims liabilities of the head company of a consolidated group that has a general insurance company member as at 30 June 2007 is $245 million. The value of its unearned premium reserve at that time is $80 million.

The general insurance company leaves the consolidated group on 1 January 2008. At that time the value the outstanding claims liabilities is $250 million and the value of the unearned premium reserve is $70 million.

If no other member of the consolidated group is a general insurance company:

- for the purpose of working out the amount that is assessable or deductible in the income year in which 1 January 2008 occurs:
  - the head company's value of outstanding claims liabilities as at the end of that income year will be $250 million;

  - the head company's value of its unearned premium reserve as at the end of that income year will be $70 million;
  - the leaving general insurance company's opening value of outstanding claims liabilities for that income year will be $250 million; and
  - the leaving general insurance company's opening value of its unearned premium reserve for that income year will be $70 million; and

- for the purpose of working out the amount that is assessable or deductible in the subsequent income year, the value of the head company's outstanding claims liabilities and unearned premium reserve as at the end of the income year in which 1 January 2008 occurs, will be nil.

The head company continues to carry on general insurance business

6.158 If the head company continues to carry on general insurance business after the leaving time because, for example, another member of the group is a general insurance company:

- the head company's value of outstanding claims liabilities at the end of the income year in which leaving time occurs will be the sum of:
  - the head company's actual value of those liabilities at the end of the income year in which the leaving time occurs; and
  - the leaving general insurance company's value of those liabilities at the leaving time; and
- the head company's value of its unearned premium reserve at the end of the income year in which leaving time occurs will be the sum of:
  - the head company's actual value of that reserve at the end of the income year in which the leaving time occurs; and
  - the leaving general insurance company's value of that reserve at the leaving time.

6.159 For the subsequent income year, the head company's value of outstanding claims liabilities at the end of the income year in which the leaving time occurs, will not include the leaving general insurance company's value of those liabilities at the leaving time. Similarly, the head company's value of its unearned premium reserve at the end of the income year in which the leaving time occurs, will not include the leaving general insurance company's value of that reserve at the leaving time.

Example 6.15

If in Example 6.14 another member of the consolidated group is a general insurance company, the head company's closing value of the outstanding claims liabilities and the unearned premium reserve for the income year in which 1 January 2008 occurs, will reflect the leaving general insurance company's value of those liabilities and that reserve at the leaving time. Therefore:

- for the purpose of working out the amount that is assessable or deductible in the income year in which 1 January 2008 occurs:
  - if the actual value of the head company's outstanding claims liabilities as at 30 June 2008 is $110 million, the head company's value of outstanding claims liabilities as at the end of that income year will be $360 million
    (i.e. $110 million + $250 million);
  - if the actual value of the head company's unearned premium reserve as at 30 June 2008 is $35 million, the head company's value of its unearned premium reserve as at the end of that income year will be $105 million
    (i.e. $35 million + $70 million);
  - the leaving general insurance company's opening value of outstanding claims liabilities for that income year will be $250 million; and
  - the leaving general insurance company's opening value of its unearned premium reserve for that income year will be $70 million; and
- for the purpose of working out the amount that is assessable or deductible in the subsequent income year:
  - the value of the head company's outstanding claims liabilities as at the end of the income year in which 1 January 2008 occurs, will be $110 million; and

the value of the head company's unearned premium reserve as at the end of the income year in which 1 January 2008 occurs, will be $35 million.

Application and transitional provisions

6.160 The amendments discussed in this chapter will take effect on 1 July 2002 (being the commencement date of the consolidation regime). Having the amendments apply from this date will provide maximum certainty and minimise the risk of arbitrary outcomes arising from a later commencement date. ***[Schedule 6, item 1, application]***

6.161 The commencement provisions for Subdivision 709-D were inserted into the Income Tax (Transitional Provisions) Act 1997. ***[Schedule 6, item 16, after Division 707 of the Income Tax (Transitional Provisions) Act 1997]***

Consequential amendments

6.162 Several consequential amendments insert notes into other areas of the law which indicate that Subdivision 709-D modifies how these other areas of the law operate. The laws allowing deductions for trusts are where the majority of these notes are inserted. ***[Schedule 6, items 6 to 11, subsections 266-35(1), 266-85(3), 266-120(1), 266-160(2), 267-25(1) and 267-65(1) in Schedule 2F to the ITAA 1936]***

6.163 A consequential amendment to section 12-5 updates the table that lists particular types of deductions to include a deduction for a debt that used to be owed to a member of a consolidated group by an entity that used to be a member of the group. ***[Schedule 6, item 12, section 12-5, table item headed 'bad debts']***

6.164 Two consequential amendments update the ITAA 1997 to allow for Subdivision 709-D. One of these updates a table in subsection 25-35(5) and the other inserts a note which indicates that Subdivision 709-D modifies the operation of subsection 165-120(1). ***[Schedule 6, items 13 and 14, subsection 165-5, table item headed 'bad debts']***

6.165 The definition of 'test time' for the purposes of the same business test in subsection 995-1(1) was modified to include a reference to 'section 709-215'. ***[Schedule 6, item 15, subsection 995-1(1)]***

Chapter 7
Simplified tax system roll-over

Outline of chapter

7.1 Schedule 7 to this Bill amends Division 328 of the *Income Tax Assessment Act 1997* (ITAA 1997) to ensure that the roll-over relief available for partnerships under the uniform capital allowances regime is also available in relation to depreciating assets allocated to simplified tax system (STS) pools.

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

Context of amendments

7.3 The STS, which commenced on 1 July 2001, was introduced as a result of recommendations in the Ralph *Review of Business Taxation* to reduce the disproportionate tax compliance burden that falls on small business. This aim is achieved by providing eligible small businesses with simpler depreciation rules than under the uniform capital allowances regime, a cash basis for recognising income and deductible expenses (see Chapter 2 for changes to this component), and simple trading stock rules.

7.4 Subdivision 328-D provides the rules for capital allowances for STS taxpayers. Broadly, an STS taxpayer allocates depreciating assets to either a general STS pool or a long life STS pool and treats each pool as a single asset. The rates of depreciation are 30 per cent for the general STS pool and 5 per cent for the long life STS pool. Assets with effective lives of less than 25 years are allocated to the general STS pool while those having effective lives of 25 years or more are allocated to the long life STS pool. There is also an immediate deduction for low-cost assets; that is, assets whose costs are less than $1,000.

7.5 Under Division 40, the uniform capital allowances regime allows deductions for the decline in value of a depreciating asset over the asset's effective life. The Division provides a set of general rules to calculate the deduction to taxpayers for the notional decline in value of most depreciating assets. It also provides pooling mechanisms under which small expenditures are pooled and taxpayers are given deductions for the decline in value of the pool.

7.6 Adjustments may be made to assessable income under the uniform capital allowances (balancing adjustments – section 40-285) when a balancing adjustment event occurs; for example, when a taxpayer stops holding an asset (section 40-295). Subsection 40-295(2), specifically, provides that a balancing adjustment event occurs for a depreciating asset if:

- there is a change in the holding of, or in the interests of entities in, the asset;
- at least one of the entities that had an interest in the asset before the change has an interest in it after the change; and
- the asset was held by a partnership either before or as a result of the change.

7.7 Balancing adjustments are usually based on the difference between the actual value of the asset at the time of the balancing adjustment event and its adjusted value (Subdivision 40-D). Under certain circumstances, either automatic roll-over relief (subsection 40-340(1)) or optional roll-over relief (subsection 40-340(3)) is available to defer the adjustment to assessable income until actual disposal of the asset.

7.8 Amendments made to Subdivision 328-D by *Taxation Laws Amendment Act (No. 2) 2004* (Act No. 20 of 2004) provide optional roll-over relief in relation to depreciating assets where there is a partial change in the ownership of an asset held by a partnership operating in the STS (section 328-240). Roll-over relief is only available where the entities both before and after the change are partnerships. Roll-over relief for partnerships in the STS ensures that the transferor taxpayer ignores the balancing adjustment amount at the time of the partnership change so that no amount is included in its assessable income.

7.9 This measure extends roll-over relief under the STS regime by removing the requirement that both entities, before and after the ownership change, must be partnerships. This will ensure that consistent roll-over relief is available for depreciating assets under both the uniform capital allowances and STS regimes.

7.10 This measure was announced by the Treasurer and the Minister for Small Business in Press Release No. 36 of 11 May 2004.

Summary of new law

7.11 Amendments will be made to Subdivision 328-D to ensure that the optional roll-over relief available under subsection 40-340(3) is available for depreciating assets held in STS pools.

7.12 The roll-over relief currently provided under section 328-240 will be extended from balancing adjustment events occurring only as a result of a change in the constitution of a partnership or in the interests of the partners to all balancing adjustment events occurring under subsection 40-295(2); that is:

- where there is a change in the holding of, or in the interests of entities in, the asset;
- at least one of the entities that had an interest in the asset before the change has an interest in it after the change; and
- the asset was a partnership asset either before the change or becomes one as a result of the change.

7.13 The extended roll-over relief will benefit STS taxpayers by removing the balancing adjustment, or taxing point, that would otherwise arise in relation to depreciating assets at the time the ownership change occurs. This will ensure that a taxable gain or loss will only arise upon disposal of the depreciating assets. This amendment ensures that consistent treatment applies to depreciating assets under the STS regime compared with the uniform capital allowances regime.

7.14 The depreciation deductions for the decline in value of depreciating assets will be split equally between the taxpayers who jointly choose roll-over relief.

Comparison of key features of new law and current law

New law	***Current law***
Allows optional roll-over relief for depreciating assets allocated to STS pools where: • there is a change in the holding of, or the interests of entities in, the asset; • at least one of the entities that had an interest in the asset before the change has an interest in it after the change; and • the asset was a partnership asset either before the change or becomes one as a result of the change.	Allows optional roll-over relief for depreciating assets where there is a partial change in the ownership of the asset held by a partnership operating in the STS.

Detailed explanation of new law

Extension of roll-over relief

7.15 Amendments are made to Subdivision 328-D to extend the availability of optional roll-over relief under subsection 40-340(3) to balancing adjustment events occurring in relation to depreciating assets in an STS pool under subsection 40-295(2); that is, when:

- a change occurs in the holding of, or in interests of entities in, the asset;
- at least one of the entities that had an interest in the asset before the change has an interest in the asset after the change; and
- the asset was a partnership asset either before or as a result of the change.

[Schedule 7, item 11, paragraph 328-243(1)(a)]

7.16 This amendment ensures that roll-over relief is available if there is a change in business structure involving a partnership. For example, if a sole trader takes on a new partner, roll-over relief will be available to defer any adjustment to taxable income resulting from that balancing adjustment event. Likewise, if a partner leaves a partnership and the remaining partner carries on as a sole trader, roll-over relief will be available. Roll-over relief continues to be available for changes in the constitution of a partnership.

7.17 An amendment is made to paragraph 40-340(4)(b) which specifies the notification procedures when roll-over relief is chosen. The amendment ensures that the requirements for making a valid choice apply to roll-over relief for assets depreciated under Subdivision 328-D as well as under Division 40 ***[Schedule 7, item 2, paragraph 40-340(4)(b)]***. These notification requirements were previously contained in section 328-240; however, this section has been repealed as a result of the extension of roll-over relief ***[Schedule 7, item 9]***.

Conditions

7.18 To be eligible for the roll-over relief, deductions for the depreciating assets must be calculated under Subdivision 328-D. Therefore, the assets subject to the roll-over relief must be allocated to the general STS pool or the long life STS pool at the time of the balancing adjustment event. ***[Schedule 7, item 11, paragraph 328-243(1)(b)]***

7.19 It should be noted that when a taxpayer leaves the STS, depreciating assets that have been allocated to a general STS pool and a long life STS pool continue to be depreciated under Subdivision 328-D (section 328-220). This means that former STS taxpayers may choose roll-over relief for depreciating assets allocated to an STS pool when a balancing adjustment event occurs under subsection 40-295(2).

7.20 An amendment is also made to section 328-220 to clarify that Subdivision 328-D applies to a transferee who is either not eligible to enter the STS or chooses not to. The transferee is treated as if they had been an STS taxpayer and then ceased to be one. This is regardless of whether roll-over relief is chosen. Therefore, the assets eligible for roll-over relief continue to be allocated to an STS pool and depreciated under Subdivision 328-D even though the transferee is not an STS taxpayer. ***[Schedule 7, item 7, subsection 328-220(3)]***

7.21 Roll-over relief is only available if the entity or entities that had an interest in the assets just before the balancing adjustment event (the transferor) and those that have an interest in the assets just after the balancing adjustment event occurred (the transferee) jointly choose the roll-over relief. ***[Schedule 7, item 11, paragraph 328-243(1)(c)]***

7.22 The condition contained in subsection 328-243(2) must also be met for roll-over relief to apply ***[Schedule 7, item 11, paragraph 328-243(1)(d)]***. Subsection 328-243(2) provides that all of the assets held by the transferor and allocated to an STS pool immediately before the balancing adjustment event occurred must be held by the transferee just after the balancing adjustment event. In other words, roll-over relief cannot be used for some of the assets in an STS pool and not others, but must apply to all assets in an STS pool.

7.23 The consequences of choosing roll-over relief are set out in section 328-245.

Deductions for pooled assets

7.24 Deductions for pooled assets are calculated under subsection 328-190(1) for general and long life STS pools and section 328-210 for low pool values of less than $1,000. If roll-over relief has been chosen, these deductions are apportioned between the transferor and the transferee under section 328-247. Amendments are made to this section to reflect the extension of the roll-over relief.

7.25 Section 328-247 applies in relation to deductions for the income year in which the balancing adjustment event occurred. This year is referred to as the balancing adjustment event year. ***[Schedule 7, item 12, subsection 328-247(1)]***

7.26 If there has been only one balancing adjustment event in the balancing adjustment event year, the amount of the deduction available under subsection 328-190(1) or section 328-210 is split equally between the transferor and the transferee. However, if there are two or more balancing adjustment events occurring for the entities in the balancing adjustment event year and roll-over is chosen for each event, the amount of the deduction is split equally between each of the entities concerned. ***[Schedule 7, item 13, paragraph 328-247(1)(b)]***

Deductions for assets first used in the balancing adjustment event year

7.27 Deductions for low-cost assets in the income year in which the asset is first used or installed ready for use are calculated under subsection 328-180(1). Deductions for pooled assets in the income year in which the asset is first used or installed ready for use are calculated under subsection 328-190(2). If roll-over relief has been chosen, these deductions are split equally between the transferor and the transferee under section 328-250. Amendments are made to this section to reflect the extension of the roll-over relief.

7.28 If the asset was first used or installed ready for use by the transferor, the deduction available under either subsection 328-180(1) or subsection 328-190(2) is split equally between the transferor and the transferee if there has been only one balancing adjustment event in the balancing adjustment event year. However, if there are two or more balancing adjustment events occurring for the entities in the balancing adjustment event year and roll-over is chosen for each event, the amount of the deduction is split equally between each of the entities concerned. ***[Schedule 7, item 14, paragraph 328-250(2)(b)]***

7.29 If the asset is first used or installed ready for use by the transferee, the transferor is not entitled to a deduction for the balancing adjustment event year. However, if there are two or more balancing adjustment events occurring for the entities in the balancing adjustment event year and roll-over is chosen for each event, the amount of the deduction available under either subsection 328-180(1) or subsection 328-190(2) is split equally between each of the entities that used the asset or had it installed ready for use. ***[Schedule 7, item 15, subparagraph 328-250(3)(b)(ii)]***

Deductions for cost addition amounts

7.30 Deductions are calculated under subsection 328-180(2) for the second element (cost addition amounts) of the cost of low-cost assets. If an STS taxpayer claimed a deduction for a low-cost asset in one income year, and in a later income year included an amount of less than $1,000 in the second element of the cost of the asset, an immediate deduction is available for that amount. Deductions for cost addition amounts for pooled assets are calculated under subsection 328-190(3). If roll-over relief has been chosen, these deductions are split equally between the transferor and the transferee under section 328-253. Amendments are made to this section to reflect the extension of the roll-over relief.

7.31 If the expenditure was incurred by the transferor, the deduction available under either subsection 328-180(2) or 328-190(3) for the balancing adjustment event year is split equally between the transferor and the transferee. However, if there are two or more balancing adjustment events occurring for the entities in the balancing adjustment event year and roll-over is chosen for each event, the amount of the deduction is split equally between each of the entities concerned. ***[Schedule 7, item 16, paragraph 328-253(2)(b)]***

7.32 If the expenditure was incurred by the transferee, the transferor cannot deduct any amount for the expenditure in the balancing adjustment event year. Instead, the transferee can claim the deduction for the expenditure incurred in the balancing adjustment event year under either subsection 328-180(2) or 328-190(3). However, if there are two or more balancing adjustment events occurring for the entities in the balancing adjustment event year and roll-over is chosen for each event, the amount of the deduction is split equally between each of the entities concerned. ***[Schedule 7, item 18, subparagraph 328-253(3)(b)(ii)]***

Closing pool balance below zero

7.33 Subsection 328-215(2) includes an amount in assessable income for a balancing adjustment event under certain circumstances. If a depreciating asset is allocated to an STS pool and either:

- the closing balance of the pool is less than zero; or
- the low pool value deduction calculated under subsection 328-210(2) is less than zero,

an amount is included in assessable income equal to the amount by which the balance is less than zero. Under section 328-255, this amount is split equally between the entities that have chosen roll-over relief. Amendment is required to section 328-255 to reflect the extension of the roll-over relief.

7.34 The amount included in assessable income under subsection 328-215(2) is split equally between the transferor and the transferee. However, if two or more balancing adjustment events have occurred and roll-over relief has been chosen for each event, the amount included in assessable income is split equally between each of the entities concerned. ***[Schedule 7, item 19, paragraph 328-255(2)(b)]***

Minor technical amendment

7.35 An amendment is made to paragraph 328-253(3)(b) to correct a minor technical error. Paragraph 328-253(3)(b) refers incorrectly to 'subsection 328-180(1) or 328-190(2)'. This reference is removed and replaced with the correct reference to 'subsection 328-180(2) or 328-190(3)'. ***[Schedule 7, item 17, paragraph 328-253(3)(b)]***

Application and transitional provisions

7.36 The amendments made by this Schedule will apply to assessments for the income year following the income year in which this Bill receives Royal Assent and later income years. ***[Schedule 7, item 20]***

Consequential amendments

7.37 A number of consequential amendments are made to update references to the extended roll-over relief provisions. These amendments are to:

- note 2 to subsection 40-340(3) ***[Schedule 7, item 1]***;
- note to subsection 328-175(3) ***[Schedule 7, item 3]***;
- note to subsection 328-190(4) ***[Schedule 7, item 4]***;
- note to section 328-200 ***[Schedule 7, item 5]***;
- note 3 to subsection 328-205(1) ***[Schedule 7, item 6]***;
- note to subsection 328-225(1) ***[Schedule 7, item 8]***; and
- heading to section 328-243 ***[Schedule 7, item 10]***.

Chapter 8 Family trust and interposed entity elections

Outline of chapter

8.1 Schedule 8 to this Bill contains modifications to the law that allow trustees to make family trust elections and interposed entity elections at any time, in relation to earlier income years.

8.2 All references to legislative provisions in this chapter are references to the *Income Tax Assessment Act 1936* (ITAA 1936) unless otherwise stated.

Context of amendments

8.3 Under the current legislation a family trust election cannot be made unless the trust both passes the family control test and specifies an individual whose family group is the subject of the election. A company, trust or partnership is required to make an interposed entity election before it can be included as part of a family group. An interposed entity election is relevant where members of the individual's family do not have fixed entitlements to all of the income and capital of the interposed entity. An entity only needs to make a family trust election or an interposed entity election once. A family trust election must be made by the trustee in the trust's income tax return for the income year from which the election is to take effect. Once made and lodged the election remains in place and carries forward unless it can be revoked (only where a fixed trust has met certain conditions) or the entity ceases to exist.

8.4 Schedule 8 modifies the rules for making family trust elections and interposed entity elections in response to concerns that the requirements to make a valid family trust election are too inflexible. The amendments aim to provide greater flexibility and remove the possibility of any ongoing uncertainty surrounding when family trust elections and/or interposed entity elections can be made.

Summary of new law

8.5 Schedule 8 to this Bill contains rules that reduce compliance costs and uncertainty for trustees by allowing them to make family trust elections and/or interposed entity elections at any time in relation to an earlier income year, provided certain conditions are met.

Comparison of key features of new law and current law

New law	*Current law*
Entities may make written family trust elections and interposed entity elections at any time in relation to an earlier income year.	Family trust elections can only be made for the earliest year for which a tax return has not yet been lodged. The election cannot be made for the specified income year if it is made after the entity's return for that year has been furnished.

Detailed explanation of new law

8.6 Schedule 8 to this Bill contains rules that provide greater flexibility and remove ongoing uncertainty by allowing entities to make family trust elections and interposed entity elections at any time, in relation to earlier income years. Family trust elections and interposed entity elections allow entities to access certain concessions available under the company and trust loss provisions and the imputation rules.

8.7 Current subsection 272-80(2) of Schedule 2F outlines the conditions for making a family trust election. The subsection states that a trust must make a family trust election in its income tax return for the specified year. Where the trustee is not required to furnish a return for that year, the family trust election must be written in an approved form; and be submitted within two months after the end of the income year specified.

8.8 Current subsection 272-80(2) is repealed so that the only condition on making a family trust election is that it must be in writing and in the approved form. The approved form is defined in section 388-50 of Schedule 1 to the *Taxation Administration Act 1953*. ***[Schedule 8, item 1, subsection 272-80(2)]***

8.9 The opportunity to elect an earlier income year is only available to entities that have acted as if they were a family entity. Entities will satisfy this requirement if at all times from the beginning of the specified income year until 30 June of the preceding income year in which the election is made:

- the entity passes the family control test; and
- any conferral of present entitlement or any actual distributions of income or capital of the trust made by the trustee during that period have been made to the individual specified in the election or to members of that individual's family group.

[Schedule 8, item 2, subsection 272-80(4A)]

8.10 Broadly, a trust passes the family control test where the individual specified in the family trust election or interposed entity election (or a member of their family) satisfies certain requirements that include the individual having control of the trust such as the beneficial enjoyment or control of the capital or income of the trust or being able to appoint or remove the trustee. A trust is only a family trust for that part of an income year for which the family control test is satisfied.

8.11 A company or partnership that is the subject of an interposed entity election passes the family control test if a group consisting of the individual (or member of the individual's family) specified in the family trust election in relation to the interposed entity election have fixed entitlements to more than 50 per cent of the income or capital of the company or partnership.

8.12 A company, trust or partnership is required to make an interposed entity election if it is to be included as part of a family group specified under a family trust election. Under the current law these elections must be included in the entity's tax return for the income year from which the elections are to have effect.

8.13 This Schedule amends the law in the same way as it does for family trust elections and allows an entity to specify an earlier income year than the one in which the election is made if:

- the entity passes the family control test for the whole part of that earlier year; and
- any conferral of present entitlement or any actual distributions of income or capital of the trust made by the trustee during that period have been made to the individual

specified in the election or to members of that individual's family group.

[Schedule 8, item 4, subsection 272-85(4A)]

8.14 An interposed entity election can be made at any time in relation to an earlier income year so long as it is in writing and in the approved form. ***[Schedule 8, item 3, subsection 272-85(2)]***

Application and transitional provisions

8.15 The amendments apply to family trust elections and interposed entity elections specifying the income year in which this Act receives Royal Assent or a later income year.

Chapter 9
Non-commercial loans

Outline of chapter

9.1 Part 1 of Schedule 9 to this Bill corrects a technical defect in Subdivision EA of Division 7A of the *Income Tax Assessment Act 1936* (ITAA 1936), which deals with loans from trustees to shareholders of corporate beneficiaries. The new rules will mean that a loan from a trustee to a shareholder of a corporate beneficiary will not be treated as a deemed dividend if the loan is repaid before the earlier of the due date for lodgement or the date of lodgement of the trust's income tax return for the year in which the loan is made.

9.2 Part 2 of Schedule 9 to this Bill amends Division 7A to allow a loan from a private company to be repaid or put on a commercial footing before the 'lodgement day' in order to avoid the loan being treated as a deemed dividend. The 'lodgement day' is the earlier of the due date for lodgement and the date of lodgement of the private company's income tax return for the income year in which the loan is made.

9.3 All references to legislative provisions in this chapter are references to the ITAA 1936 unless otherwise stated.

Context of amendments

Treatment of loans from trustees

9.4 On 12 December 2002, the Treasurer announced in Press Release No. 081 that the Government would amend section 109UB which dealt with distributions from trusts. Subdivision EA was subsequently introduced as part of *Tax Laws Amendment (2004 Measures No. 1) Act 2004* to replace section 109UB. This Act received Royal Assent on 29 June 2004 and applies to payments, loans and debts forgiven on or after 12 December 2002.

9.5 Broadly speaking, a deemed dividend will arise under Subdivision EA where a private company is presently entitled to income of the trust, but that income has been paid to a shareholder of that private company in the form of a payment, loan or forgiven debt.

9.6 As the law is currently drafted, where a trustee makes a loan to a shareholder of a corporate beneficiary (or their associate), the deemed dividend rules will not apply if the loan is put on a commercial footing before the earlier of the due date for lodgement and the date of lodgement of the trustee's return of income for the year of income of the trust in which the loan was made.

9.7 Due to a technical oversight, the same extension of time does not apply in relation to the repayment of a loan from a trustee to a shareholder of a corporate beneficiary (or their associate). This means that, without the current amendment, if a loan is not repaid by the end of the income year in which the loan is made the loan will be a deemed dividend for the purposes of Division 7A. This was not the intention of the amendments. The amendments to section 109XC in Part 1 of this Bill will overcome this technical deficiency.

Treatment of loans from private companies

9.8 Changes to the treatment of loans from private companies were announced as part of the small business measures within the 2004-05 Budget. These changes will align the treatment of loans to shareholders of private companies, with loans from trustees to shareholders of corporate beneficiaries.

Summary of new law

Treatment of loans from trustees

9.9 The new rules in Part 1 of Schedule 9 to this Bill will allow a loan from a trustee to a shareholder (or their associate) of a private company, to be repaid before the earlier of the due date for lodgement or lodgement of the trust's income tax return for the year in which the loan is made, in order to avoid the loan being treated as a deemed dividend for the purposes of Division 7A.

Treatment of loans from private companies

9.10 The new rules in Part 2 of Schedule 9 to this Bill will allow a loan from a private company to a shareholder (or their associate), to be repaid or put on a commercial footing before the earlier of the due date for lodgement or lodgement of a private company's income tax return for the year in which the loan is made, in order to avoid the loan being treated as a deemed dividend for the purposes of Division 7A.

Comparison of key features of new law and current law

New law	***Current law***
If a shareholder of a private company (or their associate) repays a loan from a trustee before the earlier of the due date for lodgement or the lodgement of the trust's income tax return for the year in which the loan was made, the loan will not be a deemed dividend.	A shareholder of a private company (or their associate) must repay a loan from a trustee prior to the end of the trust's year of income for that particular year, for the loan not be a deemed dividend.
If a shareholder (or their associate) repays a loan from a private company or puts the loan on a commercial footing before the earlier of the due date for lodgement or the lodgement of the private company's income tax return for the year in which the loan is made, the loan will not be a deemed dividend.	A shareholder (or their associate) has to repay a loan from a private company or put the loan on a commercial footing before the end of the private company's year of income for the year in which the loan was made, for the loan not to be a deemed dividend.

Detailed explanation of new law

Treatment of loans from trustees

9.11 Where a loan is repaid before the earlier of the due date for lodgement and the lodgement of the trust's return of income for the year which the loan was made, it will not be treated as a deemed dividend. ***[Schedule 9, Part 1, item 1, subsection 109XC(2A)]***

9.12 New subsection 109XC(2A) will only apply to loans made from 12 December 2002 to the end of the income year in which this Bill receives Royal Assent. Amendments made to section 109D in Part 2 of this Bill make new subsection 109XC(2A) redundant from the income year that begins after this Bill receives Royal Assent.

9.13 Consequential amendments to subsections 109E(3) and 109N(1), discussed in paragraph 9.17, make current subsections 109XC(3) and (5) redundant. ***[Schedule 9, Part 2, item 11]***

Treatment of loans from private companies

9.14 Part 2 of Schedule 9 to this Bill amends Division 7A to allow a loan from a private company to a shareholder (or their associate) to be repaid or put on a commercial footing before the private company's 'lodgement day' for that income year in order to avoid the loan being treated as a deemed dividend. ***[Schedule 9, item 4, paragraph 109D(1)(b)]***

9.15 The 'lodgement day' for a private company's year of income is the earlier of:

- the due date for lodgement of the private company's return of income for the year of income; and
- the date of lodgement of the private company's return of income for the year of income.

[Schedule 9, Part 2, items 3, 5 and 6, section 109D]

9.16 Where an amount of the loan has not been repaid before the lodgement day for the year in which the loan was made, that amount is deemed to be a dividend paid by the private company to the shareholder. ***[Schedule 9, Part 2, item 4, subsection 109D(1AA)]***

9.17 Consequential amendments are also made to subsections 109E(3) and 109N(1) and section 109ZD to reflect the extended time given to shareholders (or their associates) to repay the loan or put it on a commercial footing. These amendments ensure that a deemed dividend will not arise if a loan is repaid or put on a commercial footing before the lodgement day. ***[Schedule 9, Part 2, items 7 to 10 and 12]***

Application and transitional provisions

9.18 The amendment made by Part 1 of Schedule 9 to this Bill applies to loans made on or after 12 December 2002 (the application date for the amendments introduced in *Tax Laws Amendment (2004 Measures No. 1) Act 2004*). ***[Schedule 9, Part 1, item 2]***

9.19 The amendments made by Part 2 of Schedule 9 to this Bill apply in relation to loans made in the 2004-05 year of income or a later year of income. ***[Schedule 9, Part 2, item 13]***

Chapter 10
Technical corrections and amendments

Outline of chapter

10.1 Schedule 10 to this Bill makes technical corrections and amendments to the taxation laws but generally does not make any substantive changes.

Context of amendments

10.2 These minor corrections and amendments to the taxation laws are part of the Government's ongoing commitment to improve the quality of the taxation laws. They fix technical errors such as duplications of definitions, missing asterisks from defined terms, incorrect numbering and referencing and outdated guide material that detract from the readability of the taxation laws and sometimes confuse or mislead readers.

Summary of new law

10.3 Schedule 10 makes minor technical corrections and amendments to the taxation laws. Amendments encompass: repealing link notes and duplicate definitions; correcting misdescribed amendments; ensuring that defined terms are properly asterisked; and fixing incorrect, incomplete or inconsistent referencing, numbering and wording. More substantive amendments involve:

- updating and correcting non-operative guides, notes, headings and examples;
- merging two or three definitions of one term or similar terms into single definitions;
- deleting unnecessary definitions;
- amending an application provision so that it does what it was intended to do when it was enacted;
- relocating a Division; and
- updating terminology, figures and definitions.

10.4 The technical amendments will generally commence on Royal Assent. However, some amendments will apply retrospectively for the reasons set out in paragraphs 10.52 to 10.63.

Detailed explanation of new law

10.5 Amendments made by this Schedule fall into a number of categories.

Deleting a definition where the same term is defined twice

10.6 Some terms are defined twice. The insertion of two definitions for one term occurs because a defined term is needed for two tax measures which are introduced into Parliament around the same time. Because one measure cannot rely on Parliament enacting the other measure in time and using that other measure's definition, both the measures may insert the same or similar definitions for the one term. For example, there are two definitions for the term 'government entity' in the *Income Tax Assessment Act 1997* (ITAA 1997). The first definition was inserted by the *A New Tax System (Tax Administration) Act 1999* and the second by the *A New Tax System (Tax Administration) Act (No. 2) 2000*. The two definitions are substantially the same. In each of these cases, one of the duplicate definitions will be removed. ***[Schedule 10, items 210, 214, 216, 246, 261 and 262, subsection 995-1(1) of the ITAA 1997, definitions of 'group turnover', 'non-compulsory uniform', 'taxable supply', 'government entity', and 'participant' and subsection 136(1) of the Fringe Benefits Tax Assessment Act 1986, definition of 'approved form']***

Merging multiple definitions of one term or similar terms into single definitions

10.7 Sometimes a term is defined more than once where a similar idea is applied in different contexts. For example, there are currently four definitions of 'member' in the ITAA 1997. The substance of the four definitions is different. However, the drafting approach used in Australia's tax laws insists on only one definition for each term but allows for contextual differences. Therefore in each case the multiple definitions will be replaced with one definition with the different contextual meanings set out in separate paragraphs. ***[Schedule 10, items 45, 205, 212, 213 and 219 to 221, heading to section 34-15 and subsections 960-345(2) and 995-1(1) of the ITAA 1997, definitions of 'member', 'value' and 'value of the business supplies']***

Deleting an unnecessary definition

10.8 Section 124-520 of the ITAA 1997 defines 'company law' for the purposes of the entire Act. However, a definition is unnecessary because 'company law' is only used in paragraphs 124-520(1)(a) and (b). Amendments will repeal the definition of 'company law' in subsection 124-520(2) and will replace the label 'company law' in paragraphs 124-520(1)(a) and (b) with its current meaning. The definition of 'company law' in subsection 995-1(1) will also be repealed as it merely refers the reader to subsection 124-520(2). ***[Schedule 10, items 99, 100, 102, 103 and 207, paragraphs 124-520(1)(a) and (b) and subsections 124-520(2) and 995-1(1) of the ITAA 1997]***

Fixing incorrect references to provisions

10.9 Some provisions refer to other provisions but use the wrong cross reference. For example, section 195-1 of the *A New Tax System (Goods and Services Tax) Act 1999* lists provisions under which a goods and services tax decreasing adjustment arises. One of the provisions it lists is section 132-15, which does not exist. The table states that the subject matter of section 132-15 is 'supplies of things acquired or imported to make supplies'. This is the subject matter of section 132-5. The table should therefore list section 132-5, and not section 132-15. In each case, the incorrect reference will be corrected. ***[Schedule 10, items 1, 11, 13, 31, 33, 42, 88, 209, 232 and 260, subsection 29-15(2) and section 195-1 of the A New Tax System (Goods and Services Tax) Act 1999, paragraphs 214A(2)(e) and 410(c) of the ITAA 1936, subsections 27-10(1), 122-140(1), 820-617(1) and 995-1(1) of the ITAA 1997 and subsection 19(3) of the Superannuation Guarantee (Administration) Act 1992]***

Fixing incorrect terminology

10.10 Sometimes the ITAA 1997 uses incorrect terminology. For example, subsection 995-1(1) defines 'refund of income tax' to have the meaning given by section 205-35. However, section 205-35 does not define 'refund of income tax'. It defines 'receives a refund of income tax' instead. An amendment will replace the definition of 'refund of income tax' in subsection 995-1(1) with one for 'receives a refund of income tax'. ***[Schedule 10, items 263 and 264, subsection 995-1(1) of the ITAA 1997]***

10.11 Another example of the incorrect use of terminology in the ITAA 1997 is the use of the term 'non-resident' instead of 'foreign resident'. While the term 'non-resident' is used for the purposes of the *Income Tax Assessment Act 1936* (ITAA 1936), it has no meaning in the ITAA 1997. 'Foreign resident' is the equivalent term for the ITAA 1997. Amendments will replace references to 'non-resident' with 'foreign resident' throughout the ITAA 1997. ***[Schedule 10, items 40, 41, 76 to 81, 115, 116, 118, 120, 123, 132 to 135, 150 to 155, 166, 184, 185, 208, 215, 217, 218, 239, 240 and 243, sections 12-5, 118-435, 118-500, 136-1, 136-5, 136-10, 136-25 and 180-1, paragraphs 118-415(2)(a), 118-420(1)(a), 165-235(4)(a), 180-5(4)(a), 180-15(4)(a) and 320-37(1)(c), subsections 118-420(3), 165-115ZC(3), 165-235(1), 165-235(4), 180-5(4), 180-15(4), 207-95(4), 320-37(2) and 995-1(1), subparagraphs 118-420(6)(b)(ii), 170-255(1)(d)(v), heading to Division 136 of the ITAA 1997, headings to Subdivision 260-D and section 260-105 in Schedule 1 to the TAA 1953, paragraph 21-5(3)(b) of the Venture Capital Act 2002]***

10.12 There are other instances of the ITAA 1997 using incorrect terminology which will also be amended. ***[Schedule 10, items 7, 8, 36 to 38, 47, 50, 53, 55 to 58, 61, 62, 65, 82, 84 to 87, 89 to 98, 101, 105 to 109, 112 to 114, 117, 119, 121, 122, 124, 125, 149, 156, 158, 160, 167, 168, 173, 174, 182, 183, 189 to 194 and 241, paragraphs 80-90(a) and 80-95(a) of the A New Tax System (Goods and Services Tax) Act 1999, subsections 4-15(2), 6-5(3), 6-10(5), 36-20(2), 104-160(5), 104-165(1), 104-215(2), 104-230(7), 122-25(6), 122-25(7), 122-135(6), 122-135(7), 124-85(2), 124-795(1), 124-795(4), 124-870(3), 128-15(1), 128-25(2), 208-155(4), 396-75(2) and 405-50(5), sections 104-5, 104-160, 104-165, 128-10, 136-1, 136-20, 136-40 and 202-10, paragraphs 104-215(1)(e), 118-515(1)(a), 124-70(3)(a), 124-295(7)(b), 124-300(7)(b), 124-365(4)(b), 124-375(4)(b), 124-450(4)(b), 124-460(4)(b), 136-5(a), 202-20(a), 204-30(8)(a), 208-40(1)(a), 208-40(4)(a), 208-155(3)(a), and 220-215(1)(c), subparagraphs 124-240(f)(ii), 124-245(e)(ii), 124-520(1)(e)(ii), 124-795(5)(b)(ii), 170-255(1)(d)(i), 220-605(1)(c)(i), 376-5(1)(d)(ii), 376-15(1)(a)(ii) and 376-50(a)(i) and heading to Subdivision 136-B of the ITAA 1997 and paragraph 260-105(1)(a) to the TAA 1953]***

Inserting missing asterisks before defined terms

10.13 Most defined terms in more recent tax laws are identified by an asterisk appearing at the start of the term (e.g. '*business'). A footnote on each page of the Act refers readers to the Dictionary for definitions which are marked with an asterisk. Some defined terms have not been identified by an asterisk. In such cases, amendments will insert asterisks. For example, in paragraphs 124-70(1)(a) and (2)(a) of the ITAA 1997, an asterisk is to be inserted before the term 'foreign law'. ***[Schedule 10, items 15, 44, 46, 74, 104, 127, 186 to 188, 195, 196, 204 and 233 to 236, subparagraph 5-15(1)(a)(ii) of the A New Tax System (Wine Equalisation Tax) Act 1999, section 703-25, subsections 34-10(1), 34-25(1), 328-375(2) and (3), 328-380(1), 721-15(2), subparagraph 116-30(3)(a)(ii) and paragraphs 124-710(1)(a), 124-710(2)(a), 152-25(1)(a), 328-375(1)(a), 960-345(1)(a) of the ITAA 1997 and subsections 12-60(1) and 12-315(1) and paragraphs 12-47(c) and 12-155(a) in Schedule 1 to the TAA 1953]***

10.14 Because a proposed amendment in this Schedule will replace the definition of 'refund of income tax' with 'receives a refund of income tax' in subsection 995-1(1) of the ITAA 1997 (see paragraph 10.10), asterisks will be inserted before the term 'receives a refund of income tax'. ***[Schedule 10, items 249 to 257 and 259, section 210-120, subsections 205-50(2) and (3), 210-150(2) and (3) and paragraphs 214-45(1)(a), 214-45(2)(a), 214-105(1)(b), 214-150(4)(a), 705-90(4)(a) and (9)(a)of the ITAA 1997]***

Fixing a technical defect

10.15 Subsection 975-100(1) of the ITAA 1997 and subsection 432(2) of the ITAA 1936 define 'in existence' by reference to a company's incorporation. Companies for the purposes of the taxation laws do not need to be incorporated. So, under these definitions, companies which are not incorporated (such as unincorporated associations), literally can never be 'in existence'. This is an unintended consequence.

10.16 Further, the definition of 'in existence' in the ITAA 1997 incorporates the concept of corporate dormancy contained in the company law. The concept of 'corporate dormancy' was removed from Australia's company law in 1998.

10.17 Amendments will repeal section 975-100 of the ITAA 1997 as well as the reference to 'in existence' in subsection 995-1(1) of that Act and subsection 432(2) of the ITAA 1936 ***[Schedule 10, items 34, 206 and 211, subsection 432(2) of the ITAA 1936, section 975-100 and subsection 995-1(1) of the ITAA 1997]***. An amendment will also repeal the definition of 'in existence' in the *A New Tax System (Goods and Services Tax) Act 1999*, which refers to the ITAA 1997 definition of 'in existence'. As a consequence, companies will be 'in existence' if they exist within the ordinary meaning of that expression. Apart from correcting the unintended consequence mentioned in paragraph 10.15, this is the meaning given by the provisions being removed. ***[Schedule 10, item 14, section 195-1 of the A New Tax System (Goods and Services Tax) Act 1999]***

10.18 The repeal of section 975-100 will require the removal of asterisks from 'in existence' in the ITAA 1997 and the *A New Tax System (Goods and Services Tax) Act 1999* ***[Schedule 10, items 3 to 5, 136 to 138, 140 to 143 and 145 to 148, subsections 60-5(1) and 60-20(1) and paragraph 60-15(1)(a) of the A New Tax System (Goods and Services Tax) Act 1999, subsections 170-30(1), (2) and (4), 170-32(4) and (5), 170-130(1) and (2), 170-130(4), 170-132(4) and (5), 170-133(2) and (3) and paragraphs 170-210(1)(e), 170-210(2)(f), 170-215(1)(e), 170-215(2)(f), 170-220(1)(e), 170-220(2)(f), 170-225(1)(e) and 170-225(2)(f) of the ITAA 1997]***. An amendment will also remove a reference in the ITAA 1936 to 'in existence' within the meaning of the ITAA 1997. The repeal of subsection 432(2) of the ITAA 1936 will involve removing cross references to section 432 and subsection 432(2). ***[Schedule 10, items 20, 28 and 35, paragraph 23AH(12)(b), subsection 159GZZT(1) and subparagraph 437(2)(c)(ii) of the ITAA 1936]***

Deleting asterisks from terms which do not require an asterisk

10.19 Some defined terms have been incorrectly marked with an asterisk. Items 7 and 17 in the table of section 109-55 of the ITAA 1997 contain the defined and asterisked terms '*prospecting or mining entitlement', '*CGT event', '*100% subsidiary' and '*wholly owned group'. Because section 109-55 is non-operative guide material, the defined terms should not be asterisked (see subsection 2-15(2) of the ITAA 1997). Amendments will remove the asterisks from these defined terms. ***[Schedule 10, items 67 and 68, section 109-55 of the ITAA 1997]***

10.20 The terms 'Australian resident' and 'company' are also incorrectly marked with an asterisk throughout the ITAA 1997. Although 'Australian resident' and 'company' are defined terms, they are on the list of terms that occur too frequently to need an asterisk (see subsection 2-15(3) of the ITAA 1997). Amendments will remove the asterisks in these cases. ***[Schedule 10, items 54, 59, 60, 63, 75, 157, 159, 161 to 165, 169 to 172, 175 to 180 and 197 to 203, sections 205-30 and 208-215, subsections 104-160(1), 104-165(1), 204-25(4) to (6), 208-45(2), 208-80(2), 960-60(1), 960-80(1) and 960-90(1), paragraphs 104-165(3)(b), 104-215(2)(a), 118-37(4)(a), 202-15(c), 205-25(1)(a), 207-75(a) and (b), 208-45(1)(a), 208-155(2)(a), 208-205(a), 208-235(a), 208-240(b), 215-10(1)(a) and 960-140(a) and subparagraphs 205-25(1)(a)(i) and 215-10(2)(a)(ii) of the ITAA 1997]***

10.21 Because a proposed amendment in this Schedule will replace the definition of 'refund of income tax' with 'receives a refund of income tax' in subsection 995-1(1) of the ITAA 1997 (see paragraph 10.10), asterisks will be removed from the term 'refund of income tax'. ***[Schedule 10, items 249 to 257 and 259, section 210-120, subsections, 205-50(2) and (3) and 210-150(2) and (3) and paragraphs 214-45(1)(a), 214-45(2)(a), 214-105(1)(b), 214-150(4)(a), 705-90(4)(a) and (9)(a) of the ITAA 1997]***

10.22 'Decreasing adjustment' in section 132-5 of the *A New Tax System (Goods and Services Tax) Act 1999* is also incorrectly marked by an asterisk. Because section 132-5 defines 'decreasing adjustment', the term should not be marked by an asterisk but should be in bold italics. An amendment will remove the asterisk and put 'decreasing adjustment' in bold italics. ***[Schedule 10, item 10, subsection 132(1) of the A New Tax System (Goods and Services Tax) Act 1999]***

Updating references to repealed law

10.23 Some provisions refer to repealed law. For example, paragraphs 69-5(3)(h) and 69-5(3)(i) of the *A New Tax System (Goods and Services Tax) Act 1999* refer to the repealed Division 4A of Part III of the ITAA 1936. References to repealed law will be removed. ***[Schedule 10, items 6 and 21, paragraphs 69-5(3)(h) and (i) of the A New Tax System (Goods and Services Tax) Act 1999 and section 24AL of the ITAA 1936]***

10.24 Paragraph 35(1)(b) of the *Product Grants and Benefits Administration Act 2000* refers to section 36 which has now been repealed. Section 36 dealt with the penalty for making false and misleading statements. The relevant provision dealing with false and misleading statements is now subsection 284-75(1) in Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953). 'Section 36' will be replaced with'subsection 284-75(1) in Schedule 1 to the TAA 1953'. ***[Schedule 10, item 231, paragraph 35(1)(b) of the Product Grants and Benefits Administration Act 2000]***

10.25 In another case, subsection 6(1) of the ITAA 1936 refers to a repealed definition of 'insurance funds'. The definition is still necessary for the operation of the provision so the repealed definition of 'insurance funds' will be inserted directly into subsection 6(1). ***[Schedule 10, item 19, subsection 6(1) of the ITAA 1936, definition of 'insurance funds']***

Fixing incorrect numbering of provisions and Divisions

10.26 Some provisions are not in the correct numerical sequence. This typically occurs when two Bills are introduced into Parliament around the same time or are enacted in an unanticipated order. For example, there are two sections numbered 118-315 in the ITAA 1997. In each case, the ordering and numbering of the provisions is corrected. ***[Schedule 10, items 23 to 27, 48, 181, 223, 237, 238 and 247, sections 63CA, 63CB and 63CC and subsection 63CA(1) of the ITAA 1936, section 118-315, subsection 40-430(3) and Division 218 of the ITAA 1997, Subdivision 175-C of the Income Tax (Transitional Provisions) Act 1997 and subsections 18-75(3) and (4) in Schedule 1 to the TAA 1953]***

Changing an inappropriate heading

10.27 Some headings in the taxation laws are inappropriate. For example, the heading to Subdivision 152-C in the ITAA 1997 does not accurately reflect the content of the Subdivision. The heading of Subdivision 152-C reads 'Applying the small business concessions' which is misleading, as Subdivision 152-C mainly covers the *small business 50% reduction*. It is also inconsistent with the style of the other two Subdivision headings dealing with small business concessions. The more appropriate heading 'Small business 50% reduction' will replace 'Applying the small business concessions'. This heading change may make it difficult to find the rule contained in section 152-215, so amendments will also insert the rule into the other two Subdivisions dealing with small business concessions. Other amendments will fix other inappropriate headings in the taxation laws. ***[Schedule 10, items 43, 66, 128 to 131 and 222, heading to Subdivision 27-B, heading to section 104-250, heading to Subdivision 152-C, sections 152-215, 152-330 and 152-430 of the ITAA 1997 and the heading to Subdivision 104-J of the Income Tax (Transitional Provisions) Act 1997]***

Fixing grammatical errors

10.28 Amendments will fix two grammatical errors in section 125-80 of the ITAA 1997. The first error is the position of a comma in subsection 125-80(7). The other error is in the note to subsection 125-80(7) which reads ‘dispose your interests’ when it should read ‘dispose of your interests’. Amendments fix these errors. ***[Schedule 10, items 110 and 111, subsection 125-80(7) of the ITAA 1997]***

Updating non-operative guide material, notes and examples

10.29 Some non-operative parts of the ITAA 1997, such as guide material, notes and examples, no longer accurately reflect the content of operative provisions. While this material is non-operative, it may be used for limited purposes in interpreting operative provisions. Therefore it should be updated. For example, the guide material in section 152-5 says that the only small business concession available for CGT events J2 and J3 is the small business roll-over. Since the insertion of this guide material, the *Taxation Laws Amendment Act (No. 7) 2000* also made the small business retirement exemption available for CGT events J2 and J3 but did not amend the guide. Amendments will update this guide material and other outdated guides, notes and examples. ***[Schedule 10, items 39, 49, 51, 64, 69 to 73, 126, 139 and 144, sections 11-55, 109-60, 112-45, 112-97 and 152-5, subsections 102-5(1), 104-47(5), 104-215(5), 170-115(1) and 170-140(2) of the ITAA 1997]***

Repealing link notes

10.30 The link notes in the ITAA 1936, the ITAA 1997, the *Income Tax (Transitional Provisions) Act 1997*, the TAA 1953 and the *Venture Capital Act 2002* are no longer necessary and will be removed. This will involve consequential amendments to section 2-30 of the ITAA 1997, which refers to link notes, and the repeal of the definition of ‘link note’ in subsection 995-1(1) of the same Act. ***[Schedule 10, items 270 to 276, link notes in the ITAA 1936, the ITAA 1997, the Income Tax (Transitional Provisions) Act 1997, the TAA 1953 and the Venture Capital Act 2002 and section 2-30 and subsection 995-1(1) of the ITAA 1997]***

10.31 Link notes are included at the end of one group of provisions to indicate the number of the next provision where there is a gap in the numerical sequence. They are also used to indicate the end of a Guide. Link notes were introduced to assist users with the new numbering system in the taxation Acts. As the new numbering system and the use of guides has been in place for some time and users are now familiar with them, link notes are no longer necessary. Maintaining the link notes has proved to be a burden for drafters and the source of frequent mistakes.

Updating terminology where an Act uses an outdated term

10.32 The taxation laws sometimes use outdated terms. For example, paragraph 59(2)(a) of the *Petroleum Resource Rent Tax Assessment Act 1987* uses the term ‘in the form provided or authorised by the Commissioner’ to authorise the Commissioner of Taxation (Commissioner) to set the format required for lodgements of returns, applications, etc. The modern standard term used throughout the taxation laws for such authorisations is ‘in the approved form’. That term is defined in section 388-50 in Schedule 1 to the TAA 1953. The amendment will replace the outdated wording with the standard term and insert a reference in section 2 of the *Petroleum Resource Rent Tax Assessment Act 1987* to the definition of ‘approved form’ in the TAA 1953. Amendments will also update other outdated terminology in the taxation laws. ***[Schedule 10, items 22, 32, 52, 83 and 225 to 229, paragraphs 47(2B)(b) and 262A(5)(b) of the ITAA 1936, subsection 104-135(6) and paragraph 121-25(4)(b) of the ITAA 1997, section 2, subsections 45A(6) and 45B(6) and 98(1) and paragraph 59(2)(a) of the Petroleum Resource Rent Tax Assessment Act 1997]***

10.33 A transitional rule will provide that forms approved before the commencement of the updating of terminology to ‘approved form’ will continue to have effect after that commencement as if they had been approved under section 388-50 in Schedule 1 to the TAA 1953. ***[Schedule 10, item 230]***

Misdescribed amendments

10.34 Some amending Acts misdescribed amendments they sought to make to other Acts. Consequently, most of these misdescribed amendments failed.

10.35 Item 6 in Schedule 21 to the *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2003* attempted to amend a note after subsection 705-35(1) of the ITAA 1997. The amendment failed because it referred to ‘subsection 705-35’ instead of to ‘subsection 705-35(1)’. ‘Subsection 705-35’ will be replaced by ‘subsection 705-35(1)’. ***[Schedule 10, item 266, item 6 in Schedule 21 to the New Business Tax System (Consolidation and Other Measures) Act 2003]***

10.36 Item 85 in Schedule 2 to the A *New Tax System (Pay As You Go) Act 1999* attempted to amend subsection 12A(1) of the *Taxation (Interest on Overpayments and Early Payments) Act 1983* by inserting ‘section 163AA, section 170AA’ after ‘under’ in subparagraph 12A(1)(a)(i). The amendment failed because it did not specify after which ‘under’ the insertion should go. ‘Under’ will be replaced by ‘under (last occurring)’. ***[Schedule 10, item 244, item 85 in Schedule 2 to the A New Tax System (Pay As You Go) Act 1999]***

10.37 Item 16 in Schedule 4 to the *Energy Grants (Credits) Scheme (Consequential Amendments) Act 2003* states 'repeal the definition'. A literal reading would repeal the entire definition of 'excise law' in the *Excise Act 1901*. However, the intention, as shown by the heading of item 6 – 'Subsection 159(6) (paragraph (c) of the definition of excise law)', was to repeal only paragraph (c) of the definition. 'Definition' will be replaced by 'paragraph'. ***[Schedule 10, item 245, item 16 in Schedule 4 to the Energy Grants (Credits) Scheme (Consequential Amendments) Act 2003]***

10.38 Item 3 in Schedule 7 to the *New Business Tax System (Consolidation and Other Measures) Act 2003* attempted to replace the definition of 'previous capital losses, deductions or trading stock' in subsection 165-115BB(2) of the ITAA 1997. The amendment failed because it referred to the definition of 'residual unrealised net loss' when it should have referred to the definition of 'previous capital losses, deductions or trading stock losses'. The definition of 'previous capital losses, deductions or trading stock losses' will be changed as intended by the previously attempted amendment. ***[Schedule 10, items 224 and 248, item 3 in Schedule 7 to the New Business Tax System (Consolidation and Other Measures) Act 2003 and subsection 165-115BB(2) of the ITAA 1997]***

10.39 Some items in Schedule 5 to the *Taxation Laws Amendment (Company Law Review) Act 1998* failed because their commencement was linked to the commencement of the *Taxation Laws Amendment Act (No. 7) 1997* which never came into existence with that short title. An amendment will insert the intended commencement date into subsection 2(2) of the *Taxation Laws Amendment (Company Law Review) Act 1998*. ***[Schedule 10, item 267, subsection 2(2) of the Taxation Laws Amendment (Company Law Review) Act 1999]***

10.40 Item 2 in Schedule 4 to the *Taxation Laws Amendment (Research and Development) Act 2001* attempted to amend paragraph 73C(3)(b) of the ITAA 1936 but failed because it referred to paragraph 73(3)(b), which does not exist, instead of paragraph 73C(3)(b). 'Paragraph 73(3)(b)' will be replaced by 'paragraph 73C(3)(b)'. ***[Schedule 10, item 268, item 2 in Schedule 4 to the Taxation Laws Amendment (Research and Development) Act 2001]***

10.41 Items 6 and 7 in Schedule 1 to the *Taxation Laws Amendment Act (No. 5) 2002* attempted to insert a note at the end of the definition of 'value of an item of trading stock' in subsection 995-1(1) of the ITAA 1997. This amendment failed because there was no definition of 'value of an item of trading stock', only a definition of 'value'. The note intended by the misdescribed amendment will be inserted. ***[Schedule 10, items 221 and 242, subsection 995-1(1) of the ITAA 1997, items 6 and 7 in Schedule 1 to the Taxation Laws Amendment Act (No. 5) 2002]***

10.42 Item 9 in the table in subsection 2(1) of the *Tax Laws Amendment (2004 Measures No. 2) Act 2004* provides that item 104 in Schedule 1 to that Act is to commence immediately after the commencement of item 127 in Schedule 3 to the *New Business Tax System (Miscellaneous) Act (No. 4) 2003*. The *New Business Tax System (Miscellaneous) Act (No. 4) 2003* does not exist, hence item 104 in Schedule 1 to the *Tax Laws Amendment (2004 Measures No. 2) Act 2004* failed. The reference should have been to the *Taxation Laws Amendment Act (No. 4) 2003*. '*New Business Tax System (Miscellaneous) Act (No. 4) 2003*' will be replaced by '*Taxation Laws Amendment Act (No. 4) 2003*'. ***[Schedule 10, item 269, subsection 2(1) of the Taxation Laws Amendment (2004 Measures No. 2) Act 2001]***

Applying a definition in the *Fringe Benefits Tax Assessment Act 1986*

10.43 Subsection 59(1) of the *Fringe Benefits Tax Assessment Act 1986* uses the term 'remote area housing benefit', which is defined in subsection 58ZC(2) but only for the purposes of section 58ZC. The fringe benefits law has no other definition of the term. The intention was that 'remote area housing benefit' in subsection 59(1) should derive its meaning from the definition in subsection 58ZC(2). The definition of 'remote area housing benefit' in subsection 58ZC(2) will be applied for use throughout the fringe benefits taxation law. ***[Schedule 10, items 16 and 17, subsections 58ZC(2) and 136(1) of the Fringe Benefits Tax Assessment Act 1986]***

Updating a definition in the *Income Tax Assessment Act 1936*

10.44 Section 159S of the ITAA 1936 defines 'tax threshold' as $5,100. The definition is incorrect because the tax threshold is now $6,000. Therefore '$5,100' will be changed to the amount that is the tax-free threshold from time to time. That will ensure the same problem does not recur the next time the tax threshold amount is changed. ***[Schedule 10, item 29, section 159S of the ITAA 1936]***

Minor consequential amendments resulting from Parliamentary amendments to substantive provisions

10.45 The Senate removed a taxation measure from the New Business Tax (Miscellaneous) Bill (No. 2) 2000 (enacted as the *New Business Tax (Miscellaneous) Act (No. 2) 2000*). It removed the substantive provisions of the measure but some minor consequential amendments remained. Most of these consequential amendments have previously been removed. An amendment in Schedule 10 will remove the remaining consequential amendment. ***[Schedule 10, item 258, subsection 320-195(1) of the ITAA 1997]***

Technical amendment to an application provision

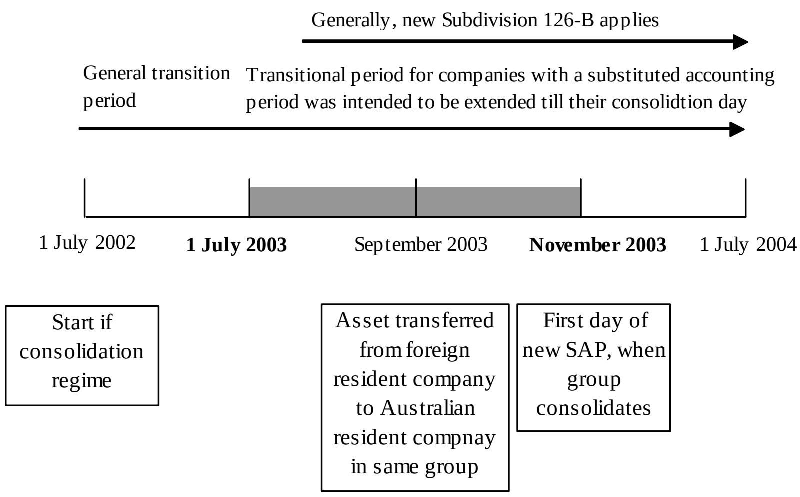
10.46 A technical amendment to the rules for the transition from the former Subdivision 126-B of the ITAA 1997 to the new Subdivision 126-B will ensure that capital gains tax (CGT) roll-over relief is available when a foreign resident company transfers an asset to an Australian resident company between 1 July 2003 and the start of the Australian company's income year beginning on or after 1 July 2004. This will ensure Australian companies with substituted accounting periods are not disadvantaged.

10.47 Subdivision 126-B sets out when a company can obtain roll-over relief when transferring or creating a CGT asset. Before the introduction of consolidation on 1 July 2002, Subdivision 126-B allowed roll-over relief for companies transferring a CGT asset to members of the same wholly-owned group. After the consolidation regime allowed wholly-owned groups of Australian resident entities to form a single entity for income tax purposes, it was no longer necessary to provide roll-over relief for transfers within a wholly-owned group. However, as foreign residents cannot form part of a consolidated group, Subdivision 126-B was modified and in its new form, applies only where one of the companies is a foreign resident.

10.48 A transitional rule allowed companies with substituted accounting periods, which were considering whether to consolidate, temporary access to the former Subdivision 126-B up until the first day of their income year starting after 30 June 2003 and before 1 July 2004. Where a foreign resident company transferred an asset to an Australian resident company who had not consolidated between 1 July 2003 and the start of the Australian company's next substituted accounting period, access to the former Subdivision 126-B was necessary for roll-over relief. This is because the new Subdivision 126-B only provides roll-over relief if the Australian resident company was a member of a consolidated group when the asset was transferred.

10.49 For example (see Diagram 10.1), if in September 2003, a foreign resident company transferred an asset to an Australian resident company with a substituted accounting period and the Australian resident company consolidated on the first day of its substituted accounting period (1 November 2003), roll-over relief would have been unavailable. Roll-over relief would only be available for transfers occurring after consolidation on 1 November 2003.

Diagram 10.1



10.50 Under the transitional rule, the former Subdivision 126-B still applies if the company transferring the asset becomes a member of a consolidated group on the first day of its substituted accounting period (see subitem 23(2) in Schedule 3 to the *New Business Tax System (Consolidation) Act (No. 1) 2002*). However, a foreign resident company cannot become a member of a consolidated group, so the transitional rule is unavailable when the asset is transferred from a foreign resident company.

10.51 To allow the transitional rule to apply in this situation, subitem 23(2) will be amended so that it applies if *either* the company transferring, or the company receiving, the asset becomes a member of a consolidated group on the first day of its substituted accounting period. ***[Schedule 10, item 265, paragraph (2)(a) of item 23 in Schedule 3 to the New Business Tax System (Consolidation) Act (No. 1) 2002*]**

Application and transitional provisions

10.52 Generally, the technical amendments proposed by Schedule 10 will commence and apply from Royal Assent ***[Subclause 2(1), item 4 in the table]***. Exceptions to this are explained below.

Amending an application provision so that it operates in accordance with what was intended when it was enacted

10.53 The amendment, discussed in paragraphs 10.46 to 10.51, will commence immediately after 24 October 2002. As the amendment applies a Subdivision to events which have already happened, it is necessary to apply it from when the Subdivision commenced. It will have no adverse effects on taxpayers as it is concessionary treatment only. ***[Subclause 2(1), item 17 in the table]***

Deleting a definition where the same term is defined twice

10.54 The amendment discussed in paragraph 10.6 removes a duplicate definition of the term 'government entity'. It will commence just after the second definition was added (1 July 2000). The amendment applies retrospectively so that, at all times, there is only one definition of 'government entity'. This avoids any confusion from having two definitions but will not adversely affect taxpayers because the two definitions have identical substantive operation. ***[Subclause 2(1), item 15 in the table]***

Fixing incorrect terminology

10.55 The first retrospective amendment fixing incorrect terminology is to paragraphs 80-90(a) and 80-95(a) of the *A New Tax System (Goods and Services Tax) Act 1999* ***[Schedule 10, items 7 and 8]***. This amendment will replace 'nominal defendant settlement arrangement' with the correct defined term 'nominal defendant settlement sharing arrangement'. This amendment will apply from the time when the incorrect term 'nominal defendant settlement arrangement' was inserted.

10.56 This amendment is to apply retrospectively so that the current paragraphs 80-90(a) and 80-95(a) do not adversely affect insurers. A literal reading of the current paragraphs could deny decreasing adjustments in certain situations. Making the correction retrospective will ensure that insurers are able to access the decreasing adjustments. ***[Schedule 10, item 9]***

10.57 The second retrospective amendment fixing incorrect terminology was discussed in paragraph 10.10. Because the corrected expression – 'receives a refund of income tax' - is only used in relation to the rewritten imputation system, this amendment is to apply from the time when the rewritten imputation system commenced (29 June 2002). This will avoid confusion which would result from having different commencement dates for amendments to the imputation system and will not have any adverse effects for taxpayers. ***[Subclause 2(1), item 16 in the table]***

Fixing incorrect referencing

10.58 An amendment fixing incorrect referencing was discussed in paragraph 10.9. That amendment and two other amendments fixing incorrect referencing are to apply from the times when the incorrect references were inserted. This ensures the integrity of the taxation system is maintained and the law operates as intended. The *intended* rights and obligations of taxpayers are clear under the current law and retrospectivity prevents abuse of the system. ***[Schedule 10, items 2 and 12, Subclause 2(1), item 14 in the table]***

Updating a definition in the *Fringe Benefits Tax Assessment Act 1986*

10.59 This amendment which was discussed in paragraph 10.43 will apply from the time that sections 58ZC and 59 of the *Fringe Benefits Tax Assessment Act 1986* were introduced: 1 April 2000. The retrospective operation of this amendment will not affect the practical operation of the law as the Commissioner has been administering the law since that time as if the definition of 'remote area housing benefit' already applied for the purposes of subsection 59(1). ***[Schedule 10, item 18]***

Updating a definition in the *Income Tax Assessment Act 1936*

10.60 The amendment, which updates the definition of 'tax threshold' in section 159S of the ITAA 1936, was discussed in paragraph 10.44. This amendment will apply to assessments for the 2000-01 income years and later income years. It will not adversely affect taxpayers because the Commissioner has been administering the sections as if the tax threshold were $6,000 and not $5,100. ***[Schedule 10, item 30]***

Renumbering incorrectly numbered provisions and Divisions

10.61 The amendment discussed in paragraph 10.26 will commence just after the commencement of the second insertion of section 118-315 in the ITAA 1997. This amendment will commence retrospectively so that the section which is being renumbered will be treated as always having been section 118-317. It will have no substantive effect as the amendment only changes the numbering of a section, not its operation.

10.62 The other amendments which renumber incorrectly numbered provisions will commence on Royal Assent. ***[Subclause 2(1), item 4 in the table]***

10.63 The removal of link notes will commence on the later of:

- Royal Assent of this Bill; and
- the commencement in Schedule 1 to the Tax Laws Amendment (2004 Measures No. 6) Bill 2004.

The link notes must be removed after the commencement of the Tax Laws Amendment (2004 Measures No. 6) Bill 2004 because that Bill relies on the existence of link notes to make amendments. ***[Subclause 2(1), item 22 in the table]***

Amending misdescribed amendments

10.64 Amendments fixing misdescribed amendments are to apply retrospectively from the date at which the original amendments attempted to amend the respective provisions. These amendments will be retrospective to ensure that the sequence of amendments made by the respective amending Acts work properly. Because the intention of the amendments was clear, taxpayers understood their intended rights and obligations. This retrospective application will maintain the integrity of the taxation system by ensuring the amendments operate as intended. ***[Subclause 2(1), items 5, 6 and 19 to 21 in the table]***

Minor consequential amendments resulting from Parliamentary amendments to substantive provisions

10.65 The amendment discussed in paragraph 10.45, removing a paragraph from the ITAA 1997, will commence when the paragraph was originally inserted (30 June 2000). This is consistent with the timing of the removal of the other consequential amendments made as a result of the Senate's removal of the primary tax measure. ***[Schedule 10, Subclause 2(1), item 12 in the table]***

Chapter 11
Minor amendment to the refundable film tax offset

Outline of chapter

11.1 Schedule 11 to this Bill amends both the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Income Tax Assessment Act 1936* (ITAA 1936) to allow revocation of provisional certificates issued under Division 10BA of the ITAA 1936 where no taxpayer has claimed a deduction under that Division in respect of the film.

Context of amendments

11.2 The refundable tax offset for large scale films, contained in Division 376 of the ITAA 1997, was introduced with effect from 4 September 2001. The offset applies at a rate of 12.5 per cent of qualifying Australian production expenditure on the film.

11.3 The Division 376 offset is designed to encourage large scale film productions to locate in Australia, and is aimed at providing greater economic, employment and skill development opportunities. Access to the offset can be denied for a number of reasons, including where a film project has a provisional Division 10BA certificate. Access is denied for holding a provisional Division 10BA certificate regardless of whether investors have accessed any Division 10BA benefits.

11.4 Division 10BA is a tax concession designed to encourage private investment in Australian film and television productions. Broadly, investors are entitled to a 100 per cent deduction for capital expenditure on Australian films in the year the expenditure is incurred. To be eligible under Division 10BA projects must be assessed and certified as a qualifying Australian film. The certification process is in two stages, provisional and final. Certification under Division 10BA is also required for Film Finance Corporation Australia Limited financial assistance.

11.5 This amendment addresses complications in industry practice. Film producers routinely seek provisional Division 10BA film certification as the first stage in raising funds for a film concept, without knowing whether or not a foreign studio will fund the project and that access to the Division 376 offset is to be sought. Therefore, where a film has a provisional Division 10BA certificate and is subsequently financed by a foreign studio, the film is unlikely to be eligible for a final Division 10BA certificate and is also excluded from the Division 376 offset.

Summary of new law

11.6 The amendments will provide for the revocation of provisional Division 10BA certificates for films where no taxpayer has claimed a Division 10BA tax deduction in respect of that film. Paragraph 376-5(2)(b) of the ITAA 1997 will also be amended to carve out provisional certificates so revoked from the general exclusion from access to the Division 376 offset for films with a provisional Division 10BA certificate.

11.7 The broad overall intent behind the film tax concessions is to preserve mutual exclusivity between the Division 376, Division 10BA and Division 10B concessions. Additionally, the intent is also to maintain mutual exclusivity between Film Finance Corporation Australia Limited funding and the Division 376 offset.

Comparison of key features of new law and current law

New law	***Current law***
Allows revocation of provisional Division 10BA certificates where no taxpayer has claimed a deduction under Division 10BA in respect of the film. Effectively dormant provisional Division 10BA certificates may be revoked, allowing a film project to then apply for the Division 376 refundable film tax offset.	A film with a provisional Division 10BA certificate, whether or not the certificate has been utilised to claim a tax deduction, is denied access to the Division 376 offset.

Detailed explanation of new law

11.8 The amendments will insert a new power for the Minister for the Arts and Sport (the Minister) to revoke provisional Division 10BA certificates ***[Schedule 11, item 1, subsection 124ZAB(6A) of the ITAA 1936]***. Currently under section 124ZAB there are already existing powers of revocation.

11.9 The original applicant for the provisional Division 10BA certificate can apply to the Minister in the approved form for revocation of that certificate, provided they fulfil certain criteria. ***[Schedule 11, item 1, paragraph 124ZAB(6A)(a) of the ITAA 1936]***

11.10 The original applicant for the provisional Division 10BA certificate must provide a statutory declaration to the Minister outlining compliance with a number of criteria in their application for revocation. ***[Schedule 11, item 1, paragraph 124ZAB(6A)(b) of the ITAA 1936]***

11.11 The mandatory criteria contained in the statutory declaration required in order to qualify for revocation are that:

- no taxpayer has claimed a deduction under Division 10BA of the ITAA 1936 in respect of the film;
- a final certificate in respect of the film has not been issued under Division 10BA of the ITAA 1936;
- a taxpayer intends to claim a tax offset under Division 376 of the ITAA 1997 in respect of the film; and
- financial assistance has not been provided by the Film Finance Corporation Australia Limited in respect of the film.

[Schedule 11, item 1, subparagraphs 124zab(6a)(B)(i to iv) of the ITAA 1936]

11.12 Revocation of a certificate under subsection 124ZAB(6A) is designed to allow a person to claim the Division 376 offset in respect of the film. The original applicant for the provisional Division 10BA certificate must state in their statutory declaration that a taxpayer intends to claim the Division 376 offset. ***[Schedule 11, item 1, subparagraph 124ZAB(6A)(b)(iii) of the ITAA 1936]***

11.13 A certificate that is revoked under subsection 124ZAB(6A) is taken never to have been in force. ***[Schedule 11, item 1, subsection 124ZAB(6A) of the ITAA 1936]***

11.14 Where, for whatever reason, both a Division 10BA claim and a claim under Division 376 for a film is made, then the Division 10BA claim will be denied first. As a revoked provisional Division 10BA certificate is taken never to have been in force, notwithstanding the truth of claims made in the mandatory statutory declaration, any deductions actually claimed under Division 10BA in relation to a film can be disallowed. ***[Schedule 11, item 1, subparagraph 124ZAB(6A)(b)(i) of the ITAA 1936]***

Example 11.1

> A producer, Alan Smithee, applies in good faith for revocation of his provisional Division 10BA certificate in relation to his dormant film project 'A Sunday Folly'. Having carefully canvassed initial investors as to whether they had claimed a Division 10BA deduction, he then signs a statutory declaration in order to revoke the certificate. This declaration states, amongst other things, that no taxpayer has claimed a Division 10BA deduction in relation to the film. The film project then proceeds, is completed and also qualifies for and claims the Division 376 refundable film tax offset. However, it later emerges that an investor did claim a Division 10BA deduction in relation to the film. In this case the Division 376 claim stands but the investor's Division 10BA deduction is denied.

11.15 Certificates revoked under subsection 124ZAB(6A) of the ITAA 1936 are carved out from the general exclusion for holding a provisional Division 10BA certificate in terms of access to the Division 376 offset. In other words the exclusion wording, 'whether or not the certificate is still in force', does not apply to certificates revoked under subsection 124ZAB(6A). ***[Schedule 11, item 4, paragraph 376-5(2)(b) of the ITAA 1997]***

Application and transitional provisions

11.16 The amendments apply to any eligible expenditure incurred, whether before or after commencement of this Bill. Effectively expenditure incurred on films completed on or after 4 September 2001 may be eligible under Division 376 of the ITAA 1997.

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Item 136, subsections 170-30(1) and (2) of the ITAA 1997	10.18
Item 137, subsection 170-30(4) of the ITAA 1997, items 1 to 3 in the table	10.18
Item 138, subsections 170-32(4) and (5) of the ITAA 1997	10.18
Item 139, note to subsection 170-115(1) of the ITAA 1997	10.29
Item 140, subsections 170-130(1) and (2) of the ITAA 1997	10.18
Item 141, subsection 170-130(4) of the ITAA 1997, items 1 to 3 in the table	10.18
Item 142, subsections 170-132(4) and (5) of the ITAA 1997	10.18
Item 143, subsections 170-133(2) and (3) of the ITAA 1997	10.18
Item 144, note 2 to subsection 170-140(2) of the ITAA 1997	10.29
Item 145, paragraphs 170-210(1)(e) and (2)(f) of the ITAA 1997	10.18
Item 146, paragraphs 170-215(1)(e) and (2)(f) of the ITAA 1997	10.18
Item 147, paragraphs 170-220(1)(e) and (2)(f) of the ITAA 1997	10.18
Item 148, paragraphs 170-225(1)(e) and (2)(f) of the ITAA 1997	10.18
Item 149, subparagraph 170-255(1)(d)(i) of the ITAA 1997	10.12
Item 150, subparagraph 170-255(1)(d)(v) of the ITAA 1997	10.11
Item 151, section 180-1 of the ITAA 1997	10.11

Bill reference	***Paragraph number***
Item 187, subsections 328-375(2) and (3) of the ITAA 1997	10.13
Item 188, subsection 328-380(1) of the ITAA 1997	10.13
Item 189, subparagraph 376-5(1)(d)(ii) of the ITAA 1997	10.12
Item 190, subparagraph 376-15(1)(a)(ii) of the ITAA 1997	10.12
Item 191, subparagraph 376-50(a)(i) of the ITAA 1997	10.12
Item 192, example to subsection 396-75(2) of the ITAA 1997	10.12
Item 193, subsection 405-50(5) of the ITAA 1997, heading to the table	10.12
Item 194, note to subsection 405-50(5) of the ITAA 1997	10.12
Item 195, section 703-25 of the ITAA 1997, item 3 in the table	10.13
Item 196, subsection 721-15(2) of the ITAA 1997	10.13
Items 197 and 198, subsection 960-60(1) of the ITAA 1997, items 1 and 2 in the table	10.20
Items 199 and 200, subsection 960-80 (1) of the ITAA 1997, items 1 and 2 in the table	10.20
Items 201 and 202, subsection 960-90(1) of the ITAA 1997, items 1 and 2 in the table	10.20
Item 203, paragraph 960-140(a) of the ITAA 1997	10.20
Item 204, paragraph 960-345(1)(a) of the ITAA 1997	10.13
Item 205, subsection 960-345(2) of the ITAA 1997	10.7
Item 206, section 975-100 of the ITAA 1997	10.17
Item 207, subsection 995-1(1) of the ITAA 1997, definition of ‘company law’	10.8
Item 208, subsection 995-1(1) of the ITAA 1997, definition of ‘foreign resident life insurance policy’	10.11
Item 209, subsection 995-1(1) of the ITAA 1997, definition of ‘group turnover’ (1st insertion)	10.9
Item 210, subsection 995-1(1) of the ITAA 1997, definition of ‘group turnover’ (2nd insertion)	10.6
Item 211, subsection 995-1(1) of the ITAA 1997, definition of ‘in existence’	10.17
Items 212 and 213, subsection 995-1(1) of the ITAA 1997, definitions of ‘member’	10.7
Item 214, subsection 995-1(1) of the ITAA 1997, definition of ‘non-compulsory uniform’	10.6
Item 215, subsection 995-1(1) of the ITAA 1997, definition of ‘non-resident life insurance policy’	10.11
Item 216, subsection 995-1(1) of the ITAA 1997, definition of	10.6

Bill reference	***Paragraph number***
Amendment Act (No. 5) 2002	
Item 243, paragraph 21-5(3)(b) of the *Venture Capital Act 2002*	10.11
Item 244, item 85 in Schedule 2 to the *A New Tax System (Pay As You Go) Act 1999*	10.36
Item 245, item 16 in Schedule 4 to the *Energy Grants (Credits) Scheme (Consequential Amendments) Act 2003*	10.37
Item 246, subsection 136(1) of the *Fringe Benefits Assessment Act 1986*, definition of 'approved form' (1st insertion)	10.6
Item 247, sections 118-313 and 118-315 (the section inserted by the *Family Law Legislation Amendment (Superannuation) (Consequential Provisions) Act 2001*) of the ITAA 1997	10.26
Item 248, subsection 165-115BB(2) of the ITAA 1997	10.38
Item 249, subsection 205-50(2) of the ITAA 1997	10.14, 10.21
Item 250, subsection 205-50(3) of the ITAA 1997	10.14, 10.21
Item 251, section 210-120 of the ITAA 1997, item 2 in the table	10.14, 10.21
Item 252, subsection 210-150(2) of the ITAA 1997	10.14, 10.21
Item 253, subsection 210-150(3) of the ITAA 1997	10.14, 10.21
Item 254, paragraph 214-45(1)(a) of the ITAA 1997	10.14, 10.21
Item 255, paragraph 214-45(2)(a) of the ITAA 1997	10.41, 10.21
Item 256, paragraph 214-105(1)(b) of the ITAA 1997	10.41, 10.21
Item 257, paragraph 214-150(4)(a) of the ITAA 1997	10.41, 10.21
Item 258, subsection 320-195(1) of the ITAA 1997	10.45
Item 259, paragraphs 705-90(4)(a) and (9)(a) of the ITAA 1997	10.14, 10.21
Item 260, subsection 820-617(1) of the ITAA 1997	10.9
Item 261, subsection 995-1(1) of the ITAA 1997, definition of 'government entity' (1st insertion)	10.6
Item 262, subsection 995-1(1) of the ITAA 1997, definition of 'participant' (1st insertion)	10.6
Item 263, subsection 995-1(1) of the ITAA 1997, definition of 'receives a refund of income tax'	10.10
Item 264, subsection 995-1(1) of the ITAA 1997, definition of 'refund of income tax'	10.10
Item 265, paragraph (2)(a) of item 23 in Schedule 3 to the *New Business Tax System (Consolidation) Act (No. 1) 2002*	10.51
Item 266, item 6 in Schedule 21 to the *New Business Tax System (Consolidation and Other Measures) Act 2003*	10.35
Item 267, subsection 2(2) of the *Taxation Laws Amendment (Company Law Review) Act 1999*	10.39

Bill reference	***Paragraph number***
Item 268, item 2 in Schedule 4 to the *Taxation Laws Amendment (Research and Development) Act 2001*	10.40
Item 269, subsection 2(1) of the *Taxation Laws Amendment (2004 Measures No. 2) Act 2001*, item 9 in the table	10.42
Item 270, link notes in the ITAA 1936	10.30
Item 271, section 2-30 of the ITAA 1997	10.30
Item 272, subsection 995-1(1) of the ITAA 1997, definition of 'link note'	10.30
Items 273 to 276, link notes in the ITAA 1997, the *Income Tax (Transitional Provisions) Act 1997*, the TAA 1953 and the *Venture Capital Act 2002*	10.30

Schedule 11: Film tax offsets

Bill reference	***Paragraph number***
Item 1, subsection 124ZAB(6A) of the ITAA 1936	11.8, 11.13
Item 1, paragraph 124ZAB(6A)(a) of the ITAA 1936	11.9
Item 1, paragraph 124ZAB(6A)(b) of the ITAA 1936	11.10
Item 1, subparagraph 124ZAB(6A)(b)(i) of the ITAA 1936	11.14
Item 1, subparagraphs 124ZAB(6A)(b)(i to iv) of the ITAA 1936	11.11
Item 1, subparagraph 124ZAB(6A)(b)(iii) of the ITAA 1936	11.12
Item 4, paragraph 376-5(2)(b) of the ITAA 1997	11.15