

2008

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

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TAX LAWS AMENDMENT (2008 MEASURES No. 4) BILL 2008

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EXPLANATORY MEMORANDUM

(Circulated by the authority of the  
Treasurer, the Hon Wayne Swan MP)



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# **Glossary**

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The following abbreviations are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
CGT	capital gains tax
GST	goods and services tax
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
PHIA 2007	<i>Private Health Insurance Act 2007</i>



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# General outline and financial impact

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## Demutualisation of private health insurers

Schedule 1 to this Bill amends the *Income Tax Assessment Act 1997* to provide relief from capital gains tax (CGT) to private health insurance policy holders when their insurer converts, by demutualising, from being a *not for profit* to a *for profit* insurer. A key requirement for this relief will, in general, be the Private Health Insurance Administration Council's approval of the insurer's conversion under the *Private Health Insurance Act 2007*.

**Date of effect:** These amendments apply to demutualisations that occur on or after 1 July 2007. This will ensure that private health insurers that demutualise prior to these amendments receiving Royal Assent may qualify for the relief.

**Proposal announced:** The Assistant Treasurer and Minister for Competition Policy and Consumer Affairs' announced in Press Release No. 013 of 26 February 2008 that the Government would provide CGT relief when private health insurers demutualise.

**Financial impact:** This measure will have these revenue implications:

2007-08	2008-09	2009-10	2010-11	2011-12
Nil	Nil	-\$2m	-\$1m	-\$1m

**Compliance cost impact:** These amendments are expected to have a low impact for both implementation and ongoing compliance costs.

## Family trusts

Schedule 2 to this Bill amends Schedule 2F to the *Income Tax Assessment Act 1936* (ITAA 1936) (the trust loss measures) to change the definition of 'family' to limit lineal descendants to children or grandchildren of the test individual or of the test individual's spouse. These amendments also remove the ability for family trusts to make a one-off variation to the test individual specified in a family trust election (other than specifically in relation to the 2007-08 income year or a marriage breakdown).

**Date of effect:** The amendments to limit lineal descendants to children or grandchildren of the test individual or of the test individual's spouse apply to the 2008-09 income year, and later income years.

The amendments to remove the ability of family trusts to make a one-off variation to the test individual specified in a family trust election (other than specifically in relation to the 2007-08 income year or a marriage breakdown) apply to the 2007-08 income year, and later income years.

**Proposal announced:** This measure was announced in the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs' Press Release No. 034 of 13 May 2008.

**Financial impact:** This measure has these revenue implications:

<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>
\$1m	\$6m	\$6m	\$6m

**Compliance cost impact:** These amendments are expected to have a small impact on compliance costs.

## Minor amendments

Schedule 3 to this Bill makes technical corrections and other minor amendments to the taxation laws. These amendments are part of the Government's commitment to the care and maintenance of the tax system.

**Date of effect:** These corrections, amendments and improvements generally commence from Royal Assent but some apply prospectively or retrospectively. The retrospective amendments do not disadvantage taxpayers.

**Proposal announced:** These amendments have not previously been announced.

**Financial impact:** Nil to low.

**Compliance cost impact:** Nil to low.



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# Chapter 1

## Demutualisation of private health insurers

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### Outline of chapter

1.1 Schedule 1 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to provide relief from capital gains tax (CGT) to private health insurance policy holders when their insurer converts, by demutualising, from being a *not for profit* to a *for profit* insurer. A key requirement for this relief will, in general, be the Private Health Insurance Administration Council's approval of the insurer's conversion under the *Private Health Insurance Act 2007* (PHIA 2007).

### Context of amendments

1.2 For taxation purposes, the principle of mutuality applies when a number of individuals associate together for a common purpose and contribute to a common fund in which all the individuals have an interest.

1.3 Demutualisation involves the participants of such a fund giving up their rights to participate in the fund. In effect, this involves the participants giving up the right to benefit in the future from any mutual surplus that has been (or may be) built. Upon demutualisation there is effectively a distribution of any accumulated mutual surplus to the participants.

1.4 Ordinarily, this would trigger a CGT taxing point.

1.5 Division 9AA of the *Income Tax Assessment Act 1936* (ITAA 1936), which does not apply to private health insurers, provides that any capital gains or losses that arise on these transactions for members and policy holders of life insurers and general insurers that demutualise are disregarded. Schedule 2H to the ITAA 1936 provides members of other mutual entities that demutualise with similar relief.

1.6 It is a requirement of the PHIA 2007 that when a *not for profit* private health insurer converts to a *for profit* health insurer by demutualising, the financial benefits of that conversion must not be distributed inequitably between policy holders and other insured persons of the insurer.

1.7 Many policy holders of *not for profit* private health insurers are not ‘members’ in the sense that is required under Schedule 2H to the ITAA 1936. This means that such policy holders of a *not for profit* private health insurer that converts to a *for profit* insurer by demutualising are not covered by the existing demutualisation provisions and would be subject to the general income and CGT provisions of the tax law on demutualisation.

1.8 A health insurance policy and the policy holder’s right to participate in the fund may be bound up in a single, indivisible CGT asset that is a personal use asset of the policy holder. The existing CGT provisions disregard any capital gain arising from a personal use asset if the first element of the asset’s cost base is less than \$10,000. In addition, the existing CGT provisions disregard any capital loss arising from a personal use asset.

1.9 It is a question of fact whether the insurance policy and the policy holder’s right to participate in the fund are parts of a single, indivisible CGT asset which may be eligible for the personal use asset exemption.

1.10 The CGT relief provided by these amendments is intended to facilitate the demutualisation of private health insurers and is available in specific situations only. More generally, these amendments are not intended to affect whether or not a health insurance policy is a personal use asset.

## **Summary of new law**

1.11 This Schedule amends the ITAA 1997 by inserting a new Division, Division 315, which broadly disregards capital gains or losses that arise from various transactions that occur when a private health insurer converts to a *for profit* insurer, by demutualising, under subsection 126-42(5) of the PHIA 2007.

1.12 Specifically, Subdivision 315-A disregards capital gains or losses that arise under the insurer’s demutualisation. Subdivision 315-C disregards capital gains or losses, and sets out other CGT consequences, that arise when shares are transferred to lost policy holders following the private health insurer’s demutualisation.

1.13 In addition, this Division provides a market value cost base for shares, or rights to acquire shares, in the demutualised private health insurer issued to policy holders under the insurer’s demutualisation. These provisions are located in Subdivision 315-B. Subdivision 315-D

sets out the cost base rules for shares, or rights to acquire shares, in another company that are issued to policy holders under a private health insurer's demutualisation.

1.14 Subdivision 315-E sets out special rules for legal personal representatives and beneficiaries of a deceased policy holder's estate who receive shares, or rights to acquire shares, that would have otherwise been issued to the deceased policy holder under the private health insurer's demutualisation.

1.15 Non-CGT tax consequences arising from a private health insurer's demutualisation are set out in Subdivision 315-F.

1.16 Division 315 is located in a new Part, Part 3-32, which will deal with co-operatives and mutual entities.

### **Comparison of key features of new law and current law**

<i>New law</i>	<i>Current law</i>
Capital gains and losses arising to policy holders when their private health insurer converts, by demutualising, to a <i>for profit</i> insurer will be disregarded.	Policy holders of life and general insurers may be able to disregard capital gains and losses that arise when their insurer demutualises.  Similar relief is not available for policy holders of health insurers.
Capital gains and losses arising on some related transactions will also be disregarded.	Capital gains and losses arising on related transactions would normally trigger CGT consequences.
Policy holders who receive shares or rights to acquire shares, in the demutualised private health insurer will receive a market value cost base for those shares or rights.  Policy holders who receive shares in another company, or rights to acquire such shares, will receive a cost base for those shares or rights that is based on the market value of the private health insurer.	Policy holders would typically receive a nil or small nominal cost base for any shares, or rights to acquire shares, that they receive under their private health insurer's demutualisation, depending on how the demutualisation is structured.

<i>New law</i>	<i>Current law</i>
No other tax consequences will arise to policy holders from them receiving shares, rights or cash under a private health insurer's demutualisation.	Distributions from a company may, in certain circumstances: <ul style="list-style-type: none"> <li>• be treated as a dividend; or</li> <li>• trigger CGT consequences.</li> </ul>
Legal personal representatives and beneficiaries of a deceased policy holder's estate who receive shares or rights to acquire shares because of the policy holder's death will receive the same cost base for the shares or rights that the deceased policy holder would have received.  Any capital gains or losses arising from the shares or rights passing to a beneficiary of the estate will be disregarded.	As these shares or rights are not held by the deceased policy holder at the time of their death, no roll-over is available when the shares or rights pass to a beneficiary of their estate.
Shares or rights issued under a private health insurer's demutualisation may be held on trust and transferred to, or sold on behalf of, policy holders without CGT consequences for the trustee.	A trustee dealing with assets in a trust will typically trigger CGT consequences for the trustee.

## Detailed explanation of new law

1.17 The PHIA 2007 requires entities carrying on health insurance business to be registered with the Private Health Insurance Administration Council. The Council is an independent statutory authority that regulates the private health insurance industry. Private health insurers may be registered as a *not for profit* private health insurer or a *for profit* private health insurer.

1.18 Under subsection 126-42(1) of the PHIA 2007, a private health insurer may apply to the Council for approval to convert from being a *not for profit* private health insurer to being a *for profit* private health insurer. Paragraph 126-42(2)(b) of the PHIA 2007 requires the private health insurer to provide the Council with its conversion scheme as part of its application.

1.19 Generally, the Council is required to approve the insurer's conversion under subsection 126-42(3) of the PHIA 2007 if it is satisfied that the insurer's conversion scheme would not in substance involve the insurer's demutualisation.

1.20 However, if the Council is satisfied that the insurer's conversion scheme would in substance involve the demutualisation of the insurer then it must approve the conversion scheme under subsection 126-42(5) of the PHIA 2007 only if it is satisfied that the scheme:

- would not result in a financial benefit to any person who is not a policy holder of, or another person insured by the insurer; and
- would not result in financial benefits from the scheme being distributed inequitably between such policy holders and insured persons.

1.21 A decision by the Private Health Insurance Administration Council to refuse an application to approve, under subsection 126-42(5) of the PHIA 2007, a private health insurer's conversion to a *for profit* insurer is reviewable by the Administrative Appeals Tribunal under item 6A of section 328-5 of the PHIA 2007.

1.22 Division 315 of the ITAA 1997 does not mean that a private health insurer, who converts to a *for profit* insurer by demutualising and distributing its accumulated mutual surplus in any of the ways provided for in the Division, will necessarily meet the requirements of subsection 126-42(5) of the PHIA 2007.

### **Eligible demutualisations**

1.23 The following requirements must be satisfied for the relief in Division 315 of the ITAA 1997 to be available.

#### ***Eligible entities***

1.24 Prior to its demutualisation, the private health insurer must be a tax exempt entity under item 6.3 in the table in section 50-30 of the ITAA 1997. Item 6.3 applies to entities which are private health insurers within the meaning of the PHIA 2007 that are not carried on for the profit or gain of their individual members. [*Schedule 1, item 11, subparagraph 315-15(a)(i)*]

1.25 In addition, the private health insurer must be an entity that is not registered under Part 3 of the *Life Insurance Act 1995*. [*Schedule 1, item 11, subparagraph 315-15(a)(ii)*]

1.26 The private health insurer must not have capital divided into shares. [*Schedule 1, item 11, subparagraph 315-15(a)(iii)*]

### ***Approval and conversion***

1.27 The private health insurer's application to convert to a *for profit* insurer must be approved under subsection 126-42(5) of the PHIA 2007 and, consistent with its conversion scheme, the insurer must become registered in due course as a *for profit* private health insurer. [*Schedule 1, item 11, paragraphs 315-15(b) and (c)*]

#### **Example 1.1**

Healthy Health Insurance Ltd (Healthy Health) is a private health insurer that is not carried on for the profit or gain of its individual members. It is therefore an exempt entity under item 6.3 in the table in section 50-30 of the ITAA 1997. Healthy Health is a company limited by guarantee.

Healthy Health is registered as a *not for profit* private health insurer under the PHIA 2007 and proposes to convert to a *for profit* insurer. Consequently, it applies to the Private Health Insurance Administration Council under subsection 126-42(1) of the PHIA 2007 to be registered as a *for profit* health insurer. A copy of Healthy Health's conversion scheme is included in its application. As part of this scheme, Healthy Health proposes to issue shares, which would reflect the value of the accumulated mutual surplus, to its participating policy holders.

Assume the Council approves this conversion and Healthy Health converts, by demutualising, to a *for profit* private health insurer.

Division 315 of the ITAA 1997 would apply to the demutualisation of Healthy Health.

#### **Example 1.2**

Impressive Insurance Ltd (Impressive Insurance) is a private health insurer registered as a *not for profit* private health insurer under the PHIA 2007. It is a tax exempt entity under item 6.3 in the table in section 50-30 of the ITAA 1997 and is a company limited by guarantee.

Impressive Insurance proposes to convert to a *for profit* private health insurer as part of a broader takeover arrangement with another *for profit* private health insurer. Instead of issuing shares, Impressive Insurance proposes to distribute the accumulated mutual surplus to its policy holders in the form of a cash payment. Impressive Insurance proposes to use a members' scheme to facilitate this conversion and so issues its participating policy holders with membership interests.

Under Impressive Insurance's proposal, these membership interests will be held on trust for the policy holders and, in exchange for the cash payment (made from its accumulated mutual surplus), the membership interests will be cancelled.

Assume the Private Health Insurance Administration Council approves this conversion and Impressive Insurance converts, by demutualising, to a *for profit* entity.

Division 315 of the ITAA 1997 would apply to the demutualisation of Impressive Insurance.

### **Relief for policy holders and other insured persons**

1.28 CGT relief will generally be available for individuals who are:

- policy holders (within the meaning of the PHIA 2007) of the private health insurer;
- former policy holders of the insurer; and
- other insured persons (within the meaning of paragraph 126-42(5)(b) of the PHIA 2007) or former insured persons of the insurer.

1.29 If such an individual dies during the demutualisation process, then CGT relief may also be available for their legal personal representative and beneficiaries of their estate.

1.30 'Policy holder' is defined in Schedule 1 to the PHIA 2007.

#### ***Relief for policy holders***

1.31 Capital gains or losses that arise under a private health insurer's demutualisation to a policy holder will be disregarded for CGT events that happen to:

- an interest the policy holder has in the insurer as a policy holder;
- a right or any other kind of interest the policy holder has in the insurer; and
- a right or any other kind of interest that arises under the demutualisation.

*[Schedule 1, item 11, section 315-5 and paragraphs 315-20(a), (c) and (d)]*

1.32 It will be a question of fact as to whether a specific transaction (and therefore a capital gain or loss) arises under the private health insurer's demutualisation. Transactions are likely to vary between demutualising private health insurers.

1.33 Consistent with the policy objective of facilitating the demutualisation of private health insurers and the distribution of any accumulated mutual surplus, transactions that occur after this distribution will not be transactions that occur under the insurer's demutualisation. This will be the case even if the transactions occur as part of a broader scheme for reorganising the private health insurer's affairs.

### **Example 1.3**

Further to Example 1.1.

Philip is a policy holder of Healthy Health and under the terms of Healthy Health's constitution, as a policy holder, Philip has a number of rights. These include the right to receive notice of Healthy Health's Annual General Meeting, the right to attend and be heard at the meeting and the right to require Healthy Health to manage its assets in a certain way and to operate on a not *for profit* basis.

Under Healthy Health's conversion scheme, Philip also acquires the right to receive 1,000 shares.

These rights are satisfied when Healthy Health distributes its accumulated mutual surplus and Philip receives his 1,000 shares.

As these rights arise under the demutualisation, Philip disregards any capital gains or losses that arise from the satisfaction of these rights.

1.34 In addition, if a policy holder has a membership interest in the private health insurer (held directly or on trust for their benefit), then any capital gains or losses that arise under the private health insurer's demutualisation to the policy holder in relation to that interest will be disregarded. [*Schedule 1, item 11, section 315-5 and paragraph 315-20(b)*]

### **Example 1.4**

Further to Example 1.2.

John is a policy holder of Impressive Insurance who receives a membership interest under its conversion scheme. Impressive Insurance subsequently cancels John's membership interest in exchange for a cash payment of \$500 and thereby distributes John's share of the accumulated mutual surplus.



John disregards any capital gains or losses arising from receiving the membership interest and from its cancellation.

### ***Former policy holders***

1.35 A former policy holder is an individual who was previously a policy holder of the private health insurer but is no longer a policy holder insurer at the time the accumulated mutual surplus is distributed. Depending on the terms of the private health insurer's conversion scheme, a former policy holder may be entitled to receive a share of the insurer's accumulated mutual surplus.

### **Example 1.5**

Further to Example 1.1.

Jennelle was a policy holder at the time Healthy Health announced its proposed demutualisation and when its policy holders approved its demutualisation. Under the terms of Healthy Health's demutualisation she is entitled to receive an allocation of shares in Healthy Health. Jennelle is no longer a policy holder of Healthy Health.

Jennelle is a former policy holder of Healthy Health.

1.36 Capital gains or losses that arise under a private health insurer's demutualisation to a former policy holder will be disregarded for CGT events that happen to:

- an interest the former policy holder had in the insurer as a policy holder;
- a right or any other kind of interest the former policy holder had or, continues to have, in the insurer; and
- a right or any other kind of interest that arises under the demutualisation.

*[Schedule 1, item 11, section 315-5 and paragraphs 315-20(a), (c) and (d)]*

### **Example 1.6**

Further to Example 1.5.

Jennelle has a right to receive 1,500 shares. Jennelle subsequently receives 1,500 shares when Healthy Health distributes its accumulated mutual surplus and so her right to receive the shares ends.

As Jennelle's right to the 1,500 shares arises under Healthy Health's demutualisation, Jennelle disregards any capital gains or losses arising from the ending of her right to the 1,500 shares.

1.37 In addition, if a former policy holder had, or continues to have, a membership interest in the private health insurer (held directly or on trust for their benefit), then any capital gains or losses that arise under the private health insurer's demutualisation to the former policy holder in relation to that interest will be disregarded. *[Schedule 1, item 11, section 315-5 and paragraph 315-20(b)]*

***Other insured persons***

1.38 Capital gains or losses that arise under a private health insurer's demutualisation to any other insured person, or former insured person, will be disregarded for CGT events that happen to:

- a right or any other kind of interest (including a membership interest) the insured person has or had in the insurer; and
- a right or any other kind of interest that arises under the demutualisation.

*[Schedule 1, item 11, section 315-5 and paragraphs 315-20(b) to (d)]*

***Legal personal representatives and beneficiaries of a deceased policy holder***

1.39 Where a policy holder, former policy holder or other insured person or former insured person dies during the private health insurer's demutualisation process, then any capital gains or losses that arise to their legal personal representative or a beneficiary of their estate under the insurer's demutualisation will be disregarded for CGT events that happen to:

- an interest the deceased individual had in the insurer as a policy holder;
- a right or any other kind of interest the deceased individual had in the insurer; and
- a right or any other kind of interest that arises under the demutualisation.

*[Schedule 1, item 11, section 315-10 and paragraphs 315-20(a), (c) and (d)]*

1.40 In addition, if the deceased policy holder had a membership interest in the private health insurer (held directly or on trust for their

benefit), then any capital gains or losses that arise under the private health insurer's demutualisation to their legal personal representative or a beneficiary of their estate in relation to that interest will also be disregarded. *[Schedule 1, item 11, section 315-10 and paragraph 315-20(b)]*

### **Relief for the demutualising insurer**

1.41 Capital gains or losses that arise under the private health insurer's demutualisation to the insurer will be disregarded. *[Schedule 1, item 11, section 315-25]*

### **Relief for other entities**

1.42 Capital gains or losses that arise under the private health insurer's demutualisation to other entities will also be disregarded when the following three requirements are satisfied. *[Schedule 1, item 11, subparagraph 315-30(c)(i)]*

1.43 Firstly, the entity must be established for the sole purpose of participating in the private health insurer's demutualisation. It will be a question of fact whether an entity meets this requirement. However, in determining this, regard should be given to the private health insurer's conversion scheme and whether, for example, it provides for the creation of the entity. *[Schedule 1, item 11, paragraph 315-30(a)]*

1.44 Secondly, the entity must not be a trust that is covered by Subdivision 315-C. This Subdivision provides for the operation of a lost policy holders trust and this is described in paragraphs 1.68 to 1.95. *[Schedule 1, item 11, paragraph 315-30(b)]*

1.45 Thirdly, the capital gains or losses realised by the entity must be connected to the allocation or distribution of the private health insurer's accumulated mutual surplus and arise either prior to, or at the time, the surplus is allocated or distributed *[Schedule 1, item 11, subparagraphs 315-30(c)(ii) and (iii)]*.

- Similar to the first requirement, it will be a question of fact whether these requirements are satisfied. For example, gains or losses arising from the entity distributing the private health insurer's accumulated mutual surplus, on the insurer's behalf, will be connected to the allocation or distribution of the surplus and will arise at the time the surplus is distributed.
- There is no requirement that the surplus must be distributed in one transaction only for this relief to be available. For example, the private health insurer's conversion scheme may

provide for the insurer to distribute its surplus in two transactions. In this case, relief would be available for both transactions. However, if a private health insurer distributes its mutual surplus in the form of shares for example, then there will be cost base implications for the shares if they are not all issued at the same time. Further information about these cost base rules are set out in paragraph 1.47.

### **Example 1.7**

Further to Example 1.2.

Impressive Insurance's conversion scheme provides for the creation of a trust, the Impressive Trust, to hold a membership interest for each of the participating policy holders in Impressive Insurance. This trust is not a lost policy holders trust.

As part of Impressive Insurance's demutualisation, the trustee of the Impressive Trust makes a cash payment to each of the participating policy holders for the cancellation of their membership interest.

As the Impressive Trust was created for the purpose of participating in the demutualisation of Impressive Insurance, any capital gains or losses that arise when the trustee makes the cash payment and the membership interest is cancelled will be disregarded as these transactions occur at the time Impressive Insurance's surplus is distributed and are connected to its distribution.

### **Shares issued to participating policy holders**

1.46 A private health insurer may distribute its mutual surplus in the form of shares in the demutualised insurer or shares in another company. Alternatively, the mutual surplus may be distributed in the form of rights to acquire shares. These rights to acquire shares are separate from any rights in the private health insurer that a participating policy holder gives up under the demutualisation. (A private health insurer may also distribute its mutual surplus in the form of a cash payment.)

1.47 However, participating policy holders who receive shares or rights to acquire shares under their private health insurer's demutualisation will only receive a cost base for those shares or rights that reflects the market value of the insurer at the time of the demutualisation when the following requirements are satisfied [*Schedule 1, item 11, paragraph 315-85(1)(b)*].

- The shares or rights must be issued in connection with the participating policy holder having rights or assets in the demutualising private health insurer varied or cancelled [*Schedule 1, item 11, paragraph 315-85(1)(c)*].
- The shares or rights must be issued simultaneously to all participating policy holders and the trustee of the lost policy holders trust [*Schedule 1, item 11, subsection 315-85(3)*].
- Where shares are issued, the shares must be issued in the demutualised private health insurer or a company that acquires the insurer under the demutualisation and so wholly owns the insurer [*Schedule 1, item 11, subparagraphs 315-85(1)(a)(i) and (iii)*].
- Where rights to acquire shares are issued, the rights must allow only for shares in the demutualised private health insurer or a company that wholly owns the insurer to be acquired [*Schedule 1, item 11, subparagraphs 315-85(1)(a)(ii) and (iv)*]. In addition, the rights must not have an exercise price [*Schedule 1, item 11, subsection 315-85(2)*].

1.48 Participating policy holders include policy holders, former policy holders, other insured persons and former insured persons of the private health insurer who are entitled to receive an allocation of shares or rights under the insurer's demutualisation. [*Schedule 1, item 11, subsection 315-90(1)*]

1.49 In addition, an entity, such as a legal personal representative, who becomes entitled to receive an allocation of shares or rights under a private health insurer's demutualisation because of a participating policy holder's death, is also taken to be a participating policy holder, provided the shares or rights are issued to the entity in connection with the deceased participating policy holder having rights or assets in the demutualising private health insurer varied or cancelled. [*Schedule 1, item 11, subsection 315-90(2)*]

1.50 For certainty, the issue of these shares or rights to the participating policy holders will be transactions that arise under the private health insurer's demutualisation. Further dealings with the shares

or rights by the participating policy holders (such as selling the shares or exercising the rights) however, will not be transactions that arise under the private health insurer's demutualisation.

1.51 Specific CGT rules relating to the issue of rights to participating policy holders are set out in paragraphs 1.62 to 1.67.

#### ***Acquisition time of shares***

1.52 Participating policy holders who receive shares under the private health insurer's demutualisation will be taken, for CGT purposes, to have acquired each of the shares at their issue time. [*Schedule 1, item 11, subsections 315-80(2) and 315-210(3)*]

1.53 There are specific rules which apply when shares or rights are issued to a deceased participating policy holder's legal personal representative. These rules are set out in paragraph 1.100.

#### ***Cost base of shares***

1.54 The first element of the cost base (or reduced cost base) of each of the shares issued to a participating policy holder under the private health insurer's demutualisation is calculated as described in paragraphs 1.55 to 1.60.

#### ***Shares issued in the demutualised private health insurer***

1.55 The first element of the cost base (or reduced cost base) of each of the shares issued in the demutualised private health insurer will be equal to the share's market value on the day of issue. [*Schedule 1, item 11, subsection 315-80(1), subparagraph 315-85(1)(a)(i)*]

#### **Example 1.8**

Further to Examples 1.1, 1.3 and 1.6.

Healthy Health issues shares to its participating policy holders on 17 October 2007. The market value of Healthy Health's shares on the day of issue is \$7.

Philip is entitled to an allocation of 1,000 shares under Healthy Health's demutualisation and Jennelle is entitled to an allocation of 1,500 shares.

The first element of the cost base of the shares Philip and Jennelle receive is \$7.

As Healthy Health issued shares on 17 October 2007, Philip and Jennelle are both taken to have acquired their shares in Healthy Health on 17 October 2007.

*Shares issued in a holding company*

1.56 A private health insurer may distribute its mutual surplus in the form of shares in a holding company. This may involve:

- the demutualising private health insurer becoming a company limited by shares;
- the insurer issuing all its shares to a holding company; and
- the holding company issuing shares to all the participating policy holders.

1.57 The first element of the cost base (or reduced cost base) of each of the shares issued in a holding company will be equal to the share's market value on the day of issue, provided the holding company owns no other assets apart from shares in the demutualised private health insurer. *[Schedule 1, item 11, subsection 315-80(1) and subparagraph 315-85(1)(a)(iii)]*

*Shares issued in a holding company with other assets*

1.58 As part of a broader arrangement, a private health insurer may distribute its mutual surplus in the form of shares in another company. Such a company may own other assets in addition to the shares it acquires in the demutualised private health insurer.

1.59 The first element of the cost base (or reduced cost base) of each of the shares issued in this company is equal to the demutualising private health insurer's market value on the day shares in the other company are issued *divided* by the total number of shares issued in the company under the demutualisation and any shares that can be acquired by exercising rights that are issued under the demutualisation to acquire such shares. *[Schedule 1, item 11, subsections 315-210(1) and (2)]*

1.60 The number of shares that are issued under the demutualisation include shares that are issued to participating policy holders and shares issued to the trustee of the lost policy holders trust. The number of rights that are issued under the demutualisation includes rights issued to participating policy holders and rights issued to the trustee of the lost policy holders trust. *[Schedule 1, item 11, subsection 315-210(2)]*

***Non-CGT tax consequences***

1.61 No amount is to be included in a participating policy holder's assessable income because they received an allocation of shares or rights to acquire shares under a private health insurer's demutualisation. *[Schedule 1, item 11, paragraphs 315-310(1)(a) and (2)(a)]*

**Rights issued to participating policy holders**

1.62 Rather than issue shares in the demutualised private health insurer or a company that wholly owns the insurer, the insurer may instead distribute its accumulated mutual surplus in the form of rights to acquire such shares.

***Acquisition time of rights***

1.63 Participating policy holders who receive rights under their private health insurer's demutualisation will be taken, for CGT purposes, to have acquired each of the rights at their issue time. *[Schedule 1, item 11, subsections 315-80(2) and 315-210(3)]*

***Cost base of rights***

1.64 The first element of the cost base (or reduced cost base) of each of the rights issued to a participating policy holder under the private health insurer's demutualisation is calculated as described in paragraphs 1.65 to 1.67.

***Rights to acquire shares in the demutualised private health insurer***

1.65 The first element of the cost base (or reduced cost base) of each of the rights to acquire shares in the demutualised private health insurer will be equal to the right's market value on the day of issue. *[Schedule 1, item 11, subsection 315-80(1), subparagraph 315-85(1)(a)(ii)]*

***Rights to acquire shares in a holding company***

1.66 The first element of the cost base (or reduced cost base) of each of the rights to acquire shares in a holding company will be equal to the right's market value on the day of issue, provided the holding company owns no other assets apart from shares in the demutualised private health insurer. *[Schedule 1, item 11, subsection 315-80(1) and subparagraph 315-85(1)(a)(iv)]*



*Rights to acquire shares in a holding company with other assets*

1.67 The first element of the cost base (or reduced cost base) of each of the rights issued in this company is equal to the demutualising private health insurer's market value on the day the rights are issued, *divided* by the total number of shares that are issued under the demutualisation and any shares that can be acquired by exercising the rights issued under the demutualisation, with the result *multiplied* by the number of shares that can be acquired by the right. [*Schedule 1, item 11, subsections 315-210(1) and (2)*]

## Lost policy holders trust

*What is a lost policy holders trust?*

1.68 As part of a private health insurer's demutualisation, a trust may be set up to hold shares, or rights to acquire shares, for individuals who are entitled to receive a share of the insurer's surplus, but are unable to receive their allocation of shares or rights directly. The trust generally exists for a finite period to allow these individuals an opportunity to receive either:

- their shares or rights from the trust; or
- have the trustee, on their behalf, dispose of their shares or rights and distribute the proceeds to them.

1.69 It is usually a requirement of the demutualisation that eligible individuals must verify their details with their private health insurer and agree to receive their allocation of shares or rights. Often, there will be a significant number of eligible individuals who, for a variety of reasons, fail to verify their details and agree to receive their allocation of shares or rights. Shares or rights that would otherwise be allocated to these individuals may instead be held on trust.

1.70 In addition, shares or rights will typically not be issued to individuals who are registered at an overseas address (regardless of whether or not they are an Australian resident for tax purposes). Instead, the shares or rights that would otherwise be issued to these individuals are held on trust. This generally occurs because these individuals may only be permitted to receive shares after certain foreign regulatory conditions are satisfied.

1.71 **Lost policy holders** include unverified and overseas policy holders. In this context, the phrase lost policy holder includes individuals who may be former policy holders, other insured persons and former insured persons as well as policy holders of the private health insurer. The trust that holds these shares or rights is commonly known as a *lost*

*policy holders trust.* Lost policy holders who subsequently receive shares or rights from the trust will be referred to as *found policy holders*.

1.72 Broadly, Subdivision 315-C provides a legislative framework for shares and rights issued to the trustee of a lost policy holders trust, under a private health insurer's demutualisation, to be held for lost policy holders and subsequently transferred to them without adverse or advantageous CGT consequences for either the trustee or the lost policy holder. This is consistent with the policy of providing CGT relief for transactions that arise under a private health insurer's demutualisation to facilitate the distribution or allocation of the accumulated mutual surplus.

1.73 Other dealings with the shares or rights issued to the trustee of the lost policy holders trust will not be transactions that arise under the private health insurer's demutualisation. However, the framework allows for the issued shares or rights to be exchanged for other assets such as under a takeover or corporate reorganisation (provided any capital gains or losses can be rolled over into the replacement asset) and the replacement asset to be transferred to the found policy holder.

1.74 Specifically, Subdivision 315-C modifies the CGT outcomes that would ordinarily arise from the operation of the trust to:

- the trustee of the trust; and
- entities that receive shares or rights from the trust.

***Requirements for the rules to apply***

1.75 These rules will only be available when the following conditions are satisfied:

- the private health insurer's conversion scheme provides for the trust [*Schedule 1, item 11, paragraph 315-140(a)*];
- the trust exists solely for the purpose of holding shares and rights on behalf of individuals (these individuals, known as lost policy holders, may include unverified and overseas policy holders) [*Schedule 1, item 11, subparagraph 315-140(c)(i)*]. If the individual has died, then the trust must hold the shares and rights on behalf of the deceased individual's legal personal representative or a beneficiary of their estate [*Schedule 1, item 11, subparagraph 315-140(c)(ii)*]; and
- shares or rights are issued to the trustee of the trust under the private health insurer's demutualisation [*Schedule 1, item 11, paragraph 315-140(b)*].

### **Example 1.9**

Further to Example 1.1.

Healthy Health's conversion scheme that was included in its application to the Private Health Insurance Administration Council provides for a trust, the Healthy Lost Trust, which has the sole purpose of holding shares on behalf of unverified policy holders and policy holders who are registered at an overseas address. The Healthy Lost Trust deed provides that the Trust will cease after three years.

Under Healthy Health's demutualisation, the Healthy Lost Trust receives 100,000 shares in Healthy Health.

Subdivision 315-C will apply to the Healthy Lost Trust.

#### ***Trustee of the lost policy holders trust***

##### *Acquisition time of shares or rights*

1.76 The trustee of the lost policy holders trust who receives shares or rights will be taken, for CGT purposes, to have acquired the shares or rights at their issue time. *[Schedule 1, item 11, subsection 315-145(2)]*

##### *Cost base of shares or rights*

1.77 The first element of the cost base (or reduced cost base) of shares or rights issued to the trustee of a lost policy holders trust under the private health insurer's demutualisation is calculated as described in paragraphs 1.78 to 1.84.

##### Shares issued in the demutualised private health insurer

1.78 The first element of the cost base (or reduced cost base) of each of the shares that are issued in the demutualised private health insurer will be equal to the share's market value on the day of issue. *[Schedule 1, item 11, subsection 315-145(1) and subparagraph 315-85(1)(a)(i)]*

##### Shares issued in a holding company

1.79 The first element of the cost base (or reduced cost base) of each of the shares issued in a holding company will be equal to the share's market value on the day of issue, provided the holding company owns no other assets apart from shares in the demutualised private health insurer. *[Schedule 1, item 11, subsection 315-145(1) and subparagraph 315-85(1)(a)(iii)]*

Shares issued in a holding company that has other assets

1.80 The first element of the cost base (or reduced cost base) of each of the shares issued in this company is equal to the demutualising private health insurer's market value on the day shares in the other company are issued, *divided* by the total number of shares issued in the company under the demutualisation and any shares that can be acquired by exercising rights that are issued under the demutualisation to acquire such shares. [Schedule 1, item 11, subsections 315-145(1), 315-210(1) and (2)]

Rights to acquire shares in the demutualised private health insurer

1.81 The first element of the cost base (or reduced cost base) of each of the rights to acquire shares in the demutualised private health insurer will be equal to the right's market value on the day of issue. [Schedule 1, item 11, subsection 315-145(1) and subparagraph 315-85(1)(a)(ii)]

Rights to acquire shares in a holding company

1.82 The first element of the cost base (or reduced) cost base of each of the rights to acquire shares in a holding company will be equal to the right's market value on the day of issue, provided the holding company owns no other assets apart from shares in the demutualised private health insurer. [Schedule 1, item 11, subsection 315-145(1) and subparagraph 315-85(1)(a)(iv)]

Rights to acquire shares in a holding company that has other assets

1.83 The first element of the cost base (or reduced cost base) of each of the rights issued in this company is equal to the demutualising private health insurer's market value on the day the rights are issued in the company *divided* by the total number of shares that are issued under the demutualisation, and any shares that can be acquired by exercising the rights that are issued under the demutualisation, with the result *multiplied* by the number of shares that can be acquired by the right. [Schedule 1, item 11, subsections 315-145(1), 315-210(1) and (2)]

1.84 Paragraphs 1.55 to 1.60 and 1.64 to 1.67 provide further information about calculating these cost bases.

**Example 1.10**

Further to Example 1.9.

The trustee of the Healthy Lost Trust acquires 100,000 shares in Healthy Health on 17 October 2007. The first element of the cost base of these shares will be \$7.

*Transfer of assets to found policy holders*

1.85 Any capital gains or losses arising to the trustee from the transfer of assets in the lost policy holders trust to a found policy holder, on whose behalf the trustee was holding the asset will be disregarded. In addition, any capital gains or losses arising to the trustee from the found policy holder becoming absolutely entitled to assets in the lost policy holder will be disregarded. [Schedule 1, item 11, subsections 315-150(1) and (2)]

**Example 1.11**

Further to Example 1.10.

Mark is a policy holder of Healthy Health and under its demutualisation was entitled to receive 600 shares. However, because Mark moved house he was unaware of Healthy Health's demutualisation and his entitlement to shares. One year after Healthy Health demutualised Mark becomes aware of his entitlement to shares and contacts the trustee of the Healthy Lost Trust.

Any capital gains or losses arising to the trustee from Mark becoming absolutely entitled to 600 shares are disregarded.

**Example 1.12**

Further to Example 1.10.

Debbie is also a policy holder of Healthy Health, entitled to receive 900 shares when Healthy Health demutualised. Debbie was aware of Healthy Health's demutualisation, but she did not agree to receive her shares.

Eighteen months after demutualising, Healthy Health reorganises its affairs by interposing a holding company Healthy Holding Ltd (Healthy Holding) between itself and its shareholders. Under the scheme for reorganising its affairs, shareholders in Healthy Health receive two shares in Healthy Holding for each share they hold in Healthy Health. The trustee of the Healthy Lost Trust subsequently receives shares in Healthy Holding and, assuming the requirements of Subdivision 124-G of the ITAA 1997 are satisfied, a roll-over of any CGT liability that would have otherwise arisen from the exchange.

Six months later (two years after Healthy Health demutualised), Debbie realises that she had an entitlement to shares under Healthy Health's demutualisation and contacts the trustee of the Healthy Lost Trust.

Any capital gains or losses arising to the trustee from Debbie becoming absolutely entitled to 1,800 shares in Healthy Holding are disregarded.

1.86 The lost policy holders trust may also provide for the trustee to dispose of shares or rights in the trust held on behalf of a lost policy holder and give the net proceeds to the policy holder, on whose behalf the trustee was holding the shares or rights. This will typically occur when the lost policy holder is registered at an overseas address.

**Example 1.13**

Further to Example 1.10.

Nick is a policy holder in Healthy Health and is entitled to receive 300 shares under its demutualisation. However, Nick is registered at an overseas address although he remains an Australian resident for tax purposes. Instead of directly receiving his 300 shares when Healthy Health demutualises, Nick's shares are issued to the trustee of the Healthy Lost Trust to sell on his behalf. Six months after Healthy Health demutualises the trustee sells the 300 shares for \$10 each.

There are no CGT consequences to the trustee.

*Transfer of assets to a legal personal representative or beneficiary*

1.87 If the lost policy holder dies before receiving shares or rights from the lost policy holders trust then any capital gains or losses arising from the trustee transferring assets in the trust to the deceased lost policy holder's legal personal representative or a beneficiary of their estate will also be disregarded. *[Schedule 1, item 11, subsections 315-150(1) and (2)]*

*Other dealings with the assets*

1.88 Any capital gains arising from the trustee dealing with the shares or rights in the lost policy holders trust in any other way will, broadly, be assessed to the trustee under section 99A of the ITAA 1936. *[Schedule 1, item 11, section 315-155]*

1.89 Specifically, for the purposes of sections 97, 98A and 100 of the ITAA 1936, the share of the net income of the trust that is attributable to the capital gains arising from these transactions will not be included in the income of any beneficiaries of the trust. In addition, the trustee will not be assessed on this share of net income under section 98 of the ITAA 1936. *[Schedule 1, item 11, subsection 315-155(2)]*

### **Example 1.14**

Further to Example 1.12.

After three years, the remaining shares in the Healthy Lost Trust are acquired by Healthy Holding for \$5 each (the then current market value of shares in Healthy Holding).

Of the remaining shares in the Healthy Lost Trust, 600 were held on behalf of Bronwyn, a lost policy holder of Healthy Health.

The disposal of the remaining shares in the Healthy Lost Trust triggers a CGT taxing point and a subsequent capital gain for the trustee of the Healthy Lost Trust. Assuming the trustee incurred no other costs in relation to holding the shares, the trustee would realise a capital gain of \$1.50 on each share acquired (ie, \$5 capital proceeds *less* a \$3.50 cost base).

The share of the net income of the trust that is attributable to these capital gains will be assessed to the trustee under section 99A of the ITAA 1936.

### ***Found policy holders who receive shares or rights***

1.90 The found policy holder will be taken to have acquired each of the shares or rights at the same time as the trustee of the lost policy holders trust acquired them. [*Schedule 1, item 11, subsection 315-150(4)*]

1.91 The first element of the cost base (or reduced cost base) of each of the shares or rights that are transferred to a found policy holder from the lost policy holders trust will be equal to the asset's cost base in the trustee's hands. [*Schedule 1, item 11, subsection 315-150(3)*]

### **Example 1.15**

Further to Example 1.11.

Mark becomes absolutely entitled to 600 Healthy Health shares held in the Healthy Lost Trust. The first element of the cost base of each of his shares will be \$7.

As the trustee of the Healthy Lost Trust acquired the shares in Healthy Health on 17 October 2007, Mark will also be taken to have acquired his 600 shares in Healthy Health on 17 October 2007.

**Example 1.16**

Further to Example 1.12.

Debbie becomes absolutely entitled to 1,800 Healthy Holding shares in the Healthy Lost Trust. The first element of the cost base of each share that Debbie receives in Healthy Holding is \$3.50.

Debbie receives this cost base because the trustee exchanged shares in Healthy Health for shares in Healthy Holding and received a roll-over under Subdivision 124-G of the ITAA 1997.

Debbie is taken to have acquired her shares in Healthy Holding on 17 October 2007.

1.92 The trustee of the lost policy holders trust would be able to inform the found policy holder, when they receive their shares or rights from the trust, what the first element of the asset's cost base will be in the found policy holder's hands. The trustee would also be able to advise the found policy holder of the date that the trustee originally acquired the shares or rights as that date will be the same date that the lost policy holder will be taken to have acquired the assets.

**Example 1.17**

Further to Example 1.13.

Nick becomes absolutely entitled to 300 shares in Healthy Health. The first element of the cost base of his shares is \$7.

The trustee of the Healthy Lost Trust then sells the shares on behalf of Nick for \$10. Assuming no other costs are incurred, Nick realises a capital gain of \$3 on each share sold (ie, \$10 capital proceeds for each share less a cost base of \$7).

***Legal personal representatives and beneficiaries who receive shares or rights***

1.93 If a lost policy holder dies before receiving shares or rights from the lost policy holders trust then their legal personal representative or a beneficiary of their estate who receives the shares or rights will be taken to have acquired each of the shares or rights at the same time they were acquired by the trustee of the lost policy holders trust. *[Schedule 1, item 11, subsection 315-150(4)]*

1.94 The first element of the cost base (or reduced cost base) of each of the shares or rights that are transferred from the lost policy holders trust to a deceased individual's legal personal representative or a beneficiary of



their estate will be equal to the share or right's cost base in the trustee's hands. *[Schedule 1, item 11, subsection 315-150(3)]*

1.95 If a found policy holder dies after receiving shares or rights from the lost policy holders trust then, if they still held the shares or rights at the time of their death, Division 128 of the ITAA 1997 may apply to the shares or rights.

### **Shares and rights issued to legal personal representatives and beneficiaries of a deceased participating policy holder**

1.96 If a participating policy holder dies during the demutualisation process before receiving shares or rights, then those shares or rights will typically be issued to their legal personal representative.

1.97 An entity that becomes entitled, under a private health insurer's demutualisation, to receive shares or rights, because of a participating policy holder's death, is also taken to be a participating policy holder for the purposes of Division 315. *[Schedule 1, item 11, subsection 315-90(2)]*

1.98 Consequently, this entity who receives the shares or rights will:

- be taken, for CGT purposes, to have acquired each of the shares or rights at their issue time; and
- receive the same first element of the cost base for each of the shares or rights that the deceased participating policy holder would have received.

These rules are set out in paragraphs 1.52 to 1.67.

#### ***Consequences for legal personal representatives***

1.99 Any capital gains or losses arising to the legal personal representative from each of the shares or rights passing to a beneficiary of the deceased participating policy holder's estate will be disregarded. *[Schedule 1, item 11, subsections 315-260(1) and (2)]*

#### **Example 1.18**

Further to Example 1.1.

William is a participating policy holder in Healthy Health's demutualisation, who is entitled to receive 300 shares. Unfortunately, William dies before Healthy Health issues its shares, and so Healthy Health issues the shares to Gary, the legal personal representative of William's estate.

Consequently, Gary is taken to have acquired 300 shares in Healthy Health on 17 October 2007, with a cost base of \$7.

Under the terms of William's will, the 300 shares pass to Adele. Any capital gains arising to Gary from the 300 shares passing to Adele are disregarded.

### ***Consequences for beneficiaries***

1.100 A beneficiary of the deceased participating policy holder's estate who receives these shares or rights will be taken, for CGT purposes, to have acquired each of the shares or rights at the same time as the legal personal representative acquired them. *[Schedule 1, item 11, subsection 315-260(4)]*

1.101 The first element of the cost base (or reduced cost base) of each of the shares or rights that pass to a beneficiary of the deceased participating policy holder's estate will be equal to the share or right's cost base in the legal personal representative's hands. *[Schedule 1, item 11, subsection 315-260(3)]*

### **Example 1.19**

Further to Example 1.18.

Adele receives the 300 shares in Healthy Health on 12 March 2008. Their market value on this day is \$8.50 per share.

For CGT purposes, Adele is taken to have acquired the shares on 17 October 2007. Assuming Gary incurred no additional costs from the shares passing to Adele, the first element of the cost base of each share Adele receives is \$7.

## **Exemption to the share tainting rules**

### ***Shares issued in the private health insurer***

1.102 A private health insurer's share capital account will not become tainted if an amount is transferred to its share capital account in connection with its demutualisation. *[Schedule 1, item 10, subsection 197-37(1)]*

1.103 This exclusion will only apply to so much of the transferred amount that, together with any amounts that were previously transferred in connection with the demutualisation, does not exceed the total market value of the shares issued by the insurer to its participating policy holders and the trustee of the lost policy holders trust. *[Schedule 1, item 10, subsection 197-37(2)]*

### ***Shares issued in a holding company***

1.104 A company's share capital account will not become tainted if an amount is transferred to its account in connection with the demutualisation of a private health insurer and Division 315 applies to the insurer's demutualisation. *[Schedule 1, item 10, subsection 197-37(1)]*

1.105 If the company owns no other assets in addition to shares in the demutualised private health insurer, this exclusion will only apply to so much of the transferred amount that, together with any amounts that were previously transferred in connection with the demutualisation, does not exceed the total market value of the shares issued by the company to participating policy holders and the trustee of the lost policy holders trust. *[Schedule 1, item 10, subsection 197-37(2) and paragraph 197-37(3)(a)]*

1.106 If the company owns other assets in addition to shares in the demutualised private health insurer, this exclusion will only apply to so much of the transferred amount that, together with any amounts that were previously transferred in connection with the demutualisation, does not exceed the sum of the values calculated under subsection 315-160(2) of the ITAA 1997 for each share issued to participating policy holders and the trustee of the lost policy holders trust. *[Schedule 1, item 10, subsection 197-37(2) and paragraph 197-37(3)(b)]*

### **Cash payment made to participating policy holders**

1.107 Rather than distribute its mutual surplus in the form of shares, a private health insurer may distribute its mutual surplus in the form of a cash payment.

1.108 A policy holder, former policy holder, other insured person or former insured person of a private health insurer who receives a cash payment under their insurer's demutualisation will not need to include any amount in their assessable income as a result of receiving that payment, provided the payment is made in connection with the individual having rights or other assets in the demutualising insurer varied or cancelled. *[Schedule 1, item 11, paragraphs 315-310(1)(b) and (2)(a)]*

#### **Example 1.20**

Further to Example 1.4.

John does not need to include the \$500 he receives under Impressive Insurance's demutualisation in his assessable income.

1.109 Similarly if an entity receives the cash payment because of the death of a policy holder, former policy holder, other insured person or

former insured person of the private health insurer, then that entity will not need to include an amount in their assessable income from that payment. *[Schedule 1, item 11, paragraphs 315-310(1)(b) and (2)(b)]*

## **Application and transitional provisions**

1.110 These amendments will commence on Royal Assent.

1.111 These amendments apply to demutualisations that occur on or after 1 July 2007. This will ensure that private health insurers that demutualise prior to these amendments receiving Royal Assent may qualify for the relief. *[Schedule 1, item 12]*

## **Consequential amendments**

1.112 Amendments will be made to exclude private health insurers from the generic CGT demutualisation relief contained in Schedule 2H to the ITAA 1936. *[Schedule 1, items 1, 2, 4 and 6]*

1.113 An amendment will be made to exclude Subdivision 126-E of the ITAA 1997 from applying in relation to a demutualisation that Division 315 of the ITAA 1997 applies to. *[Schedule 1, items 9 and 11, section 315-160]*

1.114 A consequential amendment will be made to section 118-1 of the ITAA 1997 to direct readers to the CGT exemptions in Division 315. Division 118 of the ITAA 1997 sets out various exemptions for capital gains and losses. *[Schedule 1, item 8]*

1.115 Consequential amendments will be made to the guide material in Subdivision 109-B of the ITAA 1997 to direct readers to the modified acquisition rules in Division 315. *[Schedule 1, item 5]*

1.116 Consequential amendments will also be made to the guide material in Subdivision 112-B of the ITAA 1997 to direct readers to the modified cost base rules in Division 315. *[Schedule 1, item 7]*

1.117 A consequential amendment will be made to section 11-55 of the ITAA 1997 to direct readers to the non-assessable non-exempt income provisions in Division 315. *[Schedule 1, item 3]*

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## **Chapter 2**

### ***Family trusts***

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#### **Outline of chapter**

2.1 Schedule 2 to this Bill amends Schedule 2F to the *Income Tax Assessment Act 1936* (ITAA 1936) (the trust loss measures) to change the definition of ‘family’ to limit lineal descendants to children or grandchildren of the test individual or of the test individual’s spouse. These amendments also remove the ability for family trusts to make a variation to the test individual specified in a family trust election (other than specifically in relation to the 2007-08 income year or a marriage breakdown).

2.2 All legislative references in this chapter are made to Schedule 2F to the ITAA 1936 unless otherwise specified.

#### **Context of amendments**

2.3 As a pre-election commitment, the Government announced that it would reverse the family trust changes made by the previous government in the *Tax Laws Amendment (2007 Measures No. 4) Act 2007*. However, as some of the amendments introduced in 2007 were largely technical improvements to the trust loss measures, the Government decided not to reverse all of the changes. Instead, only two of the changes will be reversed.

2.4 The trust loss measures protect the integrity of the income tax system by preventing the tax benefits arising from the recoupment of a trust’s tax losses and bad debt deductions being transferred to persons who did not bear the economic loss or bad debt when it was incurred. In order to achieve this outcome the trust loss measures examine whether there has been a change in the underlying ownership or control of a trust or whether certain schemes have been entered into in order to take advantage of a trust’s losses.

2.5 Family trusts are considered to be an ‘excepted trust’ for the purposes of the trust loss measures.

2.6 A trust becomes a family trust if it makes a family trust election in respect of an individual. By specifying the individual (the test

individual), the 'family group' is established to which distributions can be made without penalty tax. Any distribution of, or conferral of present entitlement to, income or capital of the family trust or of an entity that has made an interposed entity election, to a person who is outside of the family group is subject to family trust distribution tax. This is currently imposed at the rate of 46.5 per cent.

2.7 Family trust distribution tax is imposed by the *Family Trust Distribution Tax (Primary Liability) Act 1998* and the *Family Trust Distribution Tax (Secondary Liability) Act 1998*.

2.8 The 2007 amendments expanded the definition of 'family' to include any lineal descendant of a nephew, niece or grandchild of the test individual or the test individual's spouse.

2.9 In 2007, amendments were also made to the trust loss measures to allow a one-off variation to the test individual specified in a family trust election. A variation was available where the new test individual was a member of the original test individual's family at the election commencement time. However, the variation was not available if there had been a conferral of present entitlement to, or distribution of, income or capital of the trust (or of an entity for which an interposed entity election had been made in relation to the trust) outside the new test individual's family group during the period in which the election had been in force.

## **Summary of new law**

2.10 These amendments will change the definition of 'family' in the trust loss measures to limit lineal descendants to children or grandchildren of the test individual or of the test individual's spouse. This change will have effect from the 2008-09 income year. This definition is consistent with the definition of 'family' that applied prior to the 2007 amendments.

2.11 These amendments also prevent family trusts from making a one-off variation to the test individual specified in a family trust election (other than in relation to a marriage breakdown) from the 2008-09 income year. As a transitional measure effective from the 2007-08 income year, the amendments allow family trusts that meet the conditions specified in subsection 272-80(5A), to make a one-off variation valid for only the 2007-08 income year. A family trust that makes such a variation will revert back to the test individual specified in the original family trust election from the 2008-09 income year.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
The definition of 'family' does not include any lineal descendants of nephews, nieces or grandchildren of the test individual or the test individual's spouse.	The definition of 'family' includes any lineal descendant of a nephew, niece or child of the test individual or the test individual's spouse.
<p>From the 2008-09 income year the test individual specified in a family trust election may not be varied to a new test individual, other than in relation to a marriage breakdown.</p> <p>As a transitional measure the test individual specified in a family trust election may be varied to a new test individual (subject to the conditions set out in the current law) but it will only have effect for the 2007-08 income year.</p> <p>A family trust that makes such a variation will revert back to the test individual specified in the original family trust election from the 2008-09 income year.</p>	The test individual specified in a family trust election may be varied, once only, where the new test individual was a member of the original test individual's family provided that no conferrals of present entitlement to (or distributions of) income or capital of the trust (or an interposed entity) have been made outside the new test individual's family group.

## Detailed explanation of new law

### Definition of 'family'

2.12 Amendments are made to the definition of 'family' to limit lineal descendants to children or grandchildren of the test individual or of the test individual's spouse. This definition is consistent with the definition of 'family' that applied prior to the 2007 amendments.  
*[Schedule 2, item 5, subsections 272-95(1) and (3)]*

### Variation of a test individual

2.13 Under these amendments, a test individual specified in a family trust election cannot be varied, other than specifically in relation to the 2007-08 income year or a marriage breakdown.  
*[Schedule 2, item 1, subsection 272-80(5A)]*

2.14 A variation made under subsection 272-80(5A) can only be made once and will only be valid for the 2007-08 income year. A family

trust that has made a variation under subsection 272-80(5A) will revert back to the test individual specified in the original family trust election from the 2008-09 income year. [*Schedule 2, item 2, subsection 272-80(5B)*]

2.15 The current law allows a variation to be made in the trust's return for the income year from which the variation is to be effective. However, if the trustee is not required to lodge a return, the variation needs to be given to the Commissioner of Taxation by the end of two months after the end of the income year specified in the variation. These amendments will ensure that no variations can be made, other than specifically in relation to the 2007-08 income year or a marriage breakdown.

### **Example 2.21**

The trustee of the Bennetts trust has made a family trust election pursuant to section 272-80 of the trust loss measures and has specified Peter as the test individual.

The trustee instead wanted to make the family trust election so that Aaron, Peter's child, was the test individual of the trust. The trustee of the Bennetts trust resolves to make a one-off variation to the family trust election to specify Aaron as the test individual for the 2007-08 income year and later income years. Under the old law, the trustee would have been able to make the variation in the Bennetts' trust return for the 2007-08 income year and later income years (assuming the conditions to do so were met).

As a variation of the test individual of a trust cannot now be made other than specifically in relation to the 2007-08 income year or a marriage breakdown, the trustee will only be able to make a one-off variation to specify Aaron as the test individual of the trust for the 2007-08 income year. Peter who was the original test individual specified by the trustee will become the test individual again for the 2008-09 income year and later income years.

2.16 The amendments alter the definition of 'specified individual' in section 272-140 of the trust loss measures. This provision deals with the situation when a test individual for a family trust is varied. A reference in the trust loss measures to a person specified in a family trust election is now a reference to:

- if the family trust election has been varied under subsection 272-80(5A):
  - in respect of the 2007-08 income year — the new individual specified in the variation; or



- in respect of later income years — the individual originally specified in the election; or
- if the family trust election has been varied under subsection 272-80(5C) (because of a marriage breakdown) — the person most recently specified under that subsection.

*[Schedule 2, item 3, paragraph 272-140(2)(b)]*

2.17 If an interposed entity election has been made or is made in relation to a family trust for the 2007-08 income year, the test individual for the purpose of the interposed entity election will be the new individual specified in the variation made under subsection 272-80(5A). For the 2008-09 income year and later income years the test individual for the purpose of the interposed entity election will revert back to the test individual specified in the original family trust election.

## **Application and transitional provisions**

2.18 The amendments in Part 1 of Schedule 2 apply to the 2007-08 income year, and later years. *[Schedule 2, item 4]*

2.19 The amendments in Part 2 of Schedule 2 apply to the 2008-09 income year, and later income years. *[Schedule 2, item 8]*



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# **C**hapter 3

## **Minor amendments**

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### **Outline of chapter**

3.1 Schedule 3 to this Bill makes various minor amendments to the taxation laws.

### **Context of amendments**

3.2 Tax legislation is complex and wide-ranging. Therefore, errors can occur. Even minor errors can detract from the readability of the taxation laws and can confuse or mislead readers, so these errors need correcting.

3.3 These minor amendments are part of the Government's commitment to the care and maintenance of the taxation laws.

### **Summary of new law**

3.4 These amendments deal with issues such as:

- incorrect terminology;
- grammatical or punctuation errors;
- missing asterisks from defined terms;
- inoperative material;
- ambiguities in the law; and
- adding non-operative notes to help readers navigate their way through law.

3.5 These amendments apply from the date of Royal Assent unless otherwise stated. Where a retrospective date is stated such retrospectivity does not disadvantage taxpayers.

## Detailed explanation of new law

**Table 3.1: Amendments to the *Fringe Benefits Tax Assessment Act 1986***

<i>Provision being amended</i>	<i>What the amendment does</i>
135T(1)(a) and (h)	<p>Fringe benefits tax applies to the state and territory bodies defined in subsection 135T(1). That definition relies on listed State and Territory Acts. Two of those Acts have been replaced by new Acts. The amendment replaces the existing references with references to the new Acts. [Schedule 3, items 2 and 3, paragraphs 135T(1)(a) and (h)]</p> <p>These amendments apply to the first year of tax starting after Royal Assent. [Schedule 3, item 4]</p>

**Table 3.2: Amendments to the *Income Tax Assessment Act 1936***

<i>Provision being amended</i>	<i>What the amendment does</i>
6(2), 6(2AA) and 6(2A)	<p>Repeals some inoperative subsections.</p> <p>Subsections 6(2) and 6(2A) provide rules about ‘years of income’ that are already incorporated in the definition of ‘income year’ in the <i>Income Tax Assessment Act 1997</i> (ITAA 1997) and are therefore redundant. [Schedule 3, items 5 and 9, subsections 6(2) and 6(2A)]</p> <p>Subsection 6(2AA) is amended as a consequence. [Schedule 3, item 8, subsection 6(2AA)]</p>
16(4AA)	<p>Repeals the definition of ‘research and development activities’. Subsection 16(4AA) defines the expression for the purposes of section 16, but section 16 no longer uses the expression. Therefore, the subsection is inoperative. [Schedule 3, item 8, subsection 16(4AA)]</p>
23E(3)	<p>Replaces a reference to the <i>Commonwealth Inscribed Stock Act 1911-1946</i> with one to the <i>Commonwealth Inscribed Stock Act 1911</i> to conform to the modern way of citing Acts. [Schedule 3, item 11, subsection 23E(3)]</p>

<i>Provision being amended</i>	<i>What the amendment does</i>
23L(1A) 51AH(1)(c)	<p>Replaces references to section 15-75 with the correct reference to section 15-70.</p> <p>Section 15-70 is a re-write of former paragraph 26(eaa) of the <i>Income Tax Assessment Act 1936</i> (ITAA 1936). When references to paragraph 26(eaa) were replaced by references to the rewritten provision, a drafting error incorrectly referred to section 15-75 instead. <i>[Schedule 3, items 10 and 13, subsection 23L(1A) and paragraph 51AH(1)(c)]</i></p> <p>The amendments apply retrospectively to when the error occurred. <i>[Schedule 3, items 11 and 14]</i></p>
47A(18)(d)(ii)(G)	<p>Replaces an incorrect reference to ‘ultimate beneficiary non-disclosure tax’ with the correct reference to ‘trustee beneficiary non-disclosure tax’. This reflects a change in terminology that was made with the 2007 amendments to the reporting requirements for trustees of closely held trusts. <i>[Schedule 3, item 12, sub-subparagraph 47A(18)(d)(ii)(G)]</i></p>
73A(6)	<p>Formalises the transfer of responsibility for approving an institution, association or organization to be an approved research institute from the Secretary to the Department of Health and Ageing, to the Chief Executive Officer of the National Health and Medical Research Council. <i>[Schedule 3, items 15 and 16, subsection 73A(6)]</i></p> <p>Gifts to an approved research institute are deductible (see item 3.1.1 in the table in subsection 30-40(1) of the ITAA 1997), so receiving approved research institute status is important to the many health and medical research institutes that raise funds from the private sector to support their research.</p> <p>Currently, the Secretary of the Department of Health and Ageing has statutory responsibility for approving universities, colleges, institutes, associations and organisations to be an approved research institute. In practice, that role was performed by the relevant Assistant Secretary when the National Health and Medical Research Council was part of that Department. When the Council became a separate statutory agency in 2006, it was appropriate for that role to be formally transferred to the Chief Executive Officer of the National Health and Medical Research Council but the necessary amendments were overlooked. The current amendments correct that oversight.</p>

<i>Provision being amended</i>	<i>What the amendment does</i>
	<p>The Secretary to the Department for Innovation, Industry, Science and Research also has responsibility for approving research institutes as a result of a substituted reference order made by the Governor-General on 30 May 2008.</p> <p>The current amendments align the text of the law with that legal position. <i>[Schedule 3, items 15 and 17, subsection 73A(6)]</i></p> <p>The Commonwealth Scientific and Industrial Research Organisation is empowered to approve a body as an approved research institute under the law and that role continues.</p> <p>A transitional arrangement provides for the continuation of any approval of an approved research institute given before the amendments commence. <i>[Schedule 3, item 18]</i></p>
109Y(2) (paragraphs (a) and (b) of the definition of repayments of non-commercial loans)	Fixes a punctuation error in the definition of ‘repayments of non-commercial loans’. <i>[Schedule 3, item 20, subsection 109Y(2), paragraphs (a) and (b) of the definition of ‘repayments of non-commercial loans’]</i>
128B(3)(b) 202EE(1)(d)	<p>Repeals the redundant paragraph 128(3)(b). That paragraph deals with income that is exempt from income tax by virtue of subsection 23C(2), which was repealed in 2006. <i>[Schedule 3, item 23, paragraph 128B(3)(b)]</i></p> <p>A reference to 128B(3)(b) in paragraph 202EE(1)(d) is removed as a consequence. <i>[Schedule 3, item 36, paragraph 202EE(1)(d)]</i></p>
159H(1) 159H(2)	Repeals an inoperative provision that only applied to the 1975-76 income year, and renumbers subsection 159H(1) as a consequence. <i>[Schedule 3, items 27 and 28, subsections 159H(1) and (2)]</i>
251U(1)(d) 251U(1A) 251U(1B)	<p>Rewrites the provisions that exclude residents of certain external territories from the Medicare levy.</p> <p>The net effect of the current law is that only residents of Norfolk Island are excluded from the Medicare levy under paragraph 251U(1)(d). However, the provisions currently contain residual references to residents of Christmas Island and Cocos (Keeling) Islands, who became subject to the Medicare levy in 1985 and 1991 respectively. <i>[Schedule 3, items 37 and 38, paragraph 251U(1)(d), subsections 251U(1A) and 251U(1B)]</i></p>
57-25(4)(la) of Schedule 2D	Removes a meaningless ‘and’ at the end of a list of provisions. <i>[Schedule 3, item 39, paragraph 57-25(4)(la) of Schedule 2D]</i>

**Table 3.3: Amendments to the Income Tax Assessment Act 1997**

<i>Provision being amended</i>	<i>What the amendment does</i>
1-7	Inserts a provision to make explicit that the Commissioner of Taxation (Commissioner) has the general administration of the ITAA 1997. Currently, it is not easy for readers to work out who has the general administration of that Act, as the power is contained in the ITAA 1936. <i>[Schedule 3, item 44, section 1-7]</i>
3-10(1)(b) 30-230(1) (note) 30-230(6) 58-65(3)(a) 61-405(a) 165-115A(1C)(a) 165-115E(4)(a) 165-115U(1D)(a) 165-235(2) 180-5(2) 180-10(7) 180-20(5) 210-115(2)(a) 292-100(2)(b)(i) 292-100 (7)(b)(i) 320-30(2)(a) 820-960(2)(a) 974-110(1A)(d)(i) and (ii)	Corrects references to ‘return’, ‘return of income’ and ‘tax return’ so that they all refer to an ‘income tax return’, which is the term defined in the ITAA 1997. <i>[Schedule 3, items 45, 64, 65, 84, 119 to 122, 124, 136, 137, 158, 161, 162 and 189, subparagraphs 292-100(2)(b)(i) and (7)(b)(i) and 974-110(1A)(d)(i) and (ii), paragraphs 3-10(1)(b), 61-405(a), 210-115(2)(a), 320-30(2)(a) and 820-960(2)(a) and subsections 30-230(1) (note), 30-230(6), 165-235(2), 180-5(2), 180-10(7) and 180-20(5)]</i>  Asterisks marking the term as a defined term are added where necessary. <i>[Schedule 3, items 65, 119 to 122, 124, 136, 137, 158, 161 and 189, subparagraphs 292-100(2)(b)(i) and (7)(b)(i) and 974-110(1A)(d)(i), paragraphs 58-65(3)(a), 210-115(2)(a), 320-30(2)(a), 165-115A(1C)(a), 165-115E(4)(a), 165-115U(1D)(a) and 820-960(2)(a) and subsections 30-230(6), 165-235(2), 180-5(2), 180-10(7) and 180-20(5)]</i>
4-10(1)	Replaces a definition of ‘financial year’ with an asterisked reference to the existing dictionary definition of that expression. This reduces the risk of confusing readers by defining the same expression several times. <i>[Schedule 3, item 46, subsection 4-10(1)]</i>
9-1, items 12 and 13 in the table	Corrects the format of provisions referred to in the table. The table uses bolding to distinguish between provisions in the ITAA 1997 and <b>provisions</b> in the ITAA 1936. The provisions being corrected are in the ITAA 1936 but are not bolded. <i>[Schedule 3, items 47 and 48, section 9-1 (items 12 and 13 in the table)]</i>

<i>Provision being amended</i>	<i>What the amendment does</i>
<p><u>ITAA 1997</u></p> <p>11-15 (<i>family assistance and social security or like payments</i>)</p> <p>13-1 (<i>farm household support and social security and other benefit payments</i>)</p> <p>11-15 (<i>welfare</i>)</p> <p>51-30 (items 5.2 and 5.3 in the table)</p> <p>52-10 (items 7.1 and 7.2 in the table)</p> <p>52-15 (item 1 in the table)</p> <p>52-25(1) (in the table)</p> <p>52-40 (item 7 in the table)</p> <p>52-65(1)(b) and (ba)</p> <p>52-65(1) (note)</p> <p>52-65(1B) and (1C)</p> <p>52-75 (table items 1A and 1B)</p> <p>52-150(1)</p> <p>53-10 (item 4A in the table)</p> <p>53-15(1) and (2)</p> <p>53-25</p> <p>995-1(1) ('supplementary amount', item 2 in the table)</p> <p><u>ITAA 1936</u></p> <p>159J(6) (paragraphs (ac), (adaa), (adab), (adac), (adad) and (ae) of 'separate net income')</p> <p>160AAA(1) (paragraph (db) of 'rebtable benefit')</p>	<p>Removes inoperative references to Government payments that are no longer paid, or that will stop being paid before the amendment is made. [Schedule 3, items 29 to 35, 49, 50, 53 to 55, 59 to 61, 70 to 83 and 173, paragraphs 52-65(1)(b) and (ba), subsections 52-25(1) (table), 52-65(1) (note), 52-65(1B) and (1C), 52-150(1), 53-15(1) and (2) and 995-1(1) ('supplementary amount', item 2 in the table) and sections 11-15 ('family assistance', 'social security or like payments' and 'welfare'), 13-1 ('farm household support' and 'social security and other benefit payments'), 51-30 (items 5.2 and 5.3 in the table), 52-10 (items 7.1 and 7.2 in the table), 52-15 (item 1 in the table), 52-40 (item 7 in the table), 52-75 (items 1A and 1B in the table), 53-10 (item 4A in the table) and 53-25 of the ITAA 1997 and subsections 159J(6) (paragraphs (ac), (adaa), (adab), (adac), (adad) and (ae) of 'separate net income') and 160AAA(1) (paragraph (db) of 'rebtable benefit') of the ITAA 1936]</p>
<p>11-15 ('education...' entry under <i>foreign aspects of income taxation</i>)</p>	<p>Corrects the misspelling of 'representative'. [Schedule 3, item 51, section 11-15 ('education ...' entry under 'foreign aspects of income taxation')]</p>
<p>11-15 ('non-resident' entry under <i>foreign aspects of income taxation</i>)</p>	<p>Removes the reference to paragraph 23(r). That paragraph was repealed in 2006, so the entry is inoperative. [Schedule 3, item 52, section 11-15 ('non-resident' entry under 'foreign aspects of income taxation')]</p>
<p>11-15 (<i>social security or like payments</i>)</p>	<p>Rewrites the social security payments entry in the non-operative list of exempt income amounts. This makes it clearer that the payments are amounts <i>received</i> by the taxpayer, not <i>paid</i> by the taxpayer. [Schedule 3, item 56, section 11-15 ('social security payments' entry under 'social security or like payments')]</p>



<i>Provision being amended</i>	<i>What the amendment does</i>
11-15 ( <i>social security or like payments and welfare</i> )	Adds cross-references from the social security entry to the welfare entry in the list of amounts of exempt income and vice versa. This increases the likelihood of readers finding the item they are looking for. [ <i>Schedule 3, items 57 and 59, section 11-15 ('social security or like payments' and 'welfare')</i> ]
11-15 ( <i>vice regal</i> )	Deletes references to the provision that made the official salaries of the Governor-General and the State Governors exempt income. That provision (and the exemption it provided) was repealed in 2001, so the references to it are inoperative. [ <i>Schedule 3, item 58, section 11-15 ('vice regal')</i> ]
20-30(1) (item 1.8 in the table)	Replaces the reference to section 25-80 with a reference to 'the former' section 25-80, as it was repealed in 2006. [ <i>Schedule 3, item 62, subsection 20-30(1) (item 1.8 in the table)</i> ]
<u>ITAA 1997</u> 27-10(3)(a) 995-1(1) ( <i>registration</i> )  <u>TAA 1953</u> 110-50(2) of Schedule 1 to the TAA 1953	<p>Removes the definition of 'registration' from the dictionary. 'Registration' is defined in the ITAA 1997 as being registration for the purposes of the goods and services tax (GST) law. There are many uses of the word in the ITAA 1997 that clearly refer to something other than GST registration. To reduce the risk of confusion, the ITAA 1997 aims to define each term in only one way and to only use it in the defined way. Therefore, the amendment removes the definition so that 'registration' will take its ordinary meaning. Provisions intended to refer to GST registration are amended to make that intention clear. [<i>Schedule 3, items 63 and 170, paragraph 27-10(3)(a) and subsection 995-1(1) ('registration')</i>]</p> <p>Since the word is no longer defined, asterisks that mark it as a defined term are removed. [<i>Schedule 3, items 63 and 181, paragraph 27-10(3)(a) of the ITAA 1997 and subsection 110-50(2) of Schedule 1 to the TAA 1953 (items 3 to 7, 42 to 7, 50 and 54 in the table)</i>]</p>

<i>Provision being amended</i>	<i>What the amendment does</i>
30-15(2) (items 1 and 2 in the table) 104-10(4) 104-15(3) 104-20(3) 104-25(3) 104-30(3) 104-35(3) 104-40(3) 104-45(3) 104-55(3) 104-60(3) 104-110(3) 104-115(3) 104-130(3) 104-155(3) 116-45(1) 116-50(1) 149-15(4) and (5) 166-3(2)(b)(ii) 240-20(2)(b)	Removes excess asterisking from defined terms. In the ITAA 1997, the protocol is to mark defined terms with an asterisk but to do so only for the first occurrence of the term in each subsection. <i>[Schedule 3, item 189, subparagraph 166-3(2)(b)(ii), paragraph 240-20(2)(b), subsections 30-15(2) (items 1 and 2 in the table), 104-10(4), 104-15(3), 104-20(3), 104-25(3), 104-30(3), 104-35(3), 104-40(3), 104-45(3), 104-55(3), 104-60(3), 104-110(3), 104-115(3), 104-130(3), 104-155(3), 116-45(1), 116-50(1) and 149-15(4) and (5)]</i>
30-255 30-270(4) 30-280(1) 30-285(1)	Replaces the expression ‘Secretary to the Department of Environment, Sport and Territories’ with the equivalent defined expression ‘Environment Secretary’. <i>[Schedule 3, items 66 to 69, subsections 30-270(4), 30-280(1) and 30-285(1) and section 30-255]</i>
65-10 208-45(4)(b) 375-805(3) and (5) 717-230(3) 717-265(4) 960-120(1) (item 2 in the table)	Updates uses of the older term, ‘year of income’ to the modern equivalent ‘income year’. <i>[Schedule 3, items 85, 123, 138, 149, 150 and 159, paragraph 208-45(4)(b), subsections 375-805(3) and (5), 717-230(3), 717-265(4) and 960-120(1) (item 2 in the table) and section 65-10]</i>
102-20 (notes 3 to 5)	Inserts a non-operative note that points readers to the possibility of their making a capital gain or loss as a result of a CGT event happening to another entity. Some existing notes are renumbered as a consequence. <i>[Schedule 3, item 86, section 102-20 (notes 3 to 5)]</i> . This amendment makes it easier for readers to find the provisions that are relevant for them.

<i>Provision being amended</i>	<i>What the amendment does</i>
109-60 (table) 112-97 (items 24 to 24F in the table)	<p>Inserts additional items in the non-operative tables that list CGT acquisition and cost base modification rules that can be found outside the CGT provisions.</p> <p>These lists are intended to help readers find all the provisions relevant for them but they do not include references to CGT acquisition and cost base modification rules in the consolidation provisions. The amendments add those references. <i>[Schedule 3, items 87 and 93, sections 109-60 (table) and 112-97 (items 24 to 24F in the table)]</i></p> <p>The entries in the table in section 109-60 are also reordered to put them into numerical order. <i>[Schedule 3, item 87, section 109-60 (table)]</i></p> <p>That reordered table incorporates items proposed to be added by the First Home Saver Accounts (Consequential Amendments) Bill 2008. Therefore, the amendment that updates and reorders that table commences only after that Bill commences. <i>[Schedule 3, Clause 2, item 4 in the table]</i></p>
110-40(1) (notes) 110-43(1) (note)	Removes inoperative references to subsection 110-53(3), which was repealed in 2000. <i>[Schedule 3, items 88 and 89, subsections 110-40(1) (notes) and 110-43(1) (note)]</i>
110-53 (heading)	<p>Updates a section heading.</p> <p>Since the repeal of subsection (3) in 2000, section 110-53 no longer provides an exception to section 110-40 but it does provide one to section 110-45. Therefore, the amendment replaces the reference in the section heading to section 110-40 with one to section 110-45. <i>[Schedule 3, item 90, section 110-53 (heading)]</i></p>
112-87 (items 1 and 2 in the table)	Updates references to provisions that were relocated in 2006. <i>[Schedule 3, items 91 and 92, section 112-87 (items 1 and 2 in the table)]</i>
112-110 (note 3) 112-145 (note 2) 122-70(2) (note 2) 122-200(1) (note 2) 124-10(3) (note 5) 126-15(4) (note) 126-60(2) (note 2)	Replaces mistaken references to ‘section 125-175’ (which does not exist) with the correct references to ‘section 125-170’. <i>[Schedule 3, items 94, 96, 99 to 101, 108 and 109, subsections 122-70(2) (note 2), 122-200(1) (note 2), 124-10(3) (note 5), 126-15(4) (note), and 126-60(2) (note 2) and sections 112-110 (note 3) and 112-45 (note 2)]</i>
112-115 (item 6 in the table)	Replaces a mistaken reference to ‘Subdivision 124-CD’ (which does not exist) with the correct reference to ‘Subdivision 124-D’. <i>[Schedule 3, item 95, section 112-115 (item 6 in the table)]</i>

<i>Provision being amended</i>	<i>What the amendment does</i>
115-280(3) (formula) 396-15(2) (formula) 396-25(1) (formula) 703-15(2) (items 1 and 2 in the table) 705-65(5A)(d) 705-75(1) (formula) 705-75(5)(d) 705-110(1) 707-310(3A)(c) 719-10(1)( table) 719-20(1) (item 2 in the table) 802-30(4)(c) (formula) 802-40 (formula) 995-1(1) ( <i>general company tax rate</i> )	Removes the defined expression ‘general company tax rate’. The ITAA 1997 has two defined expressions that identify the tax rate for companies — ‘general company tax rate’ and ‘corporate tax rate’. As they do the same job, one of them is redundant. Repealing redundant definitions reduces the risk of confusing readers. <i>[Schedule 3, item 169, subsection 995-1(1) (‘general company tax rate’)]</i>  References to ‘general company tax rate’ are replaced with references to ‘corporate tax rate’. <i>[Schedule 3, items 97, 139 to 145, 148, 151, 152, 156 and 157, paragraphs 705-65(5A)(d), 705-75(5)(d), 707-310(3A)(c), 802-30(4)(c), subsections 115-280(3), 396-15(2), 396-25(1), 703-15(2) (items 1 and 2 in the table), 705-75(1), 705-110(1), 719-10(1) (table), 719-20(1) (item 2 in the table) and section 802-40]</i>
<u>ITAA 1997</u> 115-290(1)(b) 124-780(6) (note 2) 124-781(5) (note)  <u>ITAA 1936</u> 109UC(4) (paragraph (b) of <i>excluded trust</i> ) 121AQ ( <i>first trading day price and listed</i> ) 139DSA 139DSH(b) 139GCD(1)(d) 326-15(1) in Schedule 2H 326-130(2) in Schedule 2H ( <i>first trading day of demutualisation shares</i> ) Schedule 3	Updates references to the Australian Stock Exchange, which changed its name to ASX Limited in December 2006. <i>[Schedule 3, items 19, 21, 22, 24 to 26, 40, 41, 43, 98, 103 and 105, paragraph 115-290(1)(b) and subsections 124-780(6) (note 2) and 124-781(5) (note) of the ITAA 1997 and paragraphs 139DSH(b) and 139GCD(1)(d), subsections 109UC(4) (paragraph (b) of ‘excluded trust’), 326-15(1) in Schedule 2H and 326-130(2) in Schedule 2H (‘first trading day of demutualisation shares’), sections 121AQ (‘first trading day of demutualisation shares’) and 139DSA and Schedule 3 to the ITAA 1936]</i>
124-780(1) (note 2) 124-781(1) (note 2) 124-790(1)	Corrects grammatical errors by replacing the word ‘includes’ with ‘include’. <i>[Schedule 3, items 102, 104 and 106, subsections 124-780(1) (note 2), 124-781(1) (note 2) and 124-790(1)]</i>
124-782(4)	Asterisks the word ‘arrangement’ to indicate that it is a defined term. <i>[Schedule 3, item 189, subsection 124-782(4)]</i>
125-80(8)	Inserts this heading before subsection 125-80(8): ‘Partial roll-over’. Because the last heading in the section was ‘Pre-CGT interests’ (before subsection (4)), readers may not realise that subsection 125-80(8) applies to <i>post</i> -CGT interests as well as <i>pre</i> -CGT interests. <i>[Schedule 3, item 107, subsection 125-80(8)]</i>

<i>Provision being amended</i>	<i>What the amendment does</i>
128-15(1) (notes) 128-25(2) (notes)	Amends the note to subsection 128-15(1) to refer readers to provisions that deal with related rules. These notes are to help readers find provisions relevant for them. <i>[Schedule 3, item 110, subsections 128-15(1) (notes)]</i>  Omits similar notes to section 128-25 because the provisions they refer to are not relevant to section 128-25. <i>[Schedule 3, item 111, subsection 128-25(2) (notes)]</i>
130-80(4) (note 1) 130-83(4) (note) 292-20(2) (note 1)	Renames the first note to subsections 130-80(4) and 292-20(2) from ‘Note’ to ‘Note 1’ and the solitary note to subsection 130-83(4) from ‘Note 1’ to ‘Note’. <i>[Schedule 3, items 112, 113 and 135, subsections 130-80(4) (note 1), 130-83(4) (note) and 292-20(2) (note 1)]</i>
152-310(2)(a)	Corrects the way the provision makes an amount exempt income so that it conforms to the requirements specified in subsection 6-20(1). There is no change to the result. <i>[Schedule 3, item 114, paragraph 152-310(2)(a)]</i>
165-37 (heading) 165-37(1) 165-55(6)	Corrects the way the defined terms ‘more than a 50% stake’ and ‘full year deduction’ appear in the definitions of those terms. <i>[Schedule 3, items 115 to 117, subsections 165-37(1) and 165-55(6) and section 165-37 (heading)]</i>  The drafting protocol for the ITAA 1997 is that a defined term appears in <i>bold italics</i> in its actual definition, and does not include the asterisk that normally marks a defined term.
165-115H(2) (flowchart)	Corrects incorrect cross-references to other provisions. <i>[Schedule 3, item 118, subsection 165-115H(2) (flowchart)]</i>
214-5(5) 214-20(3) 214-55 214-105(1)(b) 214-185	Replaces potentially confusing references to ‘return’ with the more precise ‘franking return’. <i>[Schedule 3, items 125 to 129, paragraph 214-105(1)(b), subsections 214-5(5) and 214-20(3) and sections 214-55 and 214-85]</i>  Asterisks to mark ‘franking return’ as a defined term are added where necessary. <i>[Schedule 3, items 126 and 128, paragraph 214-105(1)(b) and subsection 214-20(3)]</i>
250-15(c)(iii) 250-55(b) 250-60(2)(b)(ii) 250-60(4)(b)(iii) 250-115(3)(b)	Replaces the older expressions ‘non-resident’ and ‘not an Australian resident’ with the defined term ‘foreign resident’. There is no change in result. <i>[Schedule 3, items 130 to 134, subparagraphs 250-15(c)(iii), 250-60(2)(b)(ii) and 250-60(4)(b)(iii) and paragraphs 250-55(b) and 250-115(3)(b)]</i>

<i>Provision being amended</i>	<i>What the amendment does</i>
707-310(3) (item 6 in the table)	<p>Corrects an inadvertent change the 2007 foreign income tax offset reforms made to the rules about how much of an entity’s losses are available to a consolidated group the entity joins.</p> <p>The 2007 amendment was intended to repeal an item in the table in subsection 707-310(3), and replace it with a new item, to reflect changes in terminology arising from the reforms. The amendment repealed the item but failed to insert the replacement item. The current amendment inserts that replacement item. <i>[Schedule 3, item 146, subsection 707-310(3) (item 6 in the table)]</i></p> <p>To achieve the outcome intended when the original amendment was made, the current amendment applies to income years, statutory accounting periods and notional accounting periods starting on or after 1 July 2008 — the start date for the foreign income tax offset rules. <i>[Schedule 3, item 147]</i></p>
770-15(1) (note)	<p>Adds a non-operative note to help readers.</p> <p>Subsection 770-15(1) defines the ‘foreign income taxes’ that count towards the tax offset for paying foreign income tax. The note alerts readers that only an amount of foreign tax <i>correctly</i> imposed, under either a foreign law or a tax treaty with Australia, can be foreign income tax. <i>[Schedule 3, item 153, subsection 770-15(1) (note)]</i></p>
770-75(4)(b)(ii)	<p>Clarifies an ambiguity in the rules that limit the amount of a taxpayer’s foreign income tax offset.</p> <p>In most cases, the limit is the difference between the Australian income tax that would normally be payable on the taxpayer’s entire taxable income and the tax that would be payable if the taxable income included neither foreign income nor related deductions. The provisions describing the ignored deductions talk about ‘debt deductions’ (broadly, interest) attributable to an overseas permanent establishment and then talk about ‘other deductions’ related to foreign income. There is an ambiguity about whether the ‘other deductions’ include debt deductions that are not attributable to an overseas permanent establishment.</p> <p>The ‘other deductions’ were intended to mean deductions other than debt deductions and the amendment resolves the ambiguity that way. <i>[Schedule 3, item 154, subparagraph 770-75(4)(b)(ii)]</i></p> <p>To ensure the original intention is achieved, the amendment applies to income years, statutory accounting periods and notional accounting periods starting on or after 1 July 2008 – the start date for the new foreign income tax offset rules. <i>[Schedule 3, item 155]</i></p>

<i>Provision being amended</i>	<i>What the amendment does</i>
974-10(5)(e) 974-112(1)(e) 974-150(1), (2), (3) and (4)	<p>Repeals an unnecessary cross-reference to the dictionary for the meaning of the word ‘scheme’. The asterisk attached to the word is linked to a footnote that directs readers to the definition in the dictionary. Therefore, the further cross-reference in subsection 974-150(1) is redundant. <i>[Schedule 3, item 164, subsection 974-150(1)]</i></p> <p>The section’s remaining subsections are renumbered and references to the renumbered subsections are updated. <i>[Schedule 3, items 160, 163 and 165, paragraphs 974-10(5)(e) and 974-112(1)(e) and subsections 974-150(2) to (4)]</i></p>
995-1(1) (subparagraph (b)(i) of <i>copyright collecting society</i> )	<p>Replaces the expression ‘a law of a State or Territory’ with the equivalent defined expressions ‘State law’ and ‘Territory law’. <i>[Schedule 3, item 166, subsection 995-1(1) (subparagraph (b)(i) of ‘copyright collecting society’)]</i></p> <p>This measure removes the confusion caused by saying the same thing in different ways but does not change the result.</p>
995-1(1) (paragraphs (b) to (d) of <i>friendly society</i> )	<p>Replaces the expression ‘a law in force in a State or Territory’ with the equivalent defined expression ‘Australian law’. <i>[Schedule 3, item 167, subsection 995-1(1) (paragraphs (b) to (d) of ‘friendly society’)]</i></p> <p>This measure removes the confusion caused by saying the same thing in different ways but does not change the result.</p>
995-1(1) ( <i>full year deductions</i> )	<p>Adds a reference to subsection 165-55(6) in the signpost to the definition of ‘full year deduction’. <i>[Schedule 3, item 168, subsection 995-1(1) (‘full year deduction’)]</i></p> <p>‘Full year deduction’ is defined in part in subsection 165-55(5) and in part in subsection (6). The signpost in subsection 995-1(1) to the definition only mentions the first of those. The amendment corrects the omission.</p>
995-1(1) ( <i>scheme</i> )	<p>Adds a non-operative note to the definition of ‘scheme’ to draw readers’ attention to the effect of subsection 974-150(2) (which deems what would otherwise be a single scheme to be multiple schemes in some cases). <i>[Schedule 3, item 171, subsection 995-1(1) (‘scheme’)]</i></p> <p>This helps readers locate all the provisions that are relevant to them.</p>
995-1(1) ( <i>short-term hire agreement</i> )	<p>Removes a repeated definition of the same expression. As the two definitions are the same, one is redundant and is removed. <i>[Schedule 3, item 172, subsection 995-1(1) (‘short-term hire agreement’)]</i></p>

**Table 3.4: Amendments to the *Income Tax (Transitional Provision) Act 1997***

<i>Provision being amended</i>	<i>What the amendment does</i>
1-7	Inserts a provision to make explicit that the Commissioner has the general administration of this Act. Currently the ITAA 1936 provides the Commissioner with the general administration of both the ITAA 1936 and the ITAA 1997 but it is only by implication that this would include the <i>Income Tax (Transitional Provisions) Act 1997</i> . [Schedule 3, item 175, section 1-7]

**Table 3.5: Amendments to the *Taxation Administration Act 1953***

<i>Provision being amended</i>	<i>What the amendment does</i>
8AAB(5) (item 2B in the table)	Omits the word 'section' to make item 2B in the table consistent with the other items in the table that list the provision number without the noun. [Schedule 3, item 177, subsection 8AAB(5) (item 2B in the table)]
8AAB(5) (item 17K in the table)	Renumbers one of the two table items numbered as 17K. Having two items numbered as 17K is potentially confusing. [Schedule 3, items 178 and 179, subsection 8AAB(5) (item 17K in the table)].
14ZQ	Removes the word 'section', as the provision currently reads 'section Division 359'. [Schedule 3, item 180, section 14ZQ]
250-10(2) of Schedule 1 (items 38A, 38B and 67 in the table)	Omits the word 'section' to make items 38A, 38B and 67 in the table consistent with the other items in the table that list the provision number without the noun. [Schedule 3, item 182, subsection 250-10(2) of Schedule 1 (items 38A, 38B and 67 in the table)]
284-220(1)(a) and (b) of Schedule 1	Removes an ambiguity by removing 'shortfall amount' from the opening words to subsection 284-220(1). Section 284-220 provides for an increase in penalty in a number of repeat offender cases. One of those cases is covered by paragraph (1)(e). It deals with a taxpayer who fails to provide a document after having failed to provide one on an early occasion. The section provides for an increase of 20 per cent of 'the base penalty amount for your shortfall amount'. There is a base penalty amount for the situation covered by paragraph (1)(e) but it is not worked out by reference to a shortfall amount. If the section were read to only apply in situations where there is a shortfall amount, and as there can be no shortfall amount under subsection 284-75(3), paragraph 284-220(1)(e) could never apply.



<i>Provision being amended</i>	<i>What the amendment does</i>
	<p>The amendment removes the ambiguity by removing the reference to shortfall amount. [Schedule 3, item 183, section 284-220 of Schedule 1]</p> <p>Consequential amendments are made to other paragraphs in the section. [Schedule 3, items 184 and 185, paragraphs 284-220(1)(a) and (b) of Schedule 1]</p>

**Table 3.6: Amendments to the *Superannuation Guarantee (Administration) Act 1992***

<i>Provision being amended</i>	<i>What the amendment does</i>
35(1)(d)(iv)	<p>Adds an 'and' to the end of paragraph 35(1)(d) to be consistent with other paragraphs in the same subsection. [Schedule 3, item 176, subparagraph 35(1)(d)(iv)]</p>

**Table 3.7: Amendments to the *A New Tax System (Goods and Services Tax) Act 1999***

<i>Provision being amended</i>	<i>What the amendment does</i>
87-25 (note)	<p>Adds a note to section 87-25 alerting readers that choosing not to apply section 87-25 will result in their supplies, other than GST-free supplies, being input taxed under section 40-35.</p> <p>Paragraphs 40-35(1)(b) and (1A)(b) refer to a supplier having a choice to make taxable supplies of long-term accommodation in commercial residential premises under section 87-25 at a reduced value rather than as input taxed supplies. However section 87-25 does not tell readers that a supplier who chooses not to apply Division 87 will have the supply input taxed under section 40-35. The amendment removes the potential for the current situation to lead to confusion for taxpayers. [Schedule 3, item 1, section 87-25 (note)]</p>

**Table 3.8: Amendments to the Tax Laws Amendment (2007 Measures No. 5) Act 2007**

<i>Provision being amended</i>	<i>What the amendment does</i>
Item 40 of Schedule 10	<p>Adds the word ‘former’ before subsection 124K(2).</p> <p>Item 40 will attempt to amend paragraph 82KH(1T)(b) in the ITAA 1936 by adding ‘former’ before ‘subsection 124KA(2)’ when that item commences on 1 July 2010.</p> <p>The amendment will fail because paragraph 82KH(1T)(b) does not mention subsection 124KA(2). Instead, it mentions subsection 124K(2). The amendment updates the item to refer to the correct provision. <i>[Schedule 3, item 187; item 40 of Schedule 10 to the Tax Laws Amendment (2007 Measures No. 5) Act 2007]</i></p>
Item 56 of Schedule 10	<p>Repeals the note to the definition of ‘tax loss’ in subsection 272-140(1) of Schedule 2F.</p> <p>Item 56 will attempt to repeal the note to the definition of ‘tax loss’ in ‘Paragraph 272-140 in Schedule 2F’ when that item commences on 1 July 2010.</p> <p>That amendment was misdescribed because 272-140 is a section, not a paragraph, and will therefore fail. <i>[Schedule 3, item 188; item 56 of Schedule 10 to the Tax Laws Amendment (2007 Measures No. 5) Act 2007]</i></p>

**Table 3.9: Amendments to the Taxation (Interest on Overpayments and Early Payments) Act 1983**

<i>Provision being amended</i>	<i>What the amendment does</i>
3A(2)	<p>Removes a redundant reference to ‘Income tax crediting amount’, a concept that was removed from the law as part of the new foreign income tax offset rules in 2007. <i>[Schedule 3, item 186, subsection 3A(2)]</i></p>

**Table 3.10: Amendments to the Income Tax (Deferred Interest Securities) (Tax File Number Withholding Tax) Act 1991**

<i>Provision being amended</i>	<i>What the amendment does</i>
4	<p>Removes an excess ‘section’ as the provision reads ‘section section 14-55’. <i>[Schedule 3, item 174, section 4]</i></p>

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