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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAX LAWS AMENDMENT (2010 MEASURES No. 2) BILL 2010

EXPLANATORY MEMORANDUM

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

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Glossary

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

<i>Abbreviation</i>	<i>Definition</i>
ATO	Australian Taxation Office
BAS	business activity statement
Commissioner	Commissioner of Taxation
DGR	deductible gift recipient
FBTAA 1986	<i>Fringe Benefits Tax Assessment Act 1986</i>
HECS-HELP benefit	Higher Education Contribution Scheme-Higher Education Loan Programme benefit
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
PAYG	pay as you go
TAA 1953	<i>Taxation Administration Act 1953</i>
TFN	tax file number
the Institute	Global Carbon Capture and Storage Institute Limited
the Review	<i>Review of Unlimited Amendment Periods in the Income Tax Laws</i>

General outline and financial impact

Improving fairness and integrity in the tax system: distributions to entities connected with a private company

Schedule 1 to this Bill amends the non-commercial loan rules in Division 7A of the *Income Tax Assessment Act 1936* to prevent a shareholder of a private company (or an associate of the shareholder) accessing tax-free dividends from the provision of company assets, for less than their market value.

Other technical amendments have also been made to strengthen the non-commercial loan rules to ensure that they operate in accordance with their original policy intent and cannot be circumvented by the use of a closely held corporate limited partnership or interposed entities.

Date of effect: This measure applies from 1 July 2009.

Proposal announced: This measure was announced jointly in the Treasurer's and the then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs' Media Release No. 067 of 12 May 2009.

Financial impact: This measure will have the following revenue implications:

<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
Nil	\$10m	\$10m	\$10m

Compliance cost impact: Low. This measure will affect only a small proportion of individuals and businesses. There is a low ongoing compliance cost impact and a low transitional impact, reflecting the need for some taxpayers to be aware of the amendment.

Extending the tax file number withholding arrangements to closely held trusts, including family trusts

Schedule 2 to this Bill amends the *Income Tax Assessment Act 1936*, the *Income Tax Assessment Act 1997* and the *Taxation Administration Act 1953* to extend the existing arrangements for tax file number (TFN)

withholding to cover closely held trusts, including family trusts. The information collected by the Australian Taxation Office (ATO) under these amendments will facilitate data-matching and allow the ATO to check whether the assessable income of beneficiaries of these trusts correctly includes their share of the net income of the trust.

Date of effect: This measure applies from 1 July 2010.

Proposal announced: This measure was announced jointly in the Treasurer's and the then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs' Media Release No. 067 of 12 May 2009.

Financial impact: This measure will have the following revenue implications:

<i>2009-10</i>	<i>2010-11</i>	<i>2011-12</i>	<i>2012-13</i>
–	\$50m	\$50m	\$50m

Compliance cost impact: Low. Trustees will be required to obtain the beneficiary's TFN or withhold the required amount under the TFN withholding arrangements. Additionally, there will be some associated reporting requirements.

Beneficiaries that do not have a TFN need to apply for one.

Income tax treatment of the HECS-HELP benefit

Schedule 3 to this Bill amends the *Income Tax Assessment Act 1997* to exempt from income tax the Higher Education Contribution Scheme-Higher Education Loan Programme benefit (HECS-HELP benefit).

The HECS-HELP benefit was an initiative first introduced in the 2008-09 Budget. The benefit gives eligible recipients a reduction in their compulsory HECS debt repayment and/or their HELP debt repayment or, in some cases where a repayment is not required due to low income, a direct reduction in their HELP debt.

Date of effect: This measure applies to assessments for the 2008-09 income year and later income years.

Proposal announced: Not previously announced.

Financial impact: Nil.

Compliance cost impact: Negligible.

Deductible gift recipients

Schedule 4 to this Bill amends the *Income Tax Assessment Act 1997* to update the list of deductible gift recipients (DGRs) to include two new entities, and extend the period for which another DGR may collect deductible gifts.

Date of effect: The changes generally apply to gifts received after the day the organisation is notified of its specific listing.

Proposal announced: The listing of the Bali Peace Park Association Inc. was announced in the Assistant Treasurer's Media Release No. 115 of 17 December 2009. The listing of the other organisation has not previously been announced.

Financial impact: This measure will have the following revenue implications:

2009-10	2010-11	2011-12	2012-13
-\$0.098m	-\$0.687m	-\$0.363m	Nil

Compliance cost impact: Nil.

Income tax exemption: Global Carbon Capture and Storage Institute Limited

Schedule 5 to this Bill amends the *Income Tax Assessment Act 1997* to make the Global Carbon Capture and Storage Institute Limited (the Institute) income tax exempt for a four-year period.

The central objective of the Institute is to accelerate the commercial deployment of carbon capture and storage projects to contribute to reducing carbon dioxide emissions.

The information and expertise developed by the Institute is to be disseminated broadly and globally to the benefit of both the Australian and global carbon capture and storage communities.

Date of effect: The exemption applies to income received on or after 1 July 2009 and before 1 July 2013.

Proposal announced: This measure was announced on 2 November 2009 in the 2009-10 *Mid-Year Economic and Fiscal Outlook*.

Financial impact: Nil.

Compliance cost impact: Low.

Repeal of certain unlimited periods for amending assessments

Schedule 6 to this Bill amends various taxation laws to repeal over 100 unlimited amendment periods. As result, a number of provisions which provide the Commissioner of Taxation with an indefinite time to amend taxpayers' assessments are replaced with the existing amendment provisions that have certain finite periods. The removal of these unlimited amendment periods will improve certainty for taxpayers in their taxation affairs and contribute to reducing the volume of unnecessary provisions in the taxation laws.

Date of effect: This measure removes the specified unlimited amendment periods the day after this Bill receives Royal Assent.

Proposal announced: This measure was announced in the then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs' Media Release No. 048 of 12 May 2009.

Financial impact: Unquantifiable, but thought to be minimal (less than \$1 million per year).

Compliance cost impact: Nil.

Chapter 1

Improving fairness and integrity in the tax system: distributions to entities connected with a private company

Outline of chapter

1.1 Schedule 1 to this Bill amends the non-commercial loan rules in Division 7A of the *Income Tax Assessment Act 1936* (ITAA 1936) to prevent a shareholder of a private company (or an associate of the shareholder) accessing tax-free dividends through the use of company assets, for less than their market value.

1.2 Other technical amendments are also made to strengthen the non-commercial loan rules to ensure that they operate in accordance with their original policy intent and cannot be circumvented by the use of a corporate limited partnership.

1.3 All of the legislative references in this chapter relate to the ITAA 1936 unless otherwise specified.

Context of amendments

1.4 The non-commercial loan rules in Division 7A are integrity provisions that treat payments, loans and other credits by private companies to shareholders (or their associates) as assessable dividends (unless they come within specified exclusions), to the extent that there are realised or unrealised profits in the company. Division 7A also ensures that an amount may be included in the assessable income of a shareholder (or their associate) if a private company has an unpaid present entitlement to income of a trust and the trustee makes a payment or loan to, or forgives a debt of, the shareholder of the private company (or their associate).

1.5 The definition of ‘payment’ for the purposes of Division 7A is contained in subsection 109C(3). A **payment** includes:

- a payment to the extent that it is to the entity, on behalf of the entity, or for the benefit of the entity; and

- a credit of an amount to the extent that it is:
 - to the entity; or
 - on behalf of the entity; or
 - for the benefit of the entity; and
- a transfer of property to the entity.

1.6 For a payment to arise under a ‘transfer of property’, the ownership of an asset needs to pass from the private company to the shareholder (or their associate), or there must be a lease of real property in existence. As such, Division 7A does not cover the mere use of an asset, or licence or right to use an asset.

1.7 As part of the 2009-10 Budget, the Government announced that it would tighten the non-commercial loan rules to improve fairness and integrity in the tax law, by ensuring that benefits provided by a private company to a shareholder (or their associate), through the use of company assets, such as holiday houses, cars and other luxury items, at less than market value would be taxable. The Government also announced that it would make a number of other technical amendments to Division 7A to ensure that it operates in accordance with its original policy intent.

1.8 These amendments treat arrangements where a private company has provided an asset to a shareholder (or their associate) for their use (other than a transfer of property, which is already covered by paragraph 109C(3)(c) of the ITAA 1936) as a payment for the purposes of Division 7A. These changes ensure that Division 7A cannot be circumvented by the provision of an asset for use. The amendments in subsection 109CA(1) do not impact upon the operation of any of the existing payments in subsection 109C(3).

1.9 After consulting with small business and farming communities, the Assistant Treasurer announced changes to the measure via Press Release No. 051 of 14 September 2009. These changes included the introduction of an otherwise deductible rule and an exception for the use of certain residences, in addition to the exception for the minor use of certain company assets.

1.10 The Government has also included a provision that excepts the use of main residences that were purchased prior to 1 July 2009 as part of these amendments. This exception ensures that taxpayers who used a company structure to purchase a home, are not impacted by these amendments (subject to a company continuity of ownership test). These exceptions only apply to payments that arise because of the operation of

section 109CA. That is, the exception applies to the use of certain dwellings, but not where there is a transfer of property within the meaning of paragraph 109C(3)(c).

1.11 In addition to the changes made to the definition of payment, these amendments also correct a number of other technical deficiencies that provide taxpayers with the opportunity to structure their affairs to circumvent the application of Division 7A.

Summary of new law

1.12 When a private company provides an asset to a shareholder, or an associate of the shareholder for use (other than a transfer of property which is covered by paragraph 109C(3)(c) of the ITAA 1936), a payment for the purposes of Division 7A will arise.

1.13 There are three exceptions to this treatment. They are for:

- the minor use of company assets;
- certain payments that would otherwise be allowable as a once-only deduction to the user of the asset; and
- the use of certain residences.

1.14 Broadly, Subdivision EA of Division 7A operates where a private company has an unpaid present entitlement to income of a trust and the trust makes a payment, loan or forgiveness of debt to a shareholder of the private company or an associate of the shareholder in particular circumstances. These amendments to Subdivision EA ensure that the operation of the Subdivision cannot be circumvented by interposing an entity between either the trust making a payment or loan to a shareholder (or their associate) or between a trust and the private company that holds an unpaid present entitlement to an amount from the net income of the trust

1.15 Other technical amendments are also made to strengthen the non-commercial loan rules to ensure that they operate in accordance with their original policy intent and cannot be circumvented by the use of a corporate limited partnership, which is a partnership taxed like a company.

1.16 Amendments are also made to put beyond doubt that Division 7A applies to arrangements that involve a non-resident private

company making a payment, loan or forgiveness of debt to a resident shareholder (or their associate).

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Division 7A applies to closely held corporate limited partnerships in the same way as it applies to private companies.	Section 94N excludes corporate limited partnerships from the operation of Division 7A.
The meaning of 'payment' is extended to include the provision of an asset for use by an entity (other than a transfer of property within the meaning of paragraph 109C(3)(c)). Not included in this extended definition of 'payment' are the minor use of company assets, certain payments that would otherwise be allowable as once-only deductions and the use of certain residences.	The meaning of 'payment' in subsection 109C(3) includes a transfer of property to an entity, which entails the ownership of an asset passing to a shareholder or their associate, and a lease of real property to an entity.
A payment made by an entity in relation to a loan from a private company must not be taken into account in determining whether a loan has been repaid in whole or in part in the year in which it was made, or in determining whether a minimum yearly repayment has been made, if a reasonable person would conclude that: <ul style="list-style-type: none"> • when the payment was made the entity intended to obtain a loan or loans from the private company of an amount similar to or larger than the payment; or • in order to make the payment the entity obtained, before the payment was made, a loan or loans from the private company of a total amount similar to, or larger than, the payment. 	A payment made by an entity in relation to a loan from a private company must not be taken into account in determining whether a loan has been repaid in whole or in part in the year in which it was made, or in determining whether a minimum yearly repayment has been made, if a reasonable person would conclude that when the payment was made the entity intended to obtain a loan from the private company of an amount similar to, or larger than, the payment.

<i>New law</i>	<i>Current law</i>
<p>The requirement under paragraph 109XA(1)(b) does not apply where a shareholder of a corporate beneficiary of a trust (or their associate) receives a payment due to the application of subsection 109XA(1) and all or part of the amount is subsequently loaned back to the trust.</p> <p>Any loan repayments made by the trustee to the shareholder (or their associate) in subsequent years may then give rise to a deemed dividend for the purposes of Division 7A, where there is an unpaid present entitlement.</p>	<p>Subdivision EA allows an amount to be included in an entity's assessable income if a trustee makes a payment, and that payment is a discharge of, or a reduction in, a present entitlement of a shareholder (or their associate) that is wholly or partly attributable to an unrealised gain and a company has an unpaid present entitlement to the income of the trust.</p> <p>Where an arrangement involves an unrealised gain and the repayment of a loan from a shareholder (or their associate) to the trust, Subdivision EA may be ineffective due to the operation of paragraph 109XA(1)(b).</p>
<p>A company or trust withholding an amount from an employee's salary or bonus and offsetting these amounts against the loan can be a repayment by an entity, in relation to a loan.</p>	<p>Only a company withholding an amount from an employee's salary or bonus and offsetting these amounts against the loan can be a repayment by an entity, in relation to a loan.</p>
<p>Where a loan that has previously been included in the assessable income of a shareholder of a private company (or their associate) under section 109XB is forgiven by the trustee, the forgiven amount does not give rise to a deemed dividend.</p>	<p>Where a loan that has previously been included in the assessable income of a shareholder of a private company (or their associate) under section 109XB is forgiven by the trustee, it may give rise to a deemed dividend.</p>
<p>Where an entity is interposed between a trust and the shareholder of a private company (or their associate), the trust will be treated as having directly paid or loaned an amount to the shareholder of the private company (or their associate) for the purposes of Subdivision EA of Division 7A, where a reasonable person would conclude that the trustee made the payment or loan as part of an arrangement involving the target entity.</p>	<p>An entity interposed between a trust and a target entity (that is, a shareholder of a private company or their associate) may circumvent the operation of Subdivision EA of Division 7A.</p>

<i>New law</i>	<i>Current law</i>
<p>If a reasonable person would conclude that a private company is entitled to an amount from a trust estate that is interposed between the private company and a trust (target trust) making a payment, loan or forgiveness of debt to a shareholder of the private company (or their associate) as part of an arrangement involving that target trust, the private company is taken to be entitled to an amount from the net income of the target trust.</p>	<p>When a private company is presently entitled to an amount from the net income of a trust estate that is interposed between the company and a trust making a payment, loan or forgiveness of a debt to a shareholder of the private company (or their associate) Subdivision EA may not apply.</p>
<p>Any amounts that result in a payment because of section 109C or a forgiveness of debt because of section 109F are recognised in the distributable surplus formula in section 109Y.</p>	<p>Payments under section 109C or a forgiveness of debt under section 109F are not currently recognised in the distributable surplus formula in section 109Y.</p>
<p>Amounts that are included in the assessable income of a shareholder of a private company (or their associate) under section 109XB, in an earlier year of income, are reflected in the non-commercial loans component of the distributable surplus formula in section 109Y.</p>	<p>Amounts included in the assessable income of a shareholder of a private company (or their associate) under section 109XB, in an earlier year of income, are not reflected in the distributable surplus formula in section 109Y.</p>
<p>If a loan from a trustee to a shareholder of a private company (or their associate) is included in their assessable income under section 109XB, and a later dividend is received by the shareholder (or their associate) and offset against that loan, the offset amount is excluded from their assessable income to the extent that the dividend is unfranked.</p>	<p>If a loan from a trustee to a shareholder of a private company (or their associate) is included in their assessable income under section 109XB and a later dividend is received by the shareholder (or their associate), that dividend cannot be offset against the loan from the trustee.</p>
<p>The law will put beyond doubt that Division 7A applies to arrangements that involve a non-resident private company making a payment, loan or forgiveness of debt to a resident shareholder (or their associate).</p>	<p>No equivalent.</p>

Detailed explanation of new law

Payment that arises from the provision of an asset for use (other than a transfer of property)

1.17 The definition of ‘payment’ in section 109C does not currently extend to a number of arrangements used by private companies to provide assets, for use, to their shareholders (or an associate of a shareholder).

1.18 These amendments extend the meaning of ‘payment’ to include the provision of an asset (other than a transfer of property) for use by an entity. This extension ensures that arrangements aimed at circumventing the operation of Division 7A, through the provision of an asset under a licence or other right to use, are now within the scope of Division 7A. *[Schedule 1, item 13, subsection 109CA(1)]*

1.19 For the purposes of subsection 109CA(1), the payment occurs as the use occurs. *[Schedule 1, item 13, paragraph 109CA(2)(a)]*

1.20 A payment may also occur when the asset is available for use to the exclusion of the company. As such, it does not matter when the right to use the asset is granted. *[Schedule 1, item 13, paragraph 109CA(2)(b)]*

Example 1.1

On 7 October 2006, Ngo Pty Ltd leases a car for five years and then provides the car to a shareholder (Barry) to use for the duration of that period. Barry pays Ngo Pty Ltd \$5,000 per year for the use of the car. After 1 July 2009, the provision of this car, for use, will be a payment under Division 7A. The payment will occur on 1 July 2009 when the car is first available for Barry’s use in the 2009-10 income year. It does not matter that the agreement was entered into in 2006 because the provision of the car continues in the 2009-10 income year. Because Barry has the right to use the car for the whole of the 2009-10 income year the value of the payment for the 2009-10 income year is based on 12 months of use. It does not matter that the car is not driven (‘used’) by Barry every day during the income year.

1.21 An asset may be available for the shareholder’s use without a formal agreement. In addition, an asset may be available for use even though there is no actual use.

Example 1.2

Brian is a shareholder of a private company that owns a luxury yacht. He does not have a formal agreement with the company in relation to the yacht, however, he takes the yacht out every second weekend.

Brian keeps the yacht at the company's business premises, but takes the key home. Brian stores several personal items on the yacht.

Brian's fortnightly use of the yacht is a payment under Division 7A. The availability of the yacht for Brian's use is also subject to Division 7A because the yacht is not readily available for use by the company. The company would need to arrange with Brian to get the key and for the removal of Brian's personal items before using the yacht. That is, the asset is available for Brian's use to the exclusion of the company.

Example 1.3

Marina is a shareholder of a private company that owns a city apartment. The apartment is generally available for rent. However, Marina asks the company not to rent the apartment out for a week so that she and her family can use the apartment over a long weekend. Marina's use of the apartment is a payment for the purposes of section 109CA.

1.22 If there is merely a general entitlement to use the company's assets, an asset is not available for a shareholder's use to the exclusion of the company.

Example 1.4

Peter is a shareholder of a private company that owns five cars for company use. Shareholders and their associates have general permission to use the cars on weekends if they are not being used for company business. Peter regularly takes one of the cars home.

Peter's use of the car that he takes home will be subject to Division 7A. This will include driving the car (actual use) and the availability of the car for his use to the exclusion of the company, such as when it is parked at home, or at a restaurant that Peter is visiting.

Although Peter may have general permission to use all five of the cars, he does not use all of them for the purposes of Division 7A. The four cars that Peter leaves at the company premises are available for the company to loan to another shareholder, employee, customer, or other party. That is, these cars are not available to Peter to the exclusion of the company.

1.23 Where an asset is used by more than one entity simultaneously, it is necessary to consider whether the use of that asset should be attributed to a particular entity or apportioned.

Example 1.5

Clare and her husband Martin are shareholders of a private company that owns a holiday house. Clare, Martin and their infant son Phoenix have a one-month holiday at the house over summer. They do not pay for the use of the holiday home.

Although Phoenix is an associate of Clare and Martin, the provision of the use of the asset is attributable to Clare and Martin. This is the case particularly because Phoenix has no power to enter into a contract with the company and because of his dependence on Clare and Martin. The company is not providing the holiday house to Phoenix for his use, and his incidental use of the house is secondary to that of Clare and Martin.

The use of the holiday house (at market value rates) can therefore be attributed to Martin and Clare in equal shares on the basis that they use the holiday house equally.

Example 1.6

Hayden is a shareholder of a private company. Hayden leases a car from the private company for 12 months for a nominal amount of \$10,000. Hayden uses the car to drive his children to school in the morning. Hayden's wife (who is also a shareholder) sometimes drives the car on weekends.

The use of the car is attributable to Hayden's relationship with the company. The use of the car by Hayden's spouse and his children is secondary to his right to use the asset and is not provided by the company for their use, but Hayden's.

Hayden is assessed on the market value of the use of the car for the full 12 months, less actual consideration paid.

Valuation of a payment that arises from the provision of an asset for use (other than a transfer of property)

1.24 The amount of a payment is the amount that would have been paid for the provision of the asset by parties dealing at arm's length less any consideration actually paid. The amount of the payment is nil if the consideration paid equals or exceeds the amount that would have been paid by parties dealing at arm's length. [*Schedule 1, item 13, subsections 109CA(10) and (11)*]

Example 1.7

Matt is a shareholder of a private company that owns a holiday home. In the 2009-10 income year, Matt uses the holiday home for one week for which he pays the company 50 per cent less than the market value

rent for the property. The market value rent for the property is \$1,000 a week. The company has therefore made a payment to Matt of an amount of \$500, which will be assessable to Matt under Division 7A, subject to the company having a distributable surplus.

1.25 Exceptions to a payment that arises from the provision of an asset for use (other than a transfer of property)

1.26 The use of an asset will not be a payment under section 109CA if it is covered by one of the exceptions. The exceptions are for the minor use of certain company assets, certain payments that would otherwise be allowable as a once-only deduction and the use of certain residences. The exceptions only apply to the operation of section 109CA and do not apply more broadly to the operation of Division 7A. For example, a transfer of a property to shareholder involving a main residence would still be a payment under paragraph 109C(3)(c) of Division 7A, while the mere use of a main residence may not be a payment.

Minor benefits

1.27 Subsection 109CA(4) provides that an amount will not constitute a payment if the provision of the asset would, if done in respect of the employment of an employee, be a minor benefit under section 58P of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA 1986).

1.28 Section 58P of the FBTAA 1986 sets out when a minor benefit provided in, or in respect of a year of tax, is an exempt benefit and hence not subject to fringe benefits tax. Paragraph 58P(1)(e) of the FBTAA 1986 provides that the notional taxable value of a minor benefit in relation to the current year of tax must be less than \$300. In addition paragraph 58P(1)(f) of the FBTAA 1986 sets out a number of other matters such as the infrequency and irregularity of the benefit which may lead to a conclusion that it would be unreasonable to treat the minor benefit as a fringe benefit for the current year of tax.

1.29 This exception will reduce compliance costs for taxpayers as they will not have to treat minor payments to shareholders of a private company (or their associates) that arise under new subsection 109CA(1), as payments that may give rise to a deemed dividend. [*Schedule 1, item 13, subsection 109CA(4)*]

Example 1.8

John is a shareholder of a private company that hires out trailers for \$250 per day. The company owns a number of trailers, one of which the company made available to John during the 2009-10 income year to move furniture and other household items.

John is not an employee of the company. However, because the value of his one-off use of the trailer in the income year is less than \$300 and his use of the trailer would be treated as a minor benefit under section 58P of the FBTAA 1986 if he was an employee, the use of the trailer does not constitute a payment under Division 7A.

Otherwise deductible payments

1.30 Subsection 109CA(5) provides that if the shareholder of a private company (or their associate) had incurred and paid expenditure in respect of the provision of the asset and a once-only deduction would have been allowable to the shareholder (or their associate), subsection 109CA(1) does not apply.

1.31 In determining whether an amount is otherwise deductible, the appropriate test is whether the payment for the use of the asset would otherwise be deductible to the user of the asset, not whether the user would be able to deduct the amount had they purchased the asset themselves. [*Schedule 1, item 13, subsection 109CA(5)*]

Example 1.9

Shop Pty Ltd owns a shopping centre. Audrey is a shareholder of Shop Pty Ltd and at various times during the 2009-10 income year she is provided with part of the property to run a gift wrapping service. Under her arrangement with Shop Pty Ltd, Audrey is not required to make payments to Shop Pty Ltd for her use of that part of the property.

Had Audrey made payments for the use of that part of the property she would be able to deduct those payments, as they would have been part of the expenses she incurred in running her business. Therefore, while Audrey's use of the property is within the scope of subsection 109CA(1), it is disregarded, as Audrey would have otherwise been able to deduct any payments made for the use of the property.

The exception would not operate if it was established that Audrey had in fact a lease of real property (that is, a transfer of property to an entity within the meaning of paragraph 109C(3)(c)). The exception in subsection 109CA(5) only applies to the extended meaning of payment in subsection 109CA(1).

A dwelling owned by a private company

1.32 The amendments contain two separate exceptions for the provision of certain kinds of dwellings.

1.33 The first exception is contained in subsection 109CA(6) and provides an exception for the provision of a dwelling for use by a shareholder or their associate (the entity) where that provision would not meet the otherwise deductible rule (that is, because the use is for private purposes). In order to qualify for the exception certain conditions must be met. These are that:

- the entity or their associate is carrying on a business;
- the entity or their associate uses or is granted or has a lease, licence or other right to use land, water or a building for the purpose of carrying on the business; and
- the provision of the dwelling to the entity is connected with that use or with that lease, licence or other right to use the land, water or building to carry on the business.

1.34 It is also necessary for there to be a connection between the provision of the dwelling and that use, lease, licence or other right to use land, water or building in carrying on a business, even if the business is being carried on by an entity other than the entity living in the dwelling. *[Schedule 1, item 13, subsection 109CA(6)]*

Example 1.10

Aaron and Liz Jones are shareholders in a private company called Farm Pty Ltd and beneficiaries of the Jones Family Trust. Farm Pty Ltd owns a property called Greenacre on which the Jones Family Trust runs a farming business.

For the 2009-10 income year Aaron and Liz live in a dwelling on Greenacre. Aaron and Liz do not make payments to Farm Pty Ltd for the use of this dwelling.

As this use is for private purposes, it does not come within the otherwise deductible exception in subsection 109CA(5).

However, as their use of the dwelling is in connection with the Jones Family Trust using Greenacre to carry on a business, the provision of the dwelling by Farm Pty Ltd is disregarded for the purposes of subsection 109CA(1).

Liz's brother Tom who is also a shareholder of Farm Pty Ltd does the accounts for the Jones Family Trust from his harbour side dwelling in Sydney. Farm Pty Ltd also owns this dwelling. Tom's use of the harbour side dwelling is not connected to the use of the land, water or building on Greenacre and therefore is not eligible for this exception.

Example 1.11

Rebecca is a shareholder of a private company called Health Pty Ltd. She is also a doctor who runs a surgery. Rebecca runs her surgery in a house owned by Health Pty Ltd under a licence agreement. The surgery takes up approximately 40 per cent of the area of the house. Health Pty Ltd has also granted Rebecca a right to use the remaining 60 per cent of the house to live in. She does not pay Health Pty Ltd under either arrangement.

Rebecca's licence to use the part of the house to run her surgery is not a payment for the purposes of subsection 109CA(1). This is because she would have been allowed a once-only deduction if she had made a payment for that use.

Rebecca's use of the remainder of the house is also exempt due to the operation of subsection 109CA(6) as she is carrying on a business, using a building that she has been granted a licence to use and there is a connection between her carrying on the business and her using the remainder of the house as her dwelling.

Example 1.12

Ernie is a shareholder of a private company called Electric Co Pty Ltd. Electric Co Pty Ltd owns the dwelling that Ernie lives in. Ernie stores his tools at the dwelling, but does not otherwise use the land or building in carrying on his business. Ernie's use of the dwelling is not exempt under subsection 109CA(6) because he does not use land, water or buildings in carrying on his business. However, the dwelling may be an exempt main residence under subsection 109CA(7).

1.35 The second residence exception is for the provision of a main residence and is contained in subsection 109CA(7). This exception relates to dwellings that are the main residence of the shareholder (or their associate) of a private company, where the dwelling has been acquired by the private company before 1 July 2009. The exception is subject to a continuity of ownership test so that the exception is not carried over if the ownership of the private company changes.

Example 1.13

Jessica is the sole shareholder of a private company called House Pty Ltd. The sole asset owned by House Pty Ltd is a dwelling that the private company acquired in 2005. Jessica currently uses this dwelling as her main residence. As long as there is no substantial change in ownership of House Pty Ltd the provision of the dwelling by House Pty Ltd, for Jessica's use, is disregarded for the purposes of subsection 109CA(1).

However, in 2012, Jessica sells her ownership interest in House Pty Ltd to Gaurav. The sale of her interest in House Pty Ltd represents a change in the ownership of the company under section 165-12 of the *Income Tax Assessment Act 1997*. Hence, if Gaurav seeks to use the dwelling owned by House Pty Ltd as his main residence, without paying market value rates, his use of the house will be treated as a payment for the purposes of subsection 109CA(1).

Gaurav will then be liable to pay tax if the payment for the use of the house is not converted to a loan and either repaid before the lodgment day of the private company, or a loan agreement complying with Division 7A requirements is made (and subject to the private company having a distributable surplus).

Closely held corporate limited partnerships

1.36 Division 7A does not currently apply to corporate limited partnerships due to the operation of section 94N, which states that a reference to a private company in relation to the year of income does not include a reference to a corporate limited partnership.

1.37 Under these amendments, corporate limited partnerships that satisfy the requirements outlined in section 109BB are subject to the operation of Division 7A. Section 109BB sets out that a corporate limited partnership will be considered to be closely held for the purposes of Division 7A where it has fewer than 50 members or an entity has, directly or indirectly, and for the entity's own benefit, an entitlement to a 75 per cent or greater share of the income or capital of the partnership. *[Schedule 1, item 11, section 109BB]*

Example 1.14

Kariba L.P is a limited partnership that has one general partner and three limited partners. Kariba L.P is a corporate limited partnership under section 94D. As Kariba L.P has less than 50 members, it is subject to the application of Division 7A from the 2009-10 income year.

Interposed entities

Payments and loans made by a trustee through interposed entities

1.38 Under Subdivision E of Division 7A, where an entity is interposed between a private company and a shareholder or their associate (target entity), a payment or loan from the private company is treated as being made directly to a target entity if certain conditions are met. There are currently no corresponding rules that apply for the purposes of Subdivision EA, where a company has an unpaid present entitlement to an

amount from the net income of a trust and an entity is interposed between the trust and the shareholder or their associate (the target entity).

1.39 The existing Subdivision EA treats a payment or loan from a trust to a shareholder (or associate) as a payment or loan from the private company, if the company has an unpaid present entitlement from the trust.

1.40 Under these amendments, where a corporate beneficiary has a present entitlement to an amount from the net income of a trust estate and the whole of that amount has not been paid, and an entity is interposed between that trust and a target entity (the shareholder of the private company or their associate), the trust is treated as having directly paid or loaned an amount to the target entity for the purposes of Division 7A. Subdivision EA then operates as if the trustee makes a payment or loan to the target entity. *[Schedule 1, item 25, sections 109XF and 109XG]*

1.41 Sections 109XF and 109XG set out three conditions that must be met before a trustee is taken to have made a payment or a loan to a target entity:

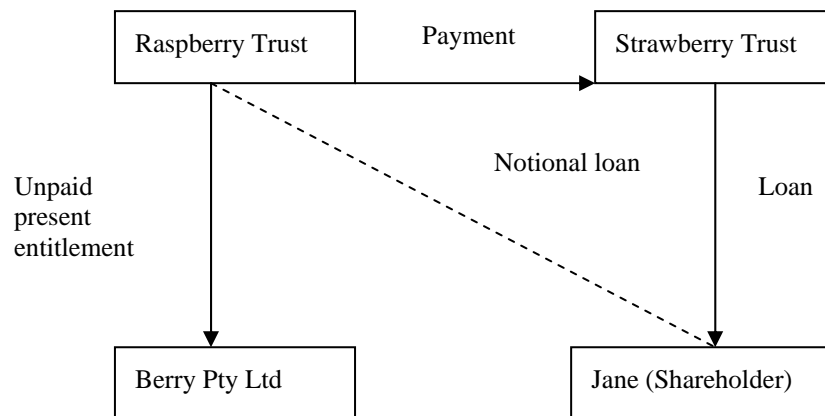
- there must be a payment or loan from the trustee to an interposed entity;
- in circumstances where a reasonable person would conclude that the payment or loan was made as part of an arrangement to make a payment (paragraph 109XF(1)(b)) or loan (paragraph 109XG(1)(b)); and
- the interposed entity, or another interposed entity, makes a payment (paragraph 109XF(1)(c)) or loan (paragraph 109XG(1)(c)) to the target entity.

[Schedule 1, item 25, subsections 109XF(1) and 109XG(1)]

1.42 Paragraphs 109XF(1)(a) and (b) and 109XG(1)(a) and (b) make reference to both a payment and a loan to ensure that the provisions operate in situations where a payment or loan is made to an interposed entity and the interposed entity then makes a loan or a payment to the target entity. The characterisation of the amount (as a payment or loan) will depend on the nature of the transaction between the last interposed entity and the target entity.

Example 1.15

Berry Pty Ltd has an unpaid present entitlement from Raspberry Trust. Raspberry Trust makes a payment to Strawberry Trust, who then makes a loan to Jane, who is a shareholder of Berry Pty Ltd, as set out in the diagram. The notional transaction between Raspberry Trust and Jane is treated as a loan, because the transaction between Jane and Strawberry Trust is a loan.



1.43 These amendments operate whether a single entity (the first interposed entity) is, or multiple entities are, interposed between the trust making the payment or loan and the target entity. [Schedule 1, item 25, paragraphs 109XF(1)(c) and 109XG(1)(c)]

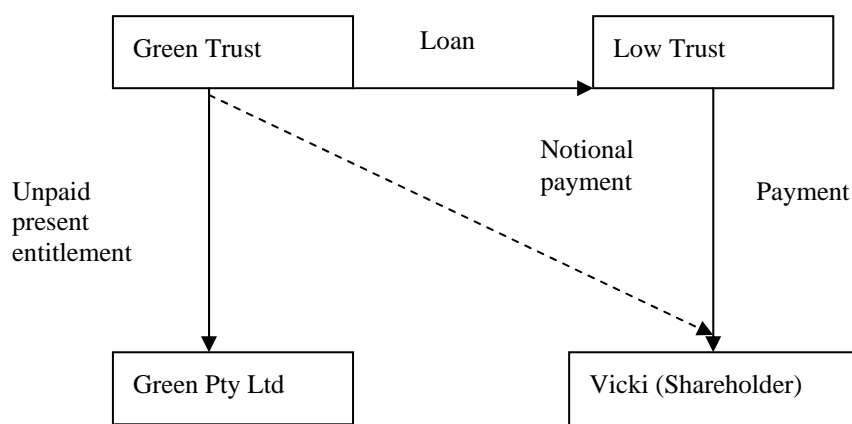
1.44 It does not matter whether the interposed entity makes the payment or loan to the target entity at the same time as the first interposed entity receives a payment or loan from the trustee. The trustee is considered to have made the payment or loan at the time the interposed entity makes the payment or loan to the target entity. [Schedule 1, item 25, subsections 109XF(2) and 109XG(2)]

1.45 Where the interposed entity makes a payment to the target entity the amount is treated as a payment for the purposes of subsection 109XA(1). This means that the payment must be a discharge, or partial discharge, of a present entitlement attributable to an unrealised gain as required by paragraph 109XA(1)(b). [Schedule 1, item 25, subsection 109XF(3)]

Example 1.16

On 1 March 2010, Green Pty Ltd enters into an arrangement involving, Green Trust, Low Trust and Vicki, who is a shareholder of Green Pty Ltd.

As part of this arrangement, the Green Trust declares a present entitlement of \$100,000 to Green Pty Ltd. The present entitlement remains unpaid. Green Trust then loans \$100,000 to Low Trust who makes a \$100,000 payment to Vicki. The \$100,000 payment to Vicki is a discharge of a present entitlement attributable to an unrealised gain in Low Trust (as set out in the diagram).



The effect of section 109XF is that, for the purposes of paragraph 109XA(1)(a), Green Trust has made a payment to Vicki.

Since the payment from Low Trust to Vicki is the discharge of a present entitlement attributable to an unrealised gain, paragraph 109XA(1)(b) is also satisfied. Paragraph 109XA(1)(c) is also satisfied because Green Pty Ltd has an unpaid present entitlement from Green Trust. Accordingly, section 109XB will apply to bring the payment within the scope of Division 7A.

Amount and timing of the payment or loan through interposed entities

1.46 The Commissioner of Taxation (Commissioner) will determine the value of the payment or loan made through an interposed entity under this type of arrangement. *[Schedule 1, item 25, subsection 109XH(1)]*

1.47 In determining this amount, the Commissioner is required to take into account the amount that the interposed entity paid or lent to the target entity, and how much of that amount represented consideration payable to the target entity by the trustee or any of the interposed entities. *[Schedule 1, item 25, subsection 109XH(2)]*

1.48 Any repayments made by the target entity to the interposed entity will be taken into account in working out the value of the loan under Division 7A. *[Schedule 1, item 25, subsection 109XG(3)]*

1.49 The amount determined by the Commissioner cannot exceed the amount of the unpaid present entitlement that the private company has from the trust. *[Schedule 1, item 25, subsection 109XH(3)]*

1.50 The time of the loan or payment is when the loan or payment is made to the target entity by the interposed entity. *[Schedule 1, item 25, subsection 109XH(4)]*

Entitlements to trust income through interposed trusts

1.51 One of the requirements to satisfy subsections 109XA(1) and (3) is that a private company, is or becomes, presently entitled to an amount from the net income of a trust estate that makes the payment, loan or debt forgiveness to the shareholder (or their associate), and that amount has not been paid.

1.52 Interposing one or more trusts between the private company and the trust that makes the payment or loan to the shareholder (or their associate) circumvents the existing operation of Subdivision EA.

1.53 Under subsection 109XI(1), the private company will be treated as having a present entitlement to an amount from the net income of the target trust for the purposes of Division 7A, where:

- one or more trusts is interposed between a private company and the target trust (the trust making the payment to the shareholder of the private company or their associate); and
- a reasonable person would conclude that the private company is, or becomes, entitled to an amount from the net income of the interposed trust, solely or mainly as part of an arrangement involving an entitlement to an amount from the target trust.

[Schedule 1, item 25, subsection 109XI(1)]

1.54 It does not matter whether the private company became, or becomes, entitled to the amount from the net income of an interposed trust at the same time the interposed trust became, or becomes, presently entitled to an amount from the net income of the target trust. *[Schedule 1, item 25, subsection 109XI(2)]*

1.55 The private company is taken to be, or to become, presently entitled to an amount from the net income of the target trust at the time the

private company is, or becomes, presently entitled to an amount from the interposed trust. *[Schedule 1, item 25, subsection 109XI(7)]*

1.56 The amount that the private company is taken to be, or to become, entitled to from the net income of the target trust is the amount determined by the Commissioner. It may be different to the amount to which the interposed trust became presently entitled. *[Schedule 1, item 25, subsection 109XI(4)]*

1.57 In determining this amount, the Commissioner must have regard to the amount the private company is entitled to from the net income of the first interposed trust and how much of that amount the Commissioner considers represents consideration payable to the private company. *[Schedule 1, item 25, subsection 109XI(6)]*

1.58 For the purposes of section 109XI the amount of the present entitlement that the private company is taken to be, or to become, entitled to from the net income of the target trust, is limited by the amount of the present entitlement that the interposed trust is, or becomes, presently entitled to from the net income of the target trust. *[Schedule 1, item 25, subsection 109XI(5)]*

1.59 A private company will not be treated as being presently entitled to an amount if that amount is included in the assessable income of a shareholder or their associate under another provision in Subdivision EA. *[Schedule 1, item 25, subsection 109XI(3)]*

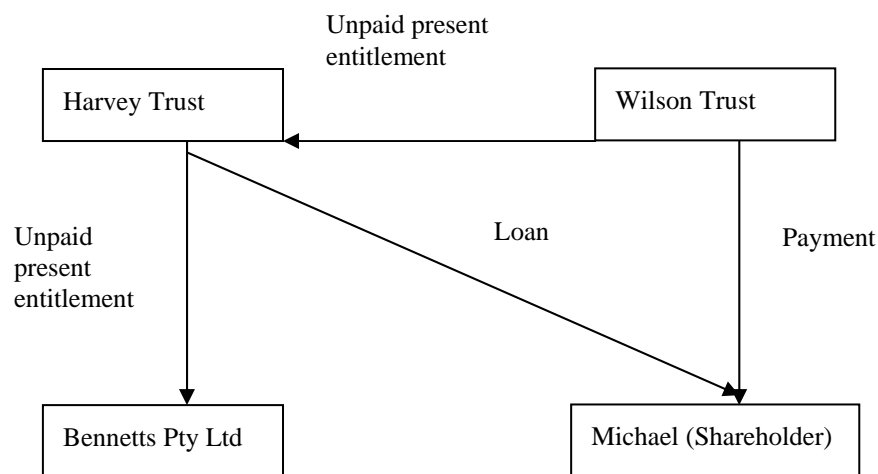
Example 1.17

Michael is a shareholder of Bennetts Pty Ltd and Bennetts Pty Ltd is a beneficiary of Harvey Trust. In the 2009-10 income year, Michael receives a payment from the trustee of the Wilson Trust, which is attributable to an unrealised gain. He receives this payment because of his shareholding in Bennetts Pty Ltd. Michael also receives a \$2,000 non-compliant Division 7A loan from the Harvey Trust.

Bennetts Pty Ltd is not presently entitled to an amount from the net income of the Wilson Trust. However, Bennetts Pty Ltd is entitled to \$10,000 from the net income of the Harvey Trust (the first interposed trust) and Harvey Trust is presently entitled to \$10,000 from the net income of the Wilson Trust. These amounts remain unpaid.

The loan made by the Harvey Trust to Michael will be included in Michael's assessable income under ordinary operation of subsection 109XA(2).

Bennetts Pty Ltd is taken to be presently entitled to \$8,000 from the Wilson Trust, which is the unpaid present entitlement of \$10,000 from the Harvey Trust, reduced by the \$2,000 loan amount that is included in Michael's assessable income under another provision of Subdivision EA.



Loan-back agreements related to the distribution of an unrealised gain

1.60 Under the current law, payments under Subdivision EA must be attributable to an unrealised gain. The amount of the payment that can be taken to be paid is limited to the present entitlement owed to the company that remains unpaid.

1.61 Taxpayers have been entering into arrangements whereby the amount of the payment received by a shareholder (or their associate) from the trustee of a trust, is significantly more than the unpaid present entitlement held by the private company to circumvent the operation of Division 7A.

1.62 The shareholder (or their associate) then loans back to the trust the amount of the payment that exceeds the unpaid present entitlement, held by the private company.

1.63 In a subsequent income year, the trustee declares a present entitlement to the private company that remains unpaid. The trustee makes a loan repayment to the shareholder (or their associate). The repayment of the loan to the shareholder (or their associate) is not caught by the operation of Division 7A as the payment is no longer a discharge of, or a reduction in, a present entitlement of the shareholder (or their associate) that is wholly or partly attributable to an amount that is an unrealised gain within the scope of subsection 109XA(1).

1.64 These amendments ensure that the requirement for the amount to be a discharge of a present entitlement attributable to an unrealised gain is disregarded where the conditions contained in subsection 109XA(1A) are satisfied.

1.65 Subsection 109XA(1A) sets out that paragraph 109XA(1)(b) is disregarded when:

- subsection 109XA(1) has previously applied because the trustee made a payment to the shareholder (or their associate) in an earlier income year;
- the shareholder (or their associate) makes a loan or loans back to the trustee on or after 1 July 2009 and a reasonable person would conclude that the shareholder (or their associate) made or intended to make the loan or loans to the trustee at the time of, or before, the original transaction took place; and
- the trustee makes a repayment of all or part of the loan.

[Schedule 1, item 18, subsection 109XA(1A)]

1.66 Section 109J (which provides that a private company is not taken to pay a dividend because of a payment, to the extent that the payment discharges an obligation of the private company to pay money to the entity on an arm's length basis) does not apply where subsection 109XA(1A) applies. This is to ensure that the loan agreement between the trust and the shareholder of the private company cannot be used to avoid the application of subsection 109XA(1A). *[Schedule 1, item 18, subsection 109XA(1B)]*

Example 1.18

In the 2010-11 income year Trust A re-values an asset and makes a distribution of \$5 million to Lucas who is a shareholder of Willis Pty Ltd. Willis Pty Ltd has a \$500,000 unpaid present entitlement to an amount from the net income of Trust A. Lucas will be required to include \$500,000 of the payment he receives in his assessable income for the 2010-11 income year (subject to the distributable surplus of Willis Pty Ltd).

When Lucas receives the payment from Trust A, he immediately loans the amount back to the trust for \$4.5 million. The trust is obliged to repay the loan over successive income years.

In the 2012-13 income year, Willis Pty Ltd holds an unpaid present entitlement of \$500,000 from the net income of Trust A. The trustee of Trust A again makes a payment of \$500,000 to Lucas. However,

this payment represents a repayment of the outstanding loan to Lucas, rather than a payment in relation to an unrealised gain.

Before the 2009-10 income year, Lucas would not have been required to include this payment in his assessable income under section 109XB. However, from the 2009-10 income year the subsequent payment made by the trustee (the repayment of the loan) is treated as the discharge of a present entitlement of the shareholder (or their associate) that is wholly or partly attributable to an amount that is an unrealised gain.

Definition of non-commercial loans

1.67 The definition of non-commercial loans in section 109Y currently includes the amounts that are shown as assets in the company's accounting records at the end of the year of income that have been taken under section 109D, section 109E and former section 108 to have been paid as dividends in earlier years of income.

1.68 These amendments allow amounts that have been included in the assessable income of a shareholder (or their associate), under section 109XB (about payments taken to be made through interposed entities), to be taken into account when determining the amount of non-commercial loans under section 109Y. [*Schedule 1, item 28, subsection 109Y(2)*]

1.69 Where an amount is included in the non-commercial loan calculation because of section 109XB, it will be reduced by the total of the unfranked parts of any later dividends received by a shareholder (or their associate) which have been set off under section 109ZCA. Subsection 109Y(2A) ensures that the amount of any non-commercial loans, for the purpose of section 109Y, does not result in an underestimate of an entity's distributable surplus. [*Schedule 1, item 30, subsection 109Y(2A)*]

Loans which have been treated as a deemed dividend that are forgiven by a trustee

1.70 Section 109G sets out that a private company is not taken to pay a dividend at the end of a year of income because of the forgiveness of an amount of a debt resulting from a loan, where the loan has already given rise to a deemed dividend. Currently, there is no equivalent provision in the law to allow a forgiven amount to be disregarded if the loan is made by a trustee rather than a private company.

1.71 These amendments introduce section 109XD, which allows an amount of a debt, resulting from a loan, to be forgiven and not be included in the assessable income of a shareholder (or their associate) of a private company where the loan has previously resulted in an amount being

included in the assessable income of the shareholder (or their associate) under section 109XB or former section 109UB. [*Schedule 1, item 24, section 109XD*]

Example 1.19

Anna is a shareholder of Elliot Pty Ltd. In a previous income year, Anna received a non-Division 7A compliant loan from the Dawson Trust that was included in her assessable income under section 109XB.

In the 2009-10 income year, the Dawson Trust forgives the amount of the loan made to Anna. As the loan has already been included in Anna's assessable income under section 109XB, she is not required to include it again in her assessable income.

The offset of later dividends against loans made by trustees

1.72 The current law sets out special rules which allow a later dividend, distributed by a private company to a shareholder (or their associate), to be set off against some or all of an amount that has already been taken to be a deemed dividend, previously paid by a company.

1.73 However, where an amount is instead included in the assessable income of a shareholder (or their associate) under section 109XB, there is no corresponding provision in the law to allow a later dividend from a private company to be set off against this amount.

1.74 These amendments allow for later dividends, distributed by a private company to a shareholder (or their associate), to be set off against some or all of an amount received from a trustee, where that amount has already been included in the assessable income of the shareholder (or their associate) under section 109XB. [*Schedule 1, item 31, subsection 109ZCA(1)*]

1.75 As a later dividend could be part of a general dividend paid by the private company, and the dividend could be either fully or partly franked, an exception is provided so that a later dividend is still considered to be assessable income to the extent that it is franked. [*Schedule 1, item 31, subsections 109ZCA(2) and (3)*]

1.76 This exception means that the franking credit attached to a later dividend is still available to shareholders, to be applied against income tax liabilities, where that franked dividend is used to offset an earlier amount treated as a dividend. [*Schedule 1, item 31, subsection 109ZCA(4)*]

Repayment of a loan by withholding amounts from an employee's salary or bonus

1.77 Under section 109R some repayments made to a private company, in relation to a loan the private company made to an entity, are not taken into account for the purpose of working out how much of the loan has been repaid for the purposes of sections 109D and 109E or the minimum yearly repayment amount in subsection 109E(5).

1.78 Subsection 109R(2) determines which payments will not be taken into account, subject to the exceptions contained in subsection 109R(3).

1.79 Paragraph 109R(3)(b) provides an exception for a payment made by setting off a loan amount against work and income support related withholding payments and benefits payable by the private company. Paragraph 109R(3)(ba) provides an exception for payments covered by section 12-55 of Schedule 1 to the *Taxation Administration Act 1953*. Currently, the exceptions in paragraphs 109R(3)(b) and 109R(3)(ba) cannot be accessed if the repayment being made is for a loan from a trustee, due to the operation of subsection 109XC(8).

1.80 These amendments allow a loan made by a trustee to be repaid by setting off the payments outlined in paragraphs 109R(3)(b) and 109R(3)(ba) against the outstanding amount of the loan. [*Schedule 1, item 23, subsection 109XC(8)*]

Example 1.20

In the 2009-10 income year, Aaron is an employee of the Bell Trust but also a shareholder of Evans Pty Ltd. Evans Pty Ltd has an unpaid present entitlement to an amount from the net income of the Bell Trust.

During the 2009-10 income year, the Bell Trust makes a loan of \$100,000 to Aaron. Aaron arranges for the Bell Trust to set off Aaron's yearly bonus against the outstanding loan as a repayment.

The amount that has been set off is treated as a repayment for the purposes of sections 109D, 109E and subsection 109E(5).

Repayment of a loan to a private company using a re-borrowing

1.81 Subsection 109R(2) currently states that a payment to repay a loan to a private company must not be taken into account if a reasonable person would conclude that, after having regard to all the circumstances, the entity making the repayment intended to obtain a loan from the private company of an amount similar to, or larger than, the repayment when the payment was made to the private company.

1.82 These amendments extend the operation of subsection 109R(2) to ensure that where a reasonable person would conclude that an entity obtained a loan from the private company, of an amount similar to, or larger than the payment, before the payment was actually made, the payment will not be taken into account for the purpose of working out how much of the loan is repaid under sections 109D and 109E, or the minimum yearly repayment amount under subsection 109E(5).

1.83 In certain circumstances, it may already be possible to disregard these payments. However, these amendments will put this matter beyond doubt and remove any ambiguity. [*Schedule 1, item 15, subsection 109R(2)*]

Example 1.21

Alicia obtains a loan of \$10,000 from Cleary Pty Ltd. Alicia has until the lodgment day to repay the loan. Two weeks before the lodgment day Alicia obtains a further \$10,000 from Cleary Pty Ltd. She then repays the original \$10,000 loan a week before the lodgment day.

The repayment of the original \$10,000 loan is not a repayment for the purposes of section 109D, because Alicia has borrowed a similar amount from Cleary Pty Ltd and in this case a reasonable person would conclude that the loan was obtained in order to make the repayment of the original \$10,000.

The original \$10,000 loan is treated as a deemed dividend subject to the distributable surplus of the private company.

Inclusion of Division 7A amounts in distributable surplus calculation

1.84 The current law does not include amounts that have been paid out by a private company in the form of a payment or a forgiveness of debt during an income year in the distributable surplus calculation made under subsection 109Y(2).

1.85 By excluding these amounts, the current formula in subsection 109Y(2) understates the distributable surplus of a private company. This may lead to an artificial reduction in the amount of deemed dividends that a private company is considered to have paid during the relevant income year.

1.86 These amendments correct this anomaly by including a reference to Division 7A amounts in the distributable surplus formula in subsection 109Y(2). This reference ensures that amounts that have been taken to be payments, under section 109C or the forgiveness of a debt under section 109F, are included in the distributable surplus of a private company under subsection 109Y(2). [*Schedule 1, item 27, subsection 109Y(2)*]

Example 1.22

On 29 June 2005, a private company has real property valued at its historical cost in the company's accounting records of \$500,000, which it acquired before 1985. The real property has a market value of \$1,500,000 and the private company has liabilities of \$400,000 and paid-up capital of \$100,000. For section 44 purposes, the private company has 'profits' of \$1,000,000 which reflects the unrealised gain in the real property.

If, on 29 June 2005, the private company makes an *in specie* distribution of the real property to a shareholder, an amount of \$1,000,000 would be included in the shareholder's assessable income as a dividend under section 44.

However, if instead of making the *in specie* distribution, the private company sells the real property to the shareholder for \$500,000, the sale of the real property is a payment within the meaning of paragraph 109C(3)(c) of an amount determined under subsection 109C(4) – being \$1,000,000.

The private company's distributable surplus under section 109Y is determined according to the private company's accounting records as at 30 June 2005. As at that date, the private company has assets of \$500,000 (being the proceeds on disposal of the real property), liabilities of \$400,000 and paid-up capital of \$100,000. The net assets of the private company for section 109Y purposes is \$100,000 and the private company's distributable surplus after deducting paid up share capital of \$100,000 is nil before these amendments. The end result is no amount is treated as a dividend under Division 7A.

By selling the real property to the shareholder at its historical cost, the private company has achieved a disguised distribution of \$1,000,000 to the shareholder tax free.

If this same transaction occurs from the 2009-10 income year after these amendments, the amount of the payment for the purpose of paragraph 109C(3)(c) will be included in the distributable surplus of the private company as a Division 7A amount. Hence, the company's distributable surplus will be \$1,000,000 and the shareholder of the company will be required to include a deemed dividend of \$1,000,000 in their assessable income.

Application of Division 7A to a resident shareholder or their associate

1.87 There has been some conjecture as to whether Division 7A applies to circumstances where a shareholder of a private company (or their associate) is an Australian resident and the private company involved in the arrangement is a foreign resident.

1.88 Section 109BC will put beyond doubt that Division 7A applies in relation to these arrangements and that the Australian resident will be liable to pay tax on any deemed dividends that arise under the operation of Division 7A.

1.89 Subsection 109BC(1) ensures that the relevant tax accounting period for a foreign company applies for the purposes of Division 7A. Subsection 109BC(2) ensures that where a company is resident in more than one foreign country the tax accounting period that ends first will be the relevant tax accounting period for the purpose of Division 7A.
[Schedule 1, item 11, section 109BC]

Application and transitional provisions

1.90 These amendments apply from 1 July 2009. *[Schedule 1, item 35]*

Chapter 2

Extending the tax file number withholding arrangements to closely held trusts, including family trusts

Outline of chapter

2.1 Schedule 2 to this Bill amends the *Income Tax Assessment Act 1936* (ITAA 1936), the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Taxation Administration Act 1953* (TAA 1953) to extend the existing arrangements for tax file number (TFN) withholding to cover closely held trusts, including family trusts. The information collected by the Australian Taxation Office (ATO) under these amendments will facilitate data-matching and allow the ATO to check whether the assessable income of beneficiaries of these trusts correctly includes their share of the net income of the trust.

2.2 All references to legislative provisions in this chapter are references to the TAA 1953 unless otherwise stated.

Context of amendments

2.3 In the late 1990s it became apparent that complex chains of trusts were being used to avoid or indefinitely defer tax. In order to address this issue, legislation was passed to require a trustee of a closely held trust to advise the Commissioner of Taxation (Commissioner) of certain details about a trust's ultimate beneficiaries and tax-preferred distributions to beneficiaries. Failure to do this, or there being no ultimate beneficiary, rendered the trustee liable to pay an *ultimate beneficiary non-disclosure tax* at the top marginal tax rate plus the Medicare levy.

2.4 The purpose of that measure was to allow the Commissioner to check that the assessable income of ultimate beneficiaries correctly included their share of trust income and that the net assets of ultimate beneficiaries reflected their receipt of tax-preferred amounts.

2.5 This measure proved to be very difficult to comply with for some trustees of closely held trusts. Consequently, from the 2008-09 income year, the ultimate beneficiary reporting rules were replaced by the

trustee beneficiary reporting rules which now require trustees of closely held trusts to report information to the Commissioner in respect of each beneficiary that is itself a trustee entitled to a share of the trust's net income or to receive tax-preferred amounts.

2.6 However, these new reporting requirements are limited to trustee beneficiaries and do not apply in respect of beneficiaries who are individuals or companies. Additionally, family trusts that have made a family trust election under the trust loss provisions in Schedule 2F to the ITAA 1936 are not subject to the trustee beneficiary reporting rules.

2.7 The current TFN withholding arrangements apply to various entities that pay or distribute income. However, the TFN withholding arrangements do not apply to trusts unless they are unit trusts.

2.8 Consequently, as part of the 2009-10 Budget, the Government announced that, with effect from 1 July 2010, it would extend the current TFN withholding arrangements to cover closely held trusts, including family trusts.

Summary of new law

2.9 This Schedule extends the TFN withholding regime under Subdivision 12-E of Schedule 1 to the TAA 1953 to closely held trusts (including family and related trusts) in respect of eligible beneficiaries to which these amendments apply. Where an eligible beneficiary receives a distribution, or at the end of the income year is presently entitled to income of the trust and the beneficiary has failed to quote their TFN to the trustee of the trust prior to that time, they will be subject to TFN withholding arrangements under these amendments.

2.10 There are four stages to the operation of these amendments where a relevant beneficiary has failed to provide their TFN to the trustee.

- The first stage imposes a withholding obligation on the trustee where a withholding event under these amendments occurs.
 - A withholding event occurs when the trustee of a trust makes a distribution to an eligible beneficiary, or when an eligible beneficiary becomes presently entitled to a share of income of the trust and the beneficiary has failed to quote their TFN to the trustee prior to either the distribution time or the end of the income year.

- When a withholding event occurs the trustee is required to withhold prior to making the distribution or for a present entitlement case, at the end of the income year.
- The second stage requires the trustee of a relevant trust to report and remit those amounts withheld to the Commissioner.
 - The trustee is required to register for pay as you go (PAYG) withholding with the ATO as well as report and remit amounts on an annual basis.
 - The trustee is also required, through the trust income tax return, to report amounts distributed to eligible beneficiaries that would have been subject to withholding had the relevant beneficiary failed to quote their TFN to the trustee.
- The third stage involves the crediting of the amounts withheld by the trustee in respect of a beneficiary on assessment of their income tax liability.
- The fourth stage involves the imposition of penalties on the trustee for failing to withhold and/or failing to remit the amount withheld to the Commissioner.
 - These penalties are the same as those that apply under the current TFN withholding arrangements.

2.11 TFN withholding does not apply where a beneficiary has provided their TFN to the trustee prior to either the time the trustee makes a distribution or at the end of the income year in the case of present entitlement amounts.

2.12 The trustee is required to report the TFNs quoted by beneficiaries to the Commissioner in the approved form. The trustee is only required to report a quoted TFN once (upon validation of it being the correct TFN) and will report the TFNs collected during a quarter in a quarterly report. Where the trustee has no new TFNs to report for a quarter, they are not required to lodge a report for that relevant quarter.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
From the 2010-11 income year, trustees of closely held trusts (and family and related trusts) must withhold amounts in respect of either distributions made to eligible beneficiaries, or at the end of the income year where the beneficiary is presently entitled to a share of the income of the trust. This obligation arises where the beneficiary fails to quote their TFN to the trustee prior to receiving the distribution or becoming presently entitled to the amount.	No equivalent.
Trustees of trusts subject to these amendments are required to report and remit amounts withheld under TFN withholding on an annual basis. Trustees are also required to report in their trust income tax return on amounts that would have been subject to withholding had the relevant beneficiary failed to quote their TFN to the trustee.	The current TFN withholding arrangements do not apply to closely held trusts.
Eligible beneficiaries who have had amounts withheld under these amendments are entitled to a credit for those amounts assessed in their income tax return.	The current TFN withholding arrangements do not apply to closely held trusts.
Trustees of trusts subject to these amendments are required to withhold and remit amounts withheld to the Commissioner or face administrative penalties for failure to withhold and/or remit an amount withheld.	The current TFN withholding arrangements do not apply to closely held trusts.
Trustees of trusts subject to these amendments are required to report to the Commissioner any TFNs quoted by their beneficiaries on a quarterly basis. Failure to do so exposes the trustee to an administrative penalty.	The current TFN withholding arrangements do not apply to closely held trusts.

Detailed explanation of new law

Scope of these amendments

2.13 The current arrangements for TFN withholding apply to various relationships including employer/employee, investment body/investor and superannuation provider/superannuant. In the context of trusts, TFN withholding in respect of investments applies to trusts (including closely held trusts) that are ‘unit trusts’ as defined in section 202A of the ITAA 1936.

2.14 This Schedule extends the TFN withholding arrangements to most closely held trusts, including family trusts. The scope of these amendments is broadly intended to cover all beneficiaries of those trusts. However, there are certain trusts and certain classes of beneficiaries that are excluded from the operation of this measure.

Trustees and trusts subject to this measure

2.15 These amendments apply to trustees of closely held trusts, including family trusts. The concept of a ‘closely held trust’ is defined in subsection 102UC(1) of the ITAA 1936 to mean a trust that is not an ‘excluded trust’ that:

- has up to 20 beneficiaries who have fixed entitlements to a 75 per cent or greater share of the income, or a 75 per cent or greater share of the capital, of the trust; or
- is a ‘discretionary trust’.

[Schedule 2, item 5, subparagraph 12-175(1)(c)(ii)]

2.16 An ‘excluded trust’, for the purpose of the definition of ‘closely held trust’, is defined in subsection 102UC(4) of the ITAA 1936 and includes complying superannuation funds, complying approved deposit funds, pooled development funds, deceased estates and fixed trusts that are unit trusts where exempt entities have fixed entitlements to all the income and capital of the trust (see paragraph (a) of the definition).

[Schedule 2, item 5, subparagraph 12-175(1)(c)(ii)]

2.17 The definition of closely held trusts in section 102UC also explicitly excludes family trusts. ‘Family trusts’ in that context include those trusts that have made a family trust election and those trusts covered by an interposed entity election that the trust is to be included in the family group of the individual specified in the family trust election. It also includes those owned by the family group of that individual (see paragraphs (c) to (e) of that definition).

2.18 However, for the purposes of these amendments, the use of the term ‘closely held trusts’ also includes family trusts and the related trusts covered under paragraphs (c) to (e) of the definition in section 102UC of the ITAA 1936. *[Schedule 2, item 5, subparagraph 12-175(1)(c)(ii)]*

2.19 For the purposes of this chapter, the use of the term ‘closely held trusts’ is intended to also cover family trusts as included within the scope of these amendments.

Trustees and trusts excluded from this measure

2.20 These amendments do not apply to trustees of trusts that do not meet the concept of closely held trust as defined under this measure. Additionally, closely held trusts that are not ‘resident trust estates’ as defined under subsection 95(2) of the ITAA 1936 are excluded from this measure. *[Schedule 2, item 5, subparagraph 12-175(1)(c)(i)]*

2.21 In the situation where a closely held trust is also a unit trust within the meaning of section 202A of the ITAA 1936, the trust will be subject to the TFN withholding rules both in respect of investments and under these amendments. In that situation the TFN withholding rules in respect of investments will apply in priority to the rules under these amendments. *[Schedule 2, item 4, subsection 12-5(2) (item 5 in the table, column headed ‘in priority to:’)]*

Example 2.1

The Newman Trust is a closely held unit trust that is a unit trust within the meaning of section 202A of the ITAA 1936 and has 10 beneficiaries (five of which are individuals and five are companies). Of all the beneficiaries, only Ray, Helen and Lindy Lou Pty Ltd have failed to provide their TFN prior to becoming presently entitled to a share of income of the Newman Trust.

Consequently, the Newman Trust is required to withhold an amount from each share (as if it was a payment) by reason of section 12-145 of the ITAA 1936. As the Newman Trust is subject to the TFN withholding rules applying to investment bodies, it is not also required to withhold under these amendments.

2.22 These amendments also facilitate the exemption of trusts as prescribed under the regulations. This provision will provide flexibility to exclude classes of trusts that may be inadvertently within the scope of this measure. *[Schedule 2, item 5, subparagraph 12-175(1)(c)(iii)]*

Beneficiaries that are subject to this measure

2.23 Generally, these amendments apply to all beneficiaries of closely held trusts, irrespective of whether they are individuals, companies or trusts. The amendments however, do not apply to excluded beneficiaries (see paragraph 2.25). [*Schedule 2, item 5, paragraph 12-175(1)(d)*]

2.24 Additionally, there are special rules that apply under these amendments to beneficiaries (including trustee beneficiaries) who are not liable to pay tax under section 98 of the ITAA 1936. There are also special rules that apply to beneficiaries (including trustee beneficiaries) that are impacted by either the family trust distribution tax or the trustee beneficiary reporting rules (refer respectively to Division 271 of Schedule 2F to the ITAA 1936 and Division 6D of Part III of the ITAA 1936). These rules are discussed in further detail from paragraphs 2.26 to 2.37.

Beneficiaries that are excluded from this measure

2.25 Certain beneficiaries are not within the scope of this measure. These classes of beneficiaries are:

- non-residents (as under Division 6 of the ITAA 1936, the trustee pays tax on their behalf) [*Schedule 2, item 5, subparagraph 12-175(1)(d)(i)*];
- an ***exempt entity***, as defined in section 995-1 of the ITAA 1997 to mean an entity all of whose ordinary or statutory income is exempt from income tax [*Schedule 2, item 5, subparagraph 12-175(1)(d)(ii)*]; or
- those under a legal disability (for example, minors and bankrupts) pursuant to section 98 of ITAA 1936 (as the trustee is liable to pay tax on their behalf) [*Schedule 2, item 5, subparagraph 12-175(1)(d)(iii)*].

The treatment of entities not liable to pay tax in respect of distribution or share under section 98 of the ITAA 1936

2.26 A special rule applies where a trustee is liable to pay tax on behalf of a beneficiary (under section 98 of the ITAA 1936) in respect of a particular share or distribution, where the beneficiary is not under a legal disability.

2.27 As discussed in paragraph 2.25, beneficiaries under a legal disability (pursuant to section 98 of the ITAA 1936) are exempt from this measure. However, under the current law, there are situations where a

trustee is liable on the behalf of a beneficiary where they are not under a legal disability but only in respect of a particular share or distribution.

2.28 One such situation arises where a beneficiary receives a vested and indefeasible interest in any of the trust and is deemed to be presently entitled by the operation of subsection 95A(2) of the ITAA 1936. In that situation subsection 98(2) of the ITAA 1936 operates so that the trustee is liable to pay tax in respect of that deemed present entitlement.

2.29 Under these amendments, where the trustee is liable to pay tax in respect of a share or distribution under section 98 of the ITAA 1936, they will not be required to withhold on that particular amount. *[Schedule 2, item 5, paragraphs 12-175(2)(b) and 12-180(2)(b)]*

2.30 The intention of this exclusion is to cover those beneficiaries who are not under a legal disability, but some portion of their share or distribution is caught under section 98 of the ITAA 1936 and the trustee is liable for tax, but only in respect of that specific amount. Those beneficiaries who *are* under a legal disability pursuant to section 98 of the ITAA 1936, will continue to be excluded from this measure entirely.

The treatment of entities subject to family trust distribution tax

2.31 Special rules apply under these amendments to trusts where the trustee is liable to pay the family trust distribution tax.

2.32 Where the trust is a family trust and the beneficiary (and/or trustee beneficiary) is within that trust's 'family group', the beneficiary is subject to these amendments in the same way as all other beneficiaries. *[Schedule 2, item 5, paragraphs 12-175(2)(d) and 12-180(2)(d)]*

2.33 However, where that trust confers present entitlement or makes a distribution of trust income to a beneficiary outside of that 'family group', the trust will be subject to the family trust distribution tax, which is a final tax liability (equivalent to 46.5 per cent). Consequently, where the trustee is liable to pay the family trust distribution tax they will not also be required to withhold an amount in respect of these amendments. *[Schedule 2, item 5, paragraphs 12-175(2)(d) and 12-180(2)(d)]*

2.34 This rule extends to all beneficiaries (including trustee beneficiaries) who receive distributions from the parent trust but are outside of the family group of the parent trust. *[Schedule 2, item 5, paragraphs 12-175(2)(d) and 12-180(2)(d)]*

Example 2.2

Stephen, as the trustee of the Gordon Family Trust, has made a family trust election identifying Mr. Gemmell as the nominated individual.

The beneficiaries of the trust include Les, Scott, Tom and the trustee of the Schneider Trust. While Scott, Tom and the Schneider Trust are all members of the family group of Mr. Gemmell, Les is not. At the end of the income year, each of the beneficiaries is made presently entitled to income of the Gordon Family Trust. However, Les, Scott and the Schneider Trust have failed to quote their TFN to Stephen prior to the end of the income year.

When Les becomes presently entitled to a share of the income of the trust, Stephen as trustee of the Gordon Family Trust becomes liable to pay the family trust distribution tax. As the imposition of that tax takes precedence over the TFN withholding under these amendments, Stephen is not required to withhold in respect of Les.

However, as Scott and the Schneider Trust are within the family group of Mr. Gemmell, no obligation to pay the family trust distribution tax arises and Stephen will be required to withhold an amount under this measure in respect of Scott and the trustee of the Schneider Trust.

As Tom has quoted his TFN prior to the end of the income year, Stephen will not be required to withhold from Tom.

Treatment of entities subject to the trustee beneficiary reporting rules

2.35 Special rules also apply under these amendments to trustees that are subject to the trustee beneficiary reporting rules under Division 6D of Part III of the ITAA 1936. Division 6D imposes obligations on the trustee of a closely held trust as defined in section 102UC of the ITAA 1936 in respect of a beneficiary that is itself the trustee of a trust (a trustee beneficiary).

2.36 Where a trust is subject to these trustee beneficiary reporting rules, they will not be required to withhold amounts under this measure in respect of the trustee beneficiary. [*Schedule 2, item 5, paragraphs 12-175(2)(c) and 12-180(2)(c)*]

2.37 Trusts subject to the trustee beneficiary rules in respect of distributions made to trustee beneficiaries are excluded from this measure for two reasons. Firstly, trusts subject to the trustee beneficiary reporting rules will be required to provide a correct trustee beneficiary statement to the Commissioner to which the trustee beneficiary's TFN would be included. Secondly, a failure to provide a correct trustee beneficiary statement (including the trustee beneficiary's TFN) exposes the trustee to the trustee beneficiary non-disclosure tax which is a final tax liability (equivalent to 46.5 per cent). [*Schedule 2, item 5, paragraphs 12-175(2)(c) and 12-180(2)(c)*]

Example 2.3

The Spiller Trust is a closely held trust for the purposes of Division 6D of the ITAA 1936. Its beneficiaries include an Australian resident company, Lolly Pty Ltd, and the trustees of the Simon Trust and the McCarthy Trust (which are also both closely held trusts). None of the three beneficiaries have provided their TFNs to the trustee of the Spiller Trust. At the end of the income year, the Spiller Trust determines that each beneficiary's share of present entitlement to the net income of the trust is \$100.

As Lolly Pty Ltd is a company and a beneficiary of the Spiller Trust, it remains subject to TFN withholding under these amendments. Consequently, the Spiller Trust is required to withhold from Lolly Pty Ltd's entitlement to the share of net income of the trust.

However, as Spiller Trust is subject to the trustee beneficiary reporting rules and is required to provide a correct trustee beneficiary statement for both the Simon Trust and the McCarthy Trust, the Spiller Trust is not required to withhold under this measure in respect of either trustee beneficiary.

Withholding obligations

2.38 For trustees and beneficiaries subject to this measure, a TFN withholding obligation will arise where either the trustee makes a distribution of an amount that includes ordinary or statutory income to the beneficiary, or at the end of the income year where the beneficiary is presently entitled to a share of the income of the trust and in either case, the beneficiary has failed to quote their TFN to the trustee.

Withholding obligation where the trustee distributes trust income

2.39 A withholding obligation will arise in respect of distributions made where:

- a trustee makes a distribution to an eligible beneficiary [*Schedule 2, item 5, paragraph 12-175(1)(a)*];
- some or all of the distribution is ordinary or statutory income of the trust [*Schedule 2, item 5, paragraph 12-175(1)(b)*];
- some or all of the distribution is not in respect of a share of net income to which the beneficiary was presently entitled to and otherwise subject to TFN withholding under this measure [*Schedule 2, item 5, subsection 12-175(4)*]; and

- the beneficiary has failed to quote their TFN at the time the distribution is made (the *distribution time*) [*Schedule 2, item 5, subsection 12-175(1)*].

2.40 However, this withholding obligation will only arise where the distribution described above is not subject to any of the special rules discussed in paragraphs 2.26 to 2.37. [*Schedule 2, item 5, paragraphs 12-175(2)(b) to (d)*]

Example 2.4

The trustee of the Kretschmann Trust (which is a closely held trust under this measure) makes regular distributions throughout the year to its two beneficiaries (Pierce and Regina). Pierce has provided his TFN to the trustee of the Kretschmann Trust prior to the making of these distributions but Regina has not.

As Regina has failed to quote her TFN prior to the trustee making the distribution, a withholding obligation is triggered for the Kretschmann Trust in respect of the distributions made to Regina.

2.41 Where the distribution made is not a payment, the PAYG withholding regime (Part 2-5 of Schedule 1 to the TAA 1953) will apply as if the trustee had paid the amount of the distribution to the beneficiary at the distribution time. [*Schedule 2, item 5, subsection 12-175(3)*]

2.42 This withholding obligation imposed on the trustee operates independently of the reporting obligations imposed under these amendments (including the requirement to report amounts withheld and to pay the amounts withheld to the Commissioner). The withholding obligation under this measure may arise at any point during the income year (where a distribution is made), whereas these amendments provide for reporting and remittance on an annual basis (discussed further in paragraphs 2.56 and 2.76). [*Schedule 2, item 5, subsections 12-175(1) and (2)*]

Withholding obligation where the beneficiary becomes presently entitled to trust income

2.43 Where, at the end of the income year, the beneficiary is presently entitled to a share of trust income, a withholding obligation arises on that share of the net income of the trust, where the beneficiary has failed to quote their TFN, but only to the extent that withholding has not occurred on a distribution of all or part of the amount during the income year. [*Schedule 2, item 5, subsections 12-180(1), (2) and (4)*]

2.44 However, this withholding obligation will only arise where the share of net income described above is not subject to any of the special

rules discussed in paragraphs 2.26 to 2.37. [*Schedule 2, item 5, paragraphs 12-180(2)(b) to (d)*]

Example 2.5

The ABC Trust (which is a closely held trust under this measure) has three beneficiaries (Jo, Rhonda and Sydney Pty Ltd). The ABC Trust has not made any distributions to the beneficiaries during the income year.

At the end of the income year, the trustee of the ABC Trust resolves to make each of the three beneficiaries presently entitled to a share of the income of the trust. Jo and Rhonda quoted their TFNs to the trustee of the ABC Trust prior to the end of the income year; however, Sydney Pty Ltd had failed to do so.

Consequently, the ABC Trust has a withholding obligation in respect of Sydney Pty Ltd's share of net income of the trust.

2.45 Where a trust ends during the income year, the withholding obligation in respect of present entitlement will apply as if the time occurring just before the trust ends, was the end of the income year. [*Schedule 2, item 5, subsection 12-180(5)*]

2.46 For the purposes of consistency with the TFN withholding framework, the PAYG withholding regime (Part 2-5 of Schedule 1 to the TAA 1953) will continue to apply as if the trustee had paid the share of income to the beneficiary at the end of the income year even though the beneficiary may be merely entitled to that share of the net income. [*Schedule 2, item 5, subsection 12-180(3)*]

2.47 Consequently, where a withholding obligation arises the trustee will be required to withhold an amount from this deemed payment and must do so at the end of the income year. [*Schedule 2, item 9, section 16-5*]

Withholding obligations operating together

2.48 Under these amendments, where a beneficiary has an amount withheld on a distribution during the year, the obligation arises at that point of distribution. Consequently, at the end of the income year, where a beneficiary is presently entitled to a share of income that includes distributions made during the income year, the withholding obligation that arises in respect of the present entitlement amount will be to the extent that the amount is in addition to the distributions made during the income year that were subject to a withholding obligation. [*Schedule 2, item 5, subsection 12-180(4)*]

2.49 This means that amounts withheld from distributions made during the income year will be offset against a withholding obligation that arises at the end of the income year in respect of present entitlement.

Example 2.6

The trustee of the Mahoney Trust (which is a closely held trust under this measure) makes a distribution of ordinary income of \$200 to each of its beneficiaries (Kate and Tamzin) during the income year. At the end of the income year, the trustee of the Mahoney Trust determines the income of the trust for the year was \$1,000 (and the net income was also \$1,000) and further determines that each beneficiary is presently entitled to the remaining \$600 (apportioned to each beneficiary as an end of year share of net income of \$300).

Both Kate and Tamzin have failed to quote their TFNs to the trustee before the end of the income year.

As both Kate and Tamzin failed to provide their TFN by the distribution time, a withholding obligation arose in respect of each \$200 distribution. In discharging this obligation, the trustee withheld from these distributions at the distribution time.

The operation of these amendments means that for each beneficiary the \$200 distribution can be subtracted from the beneficiary's total share of the net income of the trust (which is \$500). This means that for each beneficiary, the withholding obligation in respect of present entitlement will only extend to the remaining portion of the share.

Consequently, as both Kate and Tamzin have failed to quote their TFN by the end of the income year, the trustee has an additional withholding obligation for each beneficiary on their further entitlements of \$300 (calculated as: \$500 (total share) – \$200 (the amount already withheld upon)).

2.50 In summary, and subject to the exceptions explained above, an obligation on a trustee of a closely held trust to withhold under these amendments arises where:

- the beneficiary receives a distribution from the trustee (which is wholly or partly ordinary or statutory income of the trust);
or
- at the end of the income year, the beneficiary is presently entitled to a share of income of the trust;

and in either case:

- the beneficiary has not quoted their TFN to the trustee prior to either the making of the distribution or being presently entitled to a share of the income of the trust at the end of the year; and
- the distribution or share is not subject to any of the special rules under these amendments (not a distribution or share in respect of section 98 of the ITAA 1936 or subject to trustee beneficiary reporting rules or family trust distribution tax).

Amount to withhold

2.51 In accordance with existing subsection 15-10(2) of Schedule 1 the amount required to be withheld under this measure will be worked out under the regulations. Accordingly, the following paragraphs are only indicative of the amounts intended to be withheld for each obligation.

2.52 The withholding rate intended to be applied for both obligations will be established under the regulations but is intended to match the ‘top rate’. The *top rate* is defined under Subregulation 34(4) of the *Taxation Administration Regulations 1976* as the sum of the highest rate specified in Part I of Schedule 7 to the *Income Tax Rates Act 1986* and the rate of the levy specified in subsection 6(1) of the *Medicare Levy Act 1986*. This rate is currently applied for TFN withholding in respect of investments and is 46.5 per cent.

The amount to withhold in respect of a distribution of trust income

2.53 Under this measure, where a withholding obligation arises from a distribution made during the income year, the amount to withhold will be quantified based on the distribution as a whole. [*Schedule 2, item 5, subsection 12-175(1)*]

Amount to be withheld = $D \times R$

Where:

D = the distribution made to the beneficiary; and

R = the rate worked out under the regulations.

Example 2.7

As in Example 2.4 the trustee of the Kretschmann Trust has a withholding obligation in regards to distributions made during the year to the beneficiary Regina.

On 23 September 2011, the trustee distributes \$1,000 of trust income to Regina. As a withholding obligation exists, the trustee of the Kretschmann Trust must withhold an amount calculated as 46.5 per cent of the value of the distribution. This amount equates to a withholding of \$465 from the distribution.

2.54 The withholding quantum is intended to apply to the full amount of the distribution made during the year in respect of the income for that income year, regardless of whether the distribution forms part of the share of the net income to which the beneficiary becomes presently entitled at the end of that income year.

The amount to withhold in respect of present entitlement to trust income

2.55 Under this measure, where a withholding obligation arises in respect of present entitlement, the amount to withhold will be quantified on the beneficiary's share of the net income of the trust. [*Schedule 2, item 5, subsection 12-180(1)*]

$$\text{Amount to be withheld} = S \times R$$

Where:

S = the beneficiary's share of the net income of the trust; and

R = the rate worked out under the regulations.

Example 2.8

The Evans Trust (which is a closely held trust under this measure) has three beneficiaries. These beneficiaries are Courtney, Michael and Bennett Pty Ltd. The trustee of the Evans Trust has made no distributions to the beneficiaries during the income year. At the end of the year, the trustee of the Evans Trust makes a determination that each beneficiary is presently entitled to trust income of \$1,000. However, both Michael and Bennett Pty Ltd have failed to quote their TFNs to the trustee prior to the determination.

Consequently, upon making Michael and Bennett Pty Ltd presently entitled to a share of the income of the Evans Trust, a withholding obligation arises. The trustee is then required to withhold from Michael and Bennett Pty Ltd, an amount calculated as 46.5 per cent of the corresponding share of the net income of the trust, where the net income is calculated under section 95 of the ITAA 1936.

As Courtney has provided her TFN to the trustee prior to the end of the income year, no withholding obligation has arisen in respect of her share of present entitlement.

Payment of amounts withheld

2.56 Where a withholding obligation arises, the trustee is required to remit the amount withheld to the Commissioner. Under existing law, entities that withhold from payments must remit those amounts withheld to the Commissioner in accordance with the framework in Subdivision 16-B of Schedule 1 to the TAA 1953. This framework stipulates different remittance cycles for different sized withholders.

2.57 These remittance cycles apply weekly, monthly or quarterly for large, medium or small withholders respectively. For each withholder, the date of remittance is tied to the date of the withholding event.

2.58 Under these amendments, trustees that are required to withhold are not required to remit under the weekly/monthly/quarterly cycle. Rather, they are required to remit withheld amounts to the Commissioner in an approved form through the business activity statement (BAS) system on an annual cycle. *[Schedule 2, item 11, subsection 16-75(5)]*

2.59 This will require the trustee to register for PAYG withholding with the ATO and to pay the amount to the Commissioner by the 28th day of the next month following the day the trustee is required to lodge their annual report for withholding amounts (discussed in paragraph 2.76). *[Schedule 2, item 11, paragraph 16-75(5)(a)]*

2.60 The requirement to remit the amount withheld by the end of the 28th day of the month following required lodgment of the annual report is intended to administratively align with the quarterly BAS cycle and to accommodate those entities who are deferred BAS payers. The due date for payment can be longer if the Commissioner allows. *[Schedule 2, item 11, paragraph 16-75(5)(b)]*

Example 2.9

As in Example 2.8, a withholding obligation has arisen for the Evans Trust in respect to present entitlement of a share of the trust income made to both Michael and Bennett Pty Ltd.

In discharging this obligation the trustee of the Evans Trust withholds the equivalent rate (46.5 per cent) from each entitlement totalling \$465 each (calculated as $\$1,000 \times 0.465$).

The Evans Trust annual report is due on 30 September 2011, however the trustee lodges the annual report earlier on 28 July 2011. Despite the early lodgment, the Evans Trust is still required to remit the \$930 withheld through the relevant BAS by 28 October 2011.

Reporting requirements

2.61 Associated with the withholding obligations introduced under these amendments, the trustee is required to comply with three main reporting obligations to the Commissioner and to their beneficiaries.

First requirement: Reporting of TFNs quoted

2.62 Once a TFN has been quoted to the trustee, the trustee is required to report the beneficiary's TFN to the Commissioner in the approved form if the trustee has not previously reported the TFN.

2.63 Under the current TFN withholding arrangements, TFNs quoted to the withholder are reported to the Commissioner through different mechanisms. In the employer/employee scenario, TFNs are reported using TFN declarations. However, under Regulation 55 of the *Income Tax Regulations 1936*, TFNs quoted in respect of the investment body/investor scenario are reported through quarterly reports.

2.64 Under these amendments, as the withholding obligation can occur upon the making of a distribution (which can occur at any point in time during the income year), or the determination of present entitlement to a share of income (which generally occurs annually), TFNs quoted in respect of these amendments are to be reported on a quarterly basis. The reporting of these TFNs will be in a form approved by the Commissioner and the report must be provided to the Commissioner within one month after the end of the quarter to which it relates (or within such further time as the Commissioner allows). [*Schedule 2, item 1, subsections 202DP(1) and (2) of the ITAA 1936*]

Example 2.10

Tara has recently become a beneficiary of the existing Jackson Trust (which is a closely held trust under this measure). In accordance with these amendments, Tara quotes her TFN to the trustee of the Jackson Trust on 4 July 2011. Upon quotation of Tara's TFN, the trustee becomes obligated to report the TFN in the approved form within one month after 30 September 2011.

Quotation of the TFN

2.65 Under the current TFN withholding arrangements, provisions exist to facilitate the correct quotation of the TFN to the payer, in addition to providing administrative mechanisms to deal with the incorrect quotation of a TFN.

2.66 These amendments will replicate features of the current administrative requirements and facilitate the administrative mechanism

to deal with the incorrect quotation of the TFN. *[Schedule 2, item 1, sections 202DN, 202DO, 202DP and 202DR of the ITAA 1936]*

2.67 Where an incorrect TFN has been quoted and reported to the Commissioner, these amendments facilitate two mechanisms for the Commissioner to resolve this issue. The first mechanism under these amendments provides the Commissioner with the power to correct the incorrectly quoted TFN using the information available and may give the trustee a notice in writing indicating that the TFN quoted is incorrect or otherwise wrong and that the Commissioner has been able to ascertain the correct TFN. *[Schedule 2, item 1, subsection 202DR(1) of the ITAA 1936]*

2.68 Where the Commissioner is able to successfully correct an incorrectly quoted TFN, the beneficiary will be treated as having quoted their TFN from the day in which they originally quoted their TFN to the trustee. *[Schedule 2, item 1, subsections 202DR(2) and (3) of the ITAA 1936]*

2.69 The second mechanism under these amendments operates where the Commissioner cannot correct an incorrectly quoted TFN. In this case, the Commissioner must give the trustee written notice and also give a copy of the notice to the beneficiary along with a written statement of reasons indicating this decision. *[Schedule 2, item 1, subsections 202DR(4) and (5) of the ITAA 1936]*

2.70 The Commissioner would be unable to successfully correct an incorrectly quoted TFN where:

- the Commissioner is satisfied that the beneficiary's TFN has been cancelled or withdrawn *[Schedule 2, item 1, subparagraph 202DR(4)(a)(i) of the ITAA 1936]*;
- the Commissioner is satisfied for any reason that the number quoted is not the beneficiary's TFN *[Schedule 2, item 1, subparagraph 202DR(4)(a)(ii) of the ITAA 1936]*; or
- the Commissioner is not satisfied that the beneficiary has a TFN *[Schedule 2, item 1, paragraph 202DR(4)(b) of the ITAA 1936]*.

2.71 On and from the day the notice takes effect, the beneficiary is taken not to have quoted their TFN to the trustee. This has the effect that TFN withholding is not required for any withholding obligations that occurred prior to the date of the notice. However, distributions and present entitlement already made will not give rise to a retrospective withholding obligation. *[Schedule 2, item 1, subsections 202DR(6) and (7) of the ITAA 1936]*

Example 2.11

The Buchanan Trust (which is a closely held trust under this measure) has two beneficiaries, Olga and Andrew. Upon receiving a distribution during the year both Olga and Andrew had quoted their TFNs to the trustee of the Buchanan Trust by the distribution time. However, after reporting those TFNs to the Commissioner in the TFN quarterly report, it turns out that both TFNs quoted were incorrect.

Olga's TFN was incorrect because two of the numbers were accidentally transposed when the number was quoted. Consequently, the Commissioner is able to identify the correct number using other information available and advises the trustee that the TFN has been corrected. In Olga's case, she is treated as if her TFN quoted was correct and no withholding obligation will arise in respect of these amendments.

In respect to Andrew's TFN, upon receiving the TFN report the Commissioner notices that the TFN reported is incorrect and is not satisfied that Andrew actually has a TFN. Consequently, the Commissioner notifies both the trustee and Andrew of this and provides Andrew with a statement of reasons for this decision.

From the date of the Commissioner's notice to Andrew, he is deemed not to have quoted a TFN. This means that any amounts to which Andrew becomes entitled from that date gives rise to a withholding obligation under these amendments until a new (correct) TFN is quoted. However, the distribution already made will not give rise to a retrospective withholding obligation.

Reporting period

2.72 These amendments also provide a mechanism for the Commissioner to notify the trustee of a different reporting period for the purposes of TFN quotation. This gives the Commissioner the administrative flexibility to set a period longer than three months for the trustee to report the quoted TFNs in the appropriate circumstances. The Commissioner may use this power in order to facilitate a smooth administrative process for the reporting of quoted TFNs. *[Schedule 2, item 1, subsection 202DP(3) of the ITAA 1936]*

Penalties

2.73 Failure to report a quoted TFN to the Commissioner constitutes an offence under section 8C of the TAA 1953 wherein the trustee has failed to comply with a requirement under the taxation law. An offence under section 8C of the TAA 1953 is an offence of absolute liability. *[Schedule 2, item 1, note under section 202DP of the ITAA 1936]*

2.74 An offence of absolute liability in this context means that where a trustee fails to report a quoted TFN, they will have committed an offence and the defence of mistake is unavailable. There is no requirement to prove fault, and the trustee is punishable on conviction of a fine not exceeding 20 penalty units for their first offence. Subsequent offences will render the trustee punishable on conviction of a greater penalty.

Changes to the definition of 'quoted'

2.75 These amendments also change the definition of 'quote' and 'quoted' under section 995-1 of the ITAA 1997 to facilitate the requirement to quote a TFN under this measure. [*Schedule 2, items 26 and 27, definitions of 'quote' and 'quoted' in subsection 995-1(1) of the ITAA 1997*]

Second requirement: Reporting to the Commissioner of amounts withheld and amounts distributed

2.76 These amendments also require the trustee of a closely held trust to lodge two different annual reports with the Commissioner. The first report (annual report for withholding amounts) is an annual report which is designed to detail the amounts withheld by the trustee under this measure. The second report (annual report for amounts distributed) is also an annual report and is designed to detail the amounts distributed to beneficiaries, even though the trustee was not required to withhold from those distributions.

2.77 Under the current law, entities that withhold from payments are required to notify the Commissioner of those amounts withheld on or before the day the payment is due (refer to section 16-150). This is normally achieved through the BAS system as part of the remittance obligation.

2.78 In addition to this requirement, the current PAYG withholding framework requires the withholder to provide the Commissioner with an annual report detailing amounts withheld (refer to section 16-153). In the specific case of TFN withholding in respect of investments, investment bodies subject to those obligations are required to lodge an annual investment report, which provides extensive information about the investment, and the amounts withheld (refer to Regulation 56 of the *Income Tax Regulations 1936*).

Annual report for withholding amounts

2.79 Under these amendments, a trustee is required to lodge an annual report with the Commissioner in the approved form, which reports amounts withheld under this measure. [*Schedule 2, item 12, subsection 16-152(1)*]

2.80 This report is due not later than three months after the end of the income year or within such longer period as the Commissioner allows. *[Schedule 2, item 12, subsection 16-152(2)]*

2.81 This report is intended to provide the Commissioner with information regarding amounts that the trustee has withheld from eligible beneficiaries in respect of a withholding obligation from making a distribution or where the beneficiary is presently entitled to a share of income of the trust at the end of the income year.

Annual report for trust distributions

2.82 Under these amendments, a trustee is also required to lodge a report to the Commissioner on the amounts distributed to beneficiaries and amounts payable to all eligible beneficiaries (that is, their share of the net income of the trust). This means that trustees will be required to report amounts distributed or payable to beneficiaries, even though the beneficiary has quoted their TFN and a withholding obligation is not triggered under these amendments. *[Schedule 2, item 12, subsection 16-152(3)]*

2.83 This report is due on the end of the day on which the trustee lodges the trust's income tax return for the income year, or within such longer period as the Commissioner allows. *[Schedule 2, item 12, subsection 16-152(4)]*

2.84 The due date for this report will have the effect that where all the beneficiaries of a particular trustee have quoted their TFNs, the trustee will only be required to lodge the report annually with their trust tax return.

Administration provisions for annual reports

2.85 For both of these annual reports, the Commissioner retains the existing discretion under subsection 16-153(6) of Schedule 1 to vary the requirements of the reports and must follow the existing notice requirements under subsection 16-153(7) of Schedule 1 in order to do so. *[Schedule 2, item 12, subsection 16-152(5)]*

2.86 In addition, for the annual reports, the existing requirements under subsection 16-153(5) of Schedule 1 will apply so that even where the withholding amount is nil, an annual report is required. However, for the annual report of withholding amounts, this will only occur where a withholding obligation arises. *[Schedule 2, item 12, subsection 16-152(5)]*

Example 2.12

The McGovern Trust (which is a closely held trust under this measure) has only one beneficiary (iClaire Pty Ltd). iClaire Pty Ltd has quoted its TFN to the trustee prior to the distribution time.

As iClaire Pty Ltd has quoted its TFN, no withholding obligation arises in regards to distributions made by the trustee during the income year. As no amounts have been withheld, the trustee of the McGovern Trust is not required to lodge an 'annual report for withholding payments'.

However, as the trustee has made distributions to iClaire Pty Ltd throughout the year, the trustee is required to lodge an annual report with their trust tax return.

Third requirement: Reporting amounts withheld and distributed to beneficiaries

2.87 The third reporting obligation imposed by these amendments is the obligation to notify beneficiaries of amounts withheld by issuing payment summaries on an annual basis.

2.88 Currently, under the PAYG withholding arrangements, withholders are generally required to issue payment summaries within 14 days of the end of the financial year notifying the payee, employee or investor of amounts withheld (refer to section 16-155). A failure to comply with these requirements constitutes an offence of strict liability, which is punishable by a fine not exceeding 20 penalty units (refer to section 8C).

2.89 Under these amendments, trustees are required to issue an annual payment summary to each beneficiary who has had amounts withheld under these amendments. *[Schedule 2, items 15 and 17, section 16-156 and subsection 16-170(IAAA)]*

2.90 A payment summary is to be provided to the relevant beneficiary in the approved form not later than 14 days after the due date for the lodgment of the annual report for withholding amounts (discussed in paragraph 2.76) or such longer period as allowed by the Commissioner. *[Schedule 2, items 15 and 17, subsections 16-156(2) and 16-170(IAAA)]*

2.91 Under these amendments, the existing penalty for a failure to provide a payment summary will continue to constitute a strict liability offence *[Schedule 2, items 20 and 21, subsections 16-175(1)]*. A strict liability offence in this context means that there is no requirement to prove fault, however the defence of mistake is available.

Credit for amounts withheld

2.92 Under the existing TFN withholding arrangements a payee/investor is entitled to a credit equal to the amount that was withheld from their payment/distribution by the withholder (refer to section 18-15). This entitlement arises where the payee/investor lodges a return and receives an assessment for the relevant income year (including an assessment that no income tax is payable for the year). Currently, where the claimant of the credit is a trust, then the current TFN withholding arrangements provide for the credit to flow through to the beneficiary of the trust (refer to section 18-25).

2.93 Under these amendments, when a beneficiary lodges their end of year income tax return, they are entitled to a credit equal to the amounts that have been withheld and remitted by the trustee to the Commissioner in accordance with the existing crediting arrangements.

Penalties

2.94 Under the existing PAYG withholding arrangements, there are specific penalty provisions that relate to TFN withholding. These include the failure to withhold penalty under sections 16-25 and 16-30 of Schedule 1 to the TAA 1953 as well as the penalty for failure to pay within time under section 16-80 of Schedule 1 to the TAA 1953. These penalties apply to entities that are required to both withhold from certain payments and pay the amounts withheld to the Commissioner but fail to do so.

2.95 In addition to the specific PAYG withholding penalties described above, general administrative penalties also exist under Part III of the TAA 1953. These penalties apply for failure to comply with taxation requirements, making intentional errors in reports and the making of false and misleading statements.

2.96 Under these amendments, the existing penalty regime will apply to the withholding obligations and reporting requirements as required. There are no new penalties specific to the operation of these amendments.

Refunding of amounts withheld in error

2.97 Under the current TFN withholding arrangements, those amounts that are withheld by a payer and/or paid to the Commissioner in error can be refunded to the payee, where the payer becomes aware of the error or the payee applies for the refund.

2.98 The application process for the payee requires the payee to provide certain information to the payer in order to have the payer refund the amount to the payee. Similarly, the payer is then required to provide certain information to the Commissioner, in order to recover the amounts refunded to the payee, where the amounts had originally been remitted to the Commissioner.

2.99 Under these amendments, where a beneficiary has amounts withheld and/or paid to the Commissioner in error, they will be able to seek a refund using the current refund arrangements. *[Schedule 2, item 23, subparagraph 18-65(3)(d)(v)]*

Application and transitional provisions

2.100 These amendments will apply to income of a trust for an income year starting on or after 1 July 2010. For trusts with a substituted accounting period, this means that this measure will apply to them in the first income year starting after 1 July 2010. *[Schedule 2, items 24 and 25]*

Consequential amendments

2.101 There are also various other amendments, which clear up assorted headings, notes, and other things that need to be removed or changed due to the creation of the new provisions for the extension of the TFN withholding rules to closely held trusts, including family trusts. *[Schedule 2, items 2, 3, 6 to 8, 10, 13, 14, 16, 18, 19 and 22]*

Chapter 3

Income tax treatment of the HECS-HELP benefit

Outline of chapter

3.1 Schedule 3 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to exempt from income tax the value of the benefit received by eligible recipients of the Higher Education Contribution Scheme-Higher Education Loan Programme benefit (HECS-HELP benefit).

Context of amendments

3.2 The HECS-HELP benefit was an initiative first introduced in the 2008-09 Budget. This benefit gives eligible recipients a reduction in their compulsory HECS debt repayment and/or their HELP debt repayment or, in some cases where a repayment is not required due to low income, a direct reduction in their HELP debt.

3.3 Mathematics and science graduates and early childhood education teachers were initially eligible for the benefit. In the 2009-10 Budget it was announced that the HECS-HELP benefit had been extended to nurses and teachers generally.

3.4 These amendments ensure that no income tax is payable on the value of the HECS-HELP benefit received by eligible recipients.

Summary of new law

3.5 From the 2008-09 income year, the HECS-HELP benefit will be exempt from income tax.

Detailed explanation of new law

3.6 Section 157-1 of the *Higher Education Support Act 2003* allows an individual to apply to the Commissioner of Taxation (Commissioner) for the benefit if they satisfy the eligibility requirements set out in the HECS-HELP benefit guidelines.

3.7 These guidelines set out the eligibility criteria and the amount of the HECS-HELP benefit. One criterion for eligibility is that the person has completed at least one employed week in a specified occupation for their particular degree.

3.8 Once the Commissioner has determined the value of the HECS-HELP benefit in accordance with the guidelines, section 154-85 of the *Higher Education Support Act 2003* provides that a person's compulsory repayment amount is reduced by the amount of the HECS-HELP benefit received.

3.9 Section 15-2 of the ITAA 1997 deems any benefits which are provided to a person in relation to their employment to be assessable income.

3.10 These amendments ensure that the value of a benefit received by an eligible recipient of the HECS-HELP benefit is exempt from income tax.

3.11 The list of classes of exempt income in section 11-15 of the ITAA 1997 is amended to include a reference to the receipt of a HECS-HELP benefit. [*Schedule 3, item 1*]

3.12 A definition of a 'HECS-HELP benefit' is inserted into the Dictionary in subsection 995-1(1) of the ITAA 1997. [*Schedule 3, item 3*]

3.13 The table of exempt education and training amounts in section 51-10 is amended to include a reference to the receipt of a HECS-HELP benefit. [*Schedule 3, item 2*]

Application and transitional provisions

3.14 These amendments apply to assessments for the 2008-09 income year and later income years. [*Schedule 3, item 4*]

Chapter 4

Deductible gift recipients

Outline of chapter

4.1 Schedule 4 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to update the list of deductible gift recipients (DGRs) to include two new entities, and extend the period for which another DGR may collect deductible gifts.

Context of amendments

4.2 The income tax law allows taxpayers who make gifts of \$2 or more to DGRs to claim income tax deductions. To be a DGR, an organisation must fall within one of the general categories set out in Division 30 of the ITAA 1997, or be listed by name under that Division.

4.3 DGR status assists eligible funds and organisations to attract public support for their activities.

Summary of new law

4.4 These amendments add two organisations to the list of specifically listed DGRs. The amendments also extend the period for which another organisation may collect deductible gifts for another three years.

Detailed explanation of new law

4.5 This Schedule allows deductions for gifts to the organisations listed in Table 4.1 from the dates of effect and subject to the special conditions in the Table. [*Schedule 4, items 1 and 2, items 9.2.22 and 9.2.23 in the table in subsection 30-80(2) of the ITAA 1997*]

Table 4.1

<i>Name of Fund</i>	<i>Date of effect</i>	<i>Special conditions</i>
Sichuan Earthquake Surviving Children's Fund	12 May 2008	The gift must be made after 11 May 2008 and before 13 May 2010.
Bali Peace Park Association Inc.	16 December 2009	The gift must be made after 15 December 2009 and before 17 December 2011. Used for the purpose of establishing the Bali Peace Park.

4.6 The Sichuan Earthquake Surviving Children's Fund aims to raise money by donations from the public in Australia to be used to provide assistance in the reconstruction of schools in the Sichuan Province in China and provide assistance for children in the Sichuan Province, following an earthquake on 12 May 2008.

4.7 The Bali Peace Park Association Inc. aims to raise funds to acquire the Sari Club site, Bali, Indonesia, and create a 'peace park' on the land where the terrorist bomb was detonated on 12 October 2002 and to create an annual national awareness day on 12 October to allow for reflection and acknowledgement of the terrorist attack while promoting tolerance and understanding across cultures and religions.

4.8 This Schedule also extends the date until which the Yachad Accelerated Learning Project Limited may collect deductible gifts from 1 July 2009 to 1 July 2012. [*Schedule 4, item 5, item 9.2.34 in the table in subsection 30-25(2) of the ITAA 1997*]

Application and transitional provisions

4.9 The amendments to list the organisations in Table 4.1 apply from the dates of effect shown in that table. [*Schedule 4, items 6 and 7*]

Consequential amendments

4.10 A number of changes have been made to update the index of DGRs to include the new entities. [*Schedule 4, items 3 and 4, section 30-315*]

Chapter 5

Income tax exemption: Global Carbon Capture and Storage Institute Limited

Outline of chapter

5.1 Schedule 5 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to make the Global Carbon Capture and Storage Institute Limited (the Institute) income tax exempt for a four-year period.

Context of amendments

5.2 The Institute was formally launched by the Prime Minister on 16 April 2009, and was established as a not-for-profit company limited by guarantee on 12 June 2009.

5.3 The central objective of the Institute is to accelerate the commercial deployment of carbon capture and storage projects to contribute to reducing carbon dioxide emissions.

5.4 The Institute does not meet the general requirements for income tax exempt entities set out in the tax law.

5.5 The information and expertise developed by the Institute is to be disseminated broadly and globally to the benefit of both the Australian and global carbon capture and storage communities.

Summary of new law

5.6 The Institute will be made exempt from income tax over the period 1 July 2009 to 30 June 2013.

Detailed explanation of new law

5.7 Section 50-5 of the ITAA 1997 contains a table of entities (relating to charity, education, science and religion) for which all of their ordinary and statutory income is exempt from income tax. The Institute

will be added to the table, making the Institute exempt from income tax. *[Schedule 5, item 1, item 1.8 in the table in section 50-5 of the ITAA 1997]*

5.8 Section 11-5 of the ITAA 1997 lists entities that are exempt from income tax. This list will be amended to include the Institute. *[Schedule 5, item 8, section 11-5 of the ITAA 1997]*

Application and transitional provisions

5.9 The exemption applies to amounts included in assessable income on or after 1 July 2009, and before 1 July 2013. *[Schedule 5, item 1, item 1.8 in the table in section 50-5 of the ITAA 1997]*

5.10 These amendments will be repealed on 1 January 2018, by which time they will have become inoperative. *[Schedule 5, items 10 and 11]*

Consequential amendments

5.11 The definitions of ‘eligible policy’, ‘exempt entity’, ‘exempt life assurance fund’, and ‘trustee’ in section 102M of the *Income Tax Assessment Act 1936* (ITAA 1936) will be repealed and replaced with provisions that preserve the effect of the current law, but are clearer and more consistent with tax law drafting principles. *[Schedule 5, items 2 to 6]*

5.12 References in the ITAA 1997 will be updated to reflect these amendments. *[Schedule 5, item 9, paragraph 295-173(b) of the ITAA 1997]*

5.13 These consequential amendments are desirable because the current definition of ‘exempt entity’ in section 102M of the ITAA 1936 is inconsistent with the definition in the Dictionary to the ITAA 1936.

5.14 Further, the words in a heading in section 11-5 of the ITAA 1997 will be reordered, to be consistent with the ordering of the same words in section 50-5 of the ITAA 1997. *[Schedule 5, item 7]*

5.15 The consequential amendments do not involve any substantive changes to the law.

Chapter 6

Repeal of certain unlimited periods for amending assessments

Outline of chapter

6.1 Schedule 6 to this Bill amends various taxation laws to repeal over 100 unlimited amendment periods. As result, a number of provisions which provide the Commissioner of Taxation (Commissioner) with an indefinite time to amend taxpayers' assessments are replaced with the existing amendment provisions that have certain finite periods. The removal of these unlimited amendment periods will improve certainty for taxpayers in their taxation affairs and contribute to reducing the volume of unnecessary provisions in the taxation laws.

Context of amendments

6.2 In 2004, unlimited amendment periods were considered as part of the *Review of Aspects of Income Tax Self Assessment*. In consideration of these provisions this report concluded that, whether or not a taxpayer had paid the correct amount of tax in a particular year, their assessment should eventually become final, unless they had deliberately sought to evade their responsibilities.

6.3 In 2005, as a consequence of this report, amendments were made to the tax law to reduce the period during which the Commissioner could amend income tax assessments to two or four years depending upon the degree of complexity of the income tax returns. However, these amendments did not address the existing unlimited amendment periods throughout the tax laws.

6.4 Subsequently, Treasury released the *Review of Unlimited Amendment Periods in the Income Tax Laws* (the Review) discussion paper in which it proposed to remove the existing unlimited amendment periods. The Review identified over 100 provisions in the tax law that provided an indefinite time for the Commissioner to amend taxpayers' assessments. Consequently, the Review proposed to replace most of them with either the standard two or four-year amendment period, a specific fixed amendment period, or an amendment period that would commence only following a future *contingent* event.

6.5 Open public consultation was undertaken in relation to the Review and received support to eliminate the unlimited amendment periods from all the submissions. However, some submissions recommended changes to the proposed replacement amendment periods.

Summary of new law

6.6 This Schedule amends the income tax laws to repeal certain redundant unlimited amendment periods. These repeals cover situations where the general amendment provisions (under section 170 of the *Income Tax Assessment Act 1936* (ITAA 1936) provide the Commissioner with sufficient time to examine an item in an income tax return and, if necessary, amend the relevant assessment. In these circumstances, there is no reason to maintain an unlimited amendment provision for a particular item. The provisions repealed can be divided into three categories of unlimited amendment periods:

- exceptions to the operation of the general amendment provisions in subsections 170(10) and (10AA) of the ITAA 1936;
- unlimited amendment periods contained in certain specific provisions that outline the taxation treatment of a particular item that forms part of the income tax assessment; and
- those amending Acts drafted between 1985 and 2005 that contain an unlimited amendment provision due to the uncertainty surrounding the timing of the passage of the amending Act.

6.7 The vast majority of the amendments are contained in the last category. The common drafting practice that created these unlimited amendment periods ceased in 2005 as a consequence of the *Review of Aspects of Income Tax Self Assessment*.

6.8 By repealing these unlimited amendment periods, the general amendment provisions apply in those particular circumstances. The amendment periods for effected assessments will be either two or four years depending upon the complexity of the taxpayer's income tax assessment. However, under the general rules if there has been fraud or evasion, an unlimited amendment period continues to apply.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>Over 100 provisions are repealed and replaced with the existing general amendment provisions.</p> <p>These general amendment provisions provide a finite amendment period of two or four years depending on the taxpayer's circumstances.</p>	<p>Over 100 provisions in various tax laws provide an unlimited period for the Commissioner to amend a taxpayer's assessment.</p>

Detailed explanation of new law

6.9 The following provisions are repealed under these amendments.

Table 6.1: Provisions that have unlimited amendment periods by the operation of subsections 170(10) and (10AA) that are repealed

<i>Provision in ITAA 1936</i>	<i>Description</i>
section 82KJ	Deductions not allowable in respect of certain pre-paid outgoings
section 82KK	Schemes designed to postpone tax liability
<i>Provision in ITAA 1997</i>	<i>Description</i>
Subdivision 20-B	Disposal of a car for which lease payments have been deducted
The former section 42-290	Later year relief
The former section 330-175	Meaning of 'entitlement to an eligible cash bidding amount'
The former section 330-245	Limit on the amount that can be included in the agreement

[Schedule 6, items 3 and 4]

Table 6.2: Other provisions that create unlimited amendment periods that are repealed

<i>Provision in ITAA 1936</i>	<i>Description</i>
subsection 23AG(6G)	Exemption of income earned in overseas employment
subsection 454(2)	Assessment on assumption — retention of accounts etc. and compliance with information notices
<i>Provision in ITAA 1997</i>	<i>Description</i>
subsection 26-35(5)	Reducing deductions for amounts paid to related entities
section 214-130	Other later amendments (franking assessments)
subsection 900-240(2)	Deducting in anticipation of receiving an award transport payment

[Schedule 6, items 2 and 5 to 10]

Table 6.3: A list of Acts with the generic unlimited amendment periods that are repealed

<i>Act</i>	<i>Provision</i>
<i>A New Tax System (Pay As You Go) Act 1999</i>	section 4
<i>New Business Tax System (Capital Gains Tax) Act 1999</i>	section 4
<i>New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002</i>	section 4
<i>New Business Tax System (Consolidation and Other Measures) Act 2003</i>	section 4
<i>New Business Tax System (Consolidation) Act (No. 1) 2002</i>	section 4
<i>New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002</i>	section 4
<i>New Business Tax System (Income Tax Rates) Act (No. 2) 1999</i>	section 4
<i>New Business Tax System (Miscellaneous) Act (No. 1) 2000</i>	section 4
<i>New Business Tax System (Miscellaneous) Act (No. 2) 2000</i>	section 4
<i>New Business Tax System (Taxation of Financial Arrangements) Act (No. 1) 2003</i>	section 4
<i>Petroleum (Timor Sea Treaty)(Consequential Amendments) Act 2003</i>	section 4
<i>Tax Laws Amendment (2004 Measures No. 1) Act 2004</i>	section 4
<i>Tax Laws Amendment (2004 Measures No. 2) Act 2004</i>	section 4
<i>Tax Laws Amendment (2004 Measures No. 3) Act 2004</i>	section 4

Repeal of certain unlimited periods for amending assessments

<i>Act</i>	<i>Provision</i>
<i>Tax Laws Amendment (2004 Measures No. 6) Act 2005</i>	section 4
<i>Tax Laws Amendment (2004 Measures No. 7) Act 2005</i>	section 4
<i>Tax Laws Amendment (Medicare Levy and Medicare Levy Surcharge) Act 2004</i>	section 5
<i>Tax Laws Amendment (Medicare Levy and Medicare Levy Surcharge) Act 2005</i>	section 4
<i>Taxation Laws (Technical Amendments) Act 1998</i>	section 4
<i>Taxation Laws Amendment (Company Distributions) Act 1987</i>	section 19
<i>Taxation Laws Amendment (Earlier Access to Farm Management Deposits) Act 2002</i>	section 4
<i>Taxation Laws Amendment (Foreign Income Measures) Act 1997</i>	section 4, Schedule 1, subitems 128(4) and 129(8)
<i>Taxation Laws Amendment (Foreign Income) Act 1990</i>	section 61
<i>Taxation Laws Amendment (Fringe Benefits and Substantiation) Act 1987</i>	section 75
<i>Taxation Laws Amendment (Medicare Levy and Medicare Levy Surcharge) Act 2002</i>	section 4
<i>Taxation Laws Amendment (Software Depreciation) Act 1999</i>	section 4
<i>Taxation Laws Amendment (Structured Settlements and Structured Orders) Act 2002</i>	section 4
<i>Taxation Laws Amendment (Superannuation) Act (No. 2) 2002</i>	section 4 (but retain the unlimited amendment period for section 37 of the <i>Superannuation Guarantee (Administration) Act 1992</i>)
<i>Taxation Laws Amendment (Superannuation) Act 1989</i>	section 66
<i>Taxation Laws Amendment (Superannuation) Act 1992</i>	section 62
<i>Taxation Laws Amendment (Superannuation) Act 1993</i>	section 34
<i>Taxation Laws Amendment (Trust Loss and Other Deductions) Act 1998</i>	section 4
<i>Taxation Laws Amendment Act (No. 1) 1995</i>	section 3 (Schedule 1, item 90)
<i>Taxation Laws Amendment Act (No. 1) 1996</i>	section 4
<i>Taxation Laws Amendment Act (No. 1) 1997</i>	section 4
<i>Taxation Laws Amendment Act (No. 1) 1998</i>	section 4
<i>Taxation Laws Amendment Act (No. 1) 1999</i>	section 4
<i>Taxation Laws Amendment Act (No. 1) 2004</i>	section 4

<i>Act</i>	<i>Provision</i>
<i>Taxation Laws Amendment Act (No. 2) 1985</i>	section 36
<i>Taxation Laws Amendment Act (No. 2) 1986</i>	section 28
<i>Taxation Laws Amendment Act (No. 2) 1987</i>	section 48
<i>Taxation Laws Amendment Act (No. 2) 1988</i>	section 57
<i>Taxation Laws Amendment Act (No. 2) 1989</i>	section 15
<i>Taxation Laws Amendment Act (No. 2) 1990</i>	section 65
<i>Taxation Laws Amendment Act (No. 2) 1991</i>	subsection 84(1)
<i>Taxation Laws Amendment Act (No. 2) 1992</i>	section 75
<i>Taxation Laws Amendment Act (No. 2) 1993</i>	section 59
<i>Taxation Laws Amendment Act (No. 2) 1994</i>	section 122
<i>Taxation Laws Amendment Act (No. 2) 1995</i>	Section 3 (Schedule 3, item 44)
<i>Taxation Laws Amendment Act (No. 2) 1996</i>	section 4
<i>Taxation Laws Amendment Act (No. 2) 1997</i>	section 4
<i>Taxation Laws Amendment Act (No. 2) 1999</i>	section 4
<i>Taxation Laws Amendment Act (No. 2) 2000</i>	section 4
<i>Taxation Laws Amendment Act (No. 2) 2003</i>	section 4
<i>Taxation Laws Amendment Act (No. 2) 2004</i>	section 4
<i>Taxation Laws Amendment Act (No. 3) 1985</i>	section 43
<i>Taxation Laws Amendment Act (No. 3) 1987</i>	section 40
<i>Taxation Laws Amendment Act (No. 3) 1989</i>	section 23
<i>Taxation Laws Amendment Act (No. 3) 1990</i>	section 35
<i>Taxation Laws Amendment Act (No. 3) 1991</i>	section 103
<i>Taxation Laws Amendment Act (No. 3) 1992</i>	section 81
<i>Taxation Laws Amendment Act (No. 3) 1993</i>	section 116
<i>Taxation Laws Amendment Act (No. 3) 1994</i>	section 116
<i>Taxation Laws Amendment Act (No. 3) 1995</i>	section 3 (Schedule 1, item 50)
<i>Taxation Laws Amendment Act (No. 3) 1997</i>	section 4
<i>Taxation Laws Amendment Act (No. 3) 1998</i>	section 4
<i>Taxation Laws Amendment Act (No. 3) 2002</i>	section 4
<i>Taxation Laws Amendment Act (No. 3) 2003</i>	section 4
<i>Taxation Laws Amendment Act (No. 4) 1985</i>	section 24
<i>Taxation Laws Amendment Act (No. 4) 1986</i>	section 50
<i>Taxation Laws Amendment Act (No. 4) 1987</i>	section 52 and 62
<i>Taxation Laws Amendment Act (No. 4) 1988</i>	section 58

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<i>Act</i>	<i>Provision</i>
<i>Taxation Laws Amendment Act (No. 4) 1989</i>	section 32
<i>Taxation Laws Amendment Act (No. 4) 1990</i>	section 37
<i>Taxation Laws Amendment Act (No. 4) 1992</i>	section 32
<i>Taxation Laws Amendment Act (No. 4) 1994</i>	section 3 (Schedule 1, item 91)
<i>Taxation Laws Amendment Act (No. 4) 1995</i>	section 4
<i>Taxation Laws Amendment Act (No. 4) 1997</i>	section 4
<i>Taxation Laws Amendment Act (No. 4) 1999</i>	section 4
<i>Taxation Laws Amendment Act (No. 4) 2000</i>	section 4
<i>Taxation Laws Amendment Act (No. 4) 2002</i>	section 4
<i>Taxation Laws Amendment Act (No. 4) 2003</i>	section 4
<i>Taxation Laws Amendment Act (No. 5) 1988</i>	section 44
<i>Taxation Laws Amendment Act (No. 5) 1989</i>	section 50
<i>Taxation Laws Amendment Act (No. 5) 1990</i>	section 33
<i>Taxation Laws Amendment Act (No. 5) 1992</i>	section 87
<i>Taxation Laws Amendment Act (No. 5) 2000</i>	section 4
<i>Taxation Laws Amendment Act (No. 5) 2001</i>	section 4
<i>Taxation Laws Amendment Act (No. 5) 2002</i>	section 4
<i>Taxation Laws Amendment Act (No. 5) 2003</i>	section 4
<i>Taxation Laws Amendment Act (No. 6) 1992</i>	section 33
<i>Taxation Laws Amendment Act (No. 6) 2000</i>	section 4
<i>Taxation Laws Amendment Act (No. 6) 2001</i>	section 4
<i>Taxation Laws Amendment Act (No. 6) 2003</i>	section 4
<i>Taxation Laws Amendment Act (No. 7) 2000</i>	section 4
<i>Taxation Laws Amendment Act (No. 8) 2003</i>	section 4
<i>Taxation Laws Amendment Act 1985</i>	section 39
<i>Taxation Laws Amendment Act 1986</i>	section 26
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