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# Tax Office focus for 2007-08

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## INTRODUCTION

Since the last public hearing with the Committee in April 2007 we provided the Committee with our Corporate Plan 2007-08. The plan incorporate priorities that we discussed with the Committee including implementing superannuation reforms, addressing the cash economy, improving our support for small businesses and expanding e-tax and the pre-filling of electronic tax returns initiative. We also advised of the significant additional funding from Government in the May 2007 Budget to assist us in many of these areas.

On 16 August we publicly released our 6<sup>th</sup> Compliance Program. Our Compliance Program describes how we go about achieving high levels of voluntary compliance with Australia's tax and superannuation laws and our compliance priorities for the current year. The release is very much about an open and accountable Tax Office. We are the only tax administration that publishes in this way.

The themes of this year's program include the implementation of the 'Better Super' changes; reviewing the tax implications of the increase in international dealings right across the community; greater assistance for small business; and widening our focus on an expanding body of high wealth individuals.

This report provides a high level summary of some of our Compliance Program priorities. It also briefly updates the Committee on our performance in 2006-07 which will be comprehensively covered in the Commissioner of Taxation's Annual Report to the Parliament.

The report also covers some topical areas which have been of interest to the community, external scrutineers and the tax profession.

## CHAPTER 1: 2007-08 – CHALLENGES AND PRIORITIES

### CHANGE PROGRAM RELEASE 3 - REPLACING THE TAX OFFICE ENGINE

Our April 2007 report to the Committee outlined the phased timetable for Release 3 of our Change Program starting with Release 3.1 in January 2008.

The next phase of the Change Program is transforming the heart of our core processing capability by replacing all of our core processing systems. In terms of effort the next set of releases (referred to as Release 3 ) is approximately 4 times (290,000 person days) the just completed Release 2 (68,000 person days) which in turn was approximately 3 times the size of release 1(24,000 person days) delivered in 2005.

Our independent Assurers Capgemini have indicated that the introduction of new client relationship, case and work management systems in Releases 1 and 2 were amongst the biggest such implementations in the world.

Through our numerous consultative forums we have consulted with the tax professions and small business representatives on the possible impacts of the future phased releases. The key issues that we have consulted on have included; the shutdown of our existing business systems as we introduce the new integrated core processing system, the availability of the portal and the potential for stockpiling of work during that shutdown period. We will continue to consult and communicate on those issues as we move closer to the implementation date.

As planning for the staged delivery of Release 3 shapes up, managing the impacts on our people, our work and the community, particularly tax agents, is a key priority. Given the scale of change we have decided to lower some service standards for 2007-08 to acknowledge temporary productivity dips caused by implementing significant changes to our computer systems during the year. There are plans in place to carefully manage any anticipated impacts on taxpayers. We will continue to monitor our progress and review how our service standards might be affected for next year.

We will keep the broader community aware through continuing to publish our monthly performance against service standards on our website.

A copy of our service standards for 2007-08 is at **Attachment 1**.

### IMPLEMENTING THE GOVERNMENT'S LEGISLATIVE PROGRAM

A significant priority is to implement the government's legislative program in respect of Acts administered by the Commissioner. Since the April 2007 hearing further legislative changes to the tax and superannuation laws have been announced or progressed by government.

These include the release in May 2007 of the draft legislation relating to the new framework for the tax profession and the announcement by the Treasurer on 30 August 2007 of the Government's decision to proceed with Standard Business Reporting.

Of course, superannuation remains a strong focus for us given the important changes under way. A Government funded program is informing the community of these changes.

During May and late August we ran a major advertising campaign on television, radio and in the press highlighting the changes to superannuation. We also developed the 'Better Super' booklet to provide individuals with details of the Super Simplification changes.

We wrote to 740,000 employers to explain what they needed to do to comply with the changed law – particularly reminding employers to pass their employee tax file numbers to their respective superannuation funds. Guidance on the changes has also been provided on our website and in brochures.

We also contacted over 1.8 million taxpayers in order to provide their tax file number to their superfund. This exercise means that tax file numbers should now be in place for 92 % of members, up from 77%, based on the 2005-06 member contribution statements.

## **TAX TIME 2007**

We have undertaken a significant level of Tax Time campaigning in the media. As usual, we have emphasised the areas that attract our attention including deductions for work-related expenses, rental property expenses and capital gains from the sale of property and other assets to fund superannuation.

Tax agents prepare around 73% of the tax returns lodged by individuals. Of the 27% of individuals who prepared their own returns last year over half lodged online using e-tax.

The Tax Office has a wide range of information and assistance available to help people (particularly those who do not use a tax agent or e-tax) meet the 31 October 2007 deadline.

The Tax Office does not expect individuals who prepare their own returns to know more than what we have presented in TaxPack 2007 (or its alternatives, Retirees TaxPack 2007 and the Short tax return for individuals 2007) and their related publications. If our advice in these publications is misleading and they make a mistake as a result, we must still apply the law correctly. We ask them to pay the extra tax, however we won't charge a penalty or interest if they acted reasonably and in good faith.

In 2007 Tax Help will be provided to low income earners by 1,300 volunteers operating out of over 800 Community Centres throughout Australia. Last year, the program helped more than 70,000 people prepare their tax returns.

## **E-tax**

From 1 July people could prepare and lodge their return online using e-tax, which, in most cases, processes returns within 14 days. e-tax can be accessed free of charge 24 hours a day, seven days a week from our website at [ato.gov.au](http://ato.gov.au) and contains calculators, help screens and links to rulings and other advice.

By 16 September this year almost 1.3 million people had used e-tax to lodge their return and we expect that at least 1.8 million, or around 16% of individuals, will use e-tax this year.

This year we have expanded the availability of pre-filled data to progressively include interest income, dividend income and managed funds distributions. Not all income from these sources can be pre-filled as yet. We have also expanded pre-filing of payment summary data for government payments and have commenced a pilot of income data with a major payroll service bureau and Comsuper.

## **COMPLIANCE PROGRAM 2007-08 (IN BRIEF)**

One purpose of our annual Compliance Program is to invite the community to comment on the risk management choices we have made with the resources the community entrusts to us. Another purpose is to build integrity, confidence and trust in our administration of Australia's tax and superannuation systems. We are confident that our 2007-08 Compliance Program meets these objectives.

The Compliance Program reflects changes in Australia's dynamic social and economic environment and the growth in complexity and globalisation of business dealings. What is enduring are the values and aspirations that underpin our corporate goals. These include being fair and professional; applying the rule of law; supporting taxpayers who want to do the right thing; and being consultative, collaborative and willing to co-design.

Our Compliance Program is as much about helping people to comply as it is about dealing firmly with those who don't want to do the right thing. Our aim is to be unobtrusive to the majority of people who meet their obligations, but to be highly visible to those who don't. This is about fairness, and creating a level playing field for everyone.

The program's effectiveness is underpinned by putting greater resources into data matching and analytics. Given our more sophisticated risk and profiling tools, there is now a greater chance of detection of non-compliance and there are serious consequences for those that have not exercised reasonable care or who chose to be non-compliant.

## **INDIVIDUALS**

For 2007-08 our priorities in the individuals market are:

- helping Australians engage with Better Super.
- closely monitoring capital gains arising from the sale of real property and shares, including distributions from managed funds.
- focusing on public company executives to identify any under-reporting of income arising, for example, from benefits such as employee share schemes.

### **Superannuation**

We are implementing the Better Super measures through a program of help and education, supported by targeted compliance activities.

## Capital gains

Our compliance activities will reflect that taxpayers are realising capital gains from the sale of property to investment in superannuation. In 2007–08 we will write to individuals who purchased investment property, shares or units in a managed fund in 2006–07 to inform them of their capital gains tax obligations if they dispose of these assets.

We will examine around 6,000 at-risk cases this year, including taxpayers who made a gain from disposing of assets to invest in superannuation.

## High income executives

The number of highly remunerated executives and company directors has been growing and so has the sophistication of their remuneration arrangements. Consequently, we are increasing our focus on this group. In the coming year we will be examining the tax affairs of top executives of large companies with total remuneration of \$1 million or more. Of particular interest will be options and rights issues, cash bonuses and non-income capital benefits, as well as lodgment of their tax returns.

## MICRO ENTERPRISES

The micro business segment includes entities with an annual turnover of up to \$2 million and consists of individuals with business, partnership or trust income; companies, partnerships, trusts and super funds.

In 2007-08 our priorities in the micro business segment include:

- increasing support to micro enterprises through a coordinated assistance program
- expanding debt collection capabilities
- cash economy, and
- self managed superannuation funds

## The Small Business Assistance Program

A very important initiative in our Compliance Program is an expansion of support and assistance strategies for this sector.

Our Small Business Assistance Program aims to help business get on the right track from the start by developing good tax habits. It also helps established businesses who need assistance but who have been reluctant to seek this from us.

The Federal Government has allocated \$40 million over four years to provide extra support for small business and we are using this to complement our expanded and renewed commitment to assisting small business.

The clear message to us from small business is that it wants easier, cheaper, simpler ways to deal with its tax obligations and that's what we are working to provide. Small business is not looking for binding legal documents; it is looking for practical, step-by-step guidance and assistance.



This new approach is reflected in our brochure 'Helping small business stay on track' which was developed collaboratively with small business and industry groups. It is practical and has tips for small business owners, for example:

- If you have inadvertently omitted a small amount from your current BAS, put it in your next BAS
- If you are having problems paying your tax or super guarantee, give us a call so that we can talk about it
- If you want more assistance, how can we help?

As the brochure points out, if a small business has made an honest mistake, it can usually be corrected without unnecessary anxiety.

Assistance and guidance will be available to businesses on start up and at various other points in the business life cycle. For example, at the stage where a business decides to take on employees, registers for GST and, in particular, if a business is having difficulties in meeting obligations.

Delivery will include a mix of personal assistance visits, seminars, workshops and telephone support. We'll engage more with local industry groups, business assistance centres and chambers of commerce to ensure small businesses get the help they need, and how they need it.

We will be calling businesses to see if they need help installing the business portal and other electronic tools and calculators and products such as e-Record. We plan to make over 1000 assistance visits.

### **Reducing small business debt**

There is no better example of prevention being better than cure than in the area of debt. If taxpayers fall behind or are having difficulties, they can contact us early and let us know their situation – we'll work with them on a solution.

Small businesses with a turnover of less than \$2 million account for about two-thirds of outstanding collectable debt, and have done so for a number of years. Recognising this, the Federal Government provided \$125.7 million over four years in the May Budget to expand our debt collection capability. We will do this by expanding our automatic dialler technology, referring some debts to external debt collection agencies, and by dedicating more staff to recovering superannuation guarantee charge debts owed to employees.

Our approach is to use this funding to reduce the number of debts over two years old and target outstanding superannuation guarantee charge debts.

We are also using risk modelling to better tailor our treatment of taxpayers who have a debt by applying different strategies depending on their individual circumstances. By using this capability, we can identify taxpayers who benefit from early contact, helping them to avoid problems further down the track.

### **Cash economy**

We are continuing our focus on the cash economy with a range of new strategies.

Strategies for 2007-08 include more effective follow-up of information from third parties to identify those whose lifestyles are out of step with their reported income.

Business-to-consumer cash transactions will get special attention – especially retail businesses where non-reporting of cash transactions is facilitated by high volume, low value cash transactions.

### **Superannuation**

The number of Self Managed Superannuation Funds is continuing to grow from around 320,000 at the end of June 2006 to almost 360,000 at the end of June 2007. We are developing support tools for trustees and auditors while increasing reviews and audits, and pursuing outstanding lodgments. We will conduct compliance checks on any reported issues with new registrants.

A key change this year is a significant increase in compliance activities focusing on regulatory issues such as in-house assets and loans to members. Auditor contravention reports will continue to be examined, as will firms undertaking a large number of audits without any auditor contravention reports. Where funds do not meet the definition of a self managed superannuation fund, we will work with the trustees to restructure the fund so that it can meet the definition.

### **SMALL TO MEDIUM ENTERPRISES**

We are increasing our assistance to fast growing enterprises to help them meet reporting requirements relating to international dealings, capital management, trusts and beneficiaries. Practical guidance materials will be available to these businesses, as well as our more technical products designed mainly for tax professionals.

An important new measure is the introduction of a uniform eligibility test for small business in relation to concessions covering capital gains tax, GST and the Simplified Tax System.

For small to medium enterprises we will pay close attention where we see non-disclosure and under-reporting of capital gains, offshore transactions involving concealment of assets and income and the abuse of tax concessions.

Our priorities include:

- High wealth individuals
- Accessing business profits, and
- Business exit strategies

### **Wealthy individuals**

More individuals now fit into the wealthy category – defined by us as those controlling assets of \$30 million or more. The number now exceeds 1100.

A new strategy for 2007-08 is the release of a booklet for high wealth individuals setting out what attracts our attention, what we consider to be a risk and details of our information

collection and compliance processes. We are working with representatives of these taxpayers on this initiative.

Enhanced data matching will substantially improve our profiling and risk assessment of wealthy individuals. We have developed new automated ways of using and accessing third party information on large financial transactions and capital holdings, together with a tool that maps relationships in data and helps identify connected individuals, entities and transactions.

We will conduct 200 risk reviews and commence 40 audits of high wealth individuals this year.

### **Extracting wealth from businesses**

Business owners trying to extract value from their business without paying the correct tax will be closely examined. This has added importance given the legislative changes affecting the treatment of shareholder loans.

A number of arrangements will be subject to close examination. These include loans, payments and debts forgiven by private companies that in effect, distribute company profits to shareholders in a non-taxable form; divestment of business assets via mechanisms such as share buy-backs, capital reductions, the sale of shares; and the application of the demerger provisions where the purpose of business efficiency is not clear.

### **Accessing business profits**

With inter-generational change leading to an increase in owners disposing of their businesses, we are working to raise their awareness of tax risks around this key stage in the business lifecycle.

## **LARGE BUSINESSES**

Our priorities this year include:

- Promoting good governance
- Alignment of tax and economic performance, and
- International

### **Good governance and greater certainty**

We are working closely with large businesses to identify, as early as possible, issues that may give rise to tax risks and to provide more certainty about their tax affairs. Initiatives to provide more certainty and reduce compliance costs include a priority rulings process, forward compliance arrangements and advance pricing agreements.

### **Alignment of tax and economic performance**

More attention is being paid to corporate tax performance at odds with economic performance. Disclosure of large accounting profits to shareholders but low levels of taxable income or sustained tax is a risk indicator for us, requiring a reconciliation of the different outcomes.

## **International**

The flow of international transactions by large and many medium sized businesses has increased in recent years. We are expanding our scrutiny of these transactions, especially those that may be producing artificially generated tax benefits.

We will be examining the use of tax havens, cross border arbitrage, transfer pricing and profit shifting, as well as corporate restructuring which shifts assets, functions and risks offshore.

We announced in July that we will be writing to a number of Australian resident tax haven account holders to encourage voluntary compliance.

## **TAX PRACTITIONERS**

Tax practitioners play a vital role in influencing voluntary compliance. If the long awaited regulatory framework for tax practitioners becomes law, we will work with the professional bodies and other government agencies to ensure that it achieves its policy intent.

Our approach is to support tax practitioners to be self sufficient, through ease of access to information and advice. We are also serious about consulting with agents on issues that affect them in their day to day practice and in order to facilitate this we have established senior Tax Office representatives in three pilot regions (Far north Queensland, Tasmania and Melbourne) and established regional forums in these three pilot regions.

### **Towards self-sufficiency**

To progress this, we are developing 'new to the profession' training products in foundation tax topics, new legislation, research techniques, the lodgment program, website navigation and portal operation.

To determine the products required, we held holding focus groups with tax professionals canvassing needs in topics such as taxation of companies, partnerships and trusts, determining assessable income, Capital Gains Tax, Fringe Benefit Tax, Goods and Services Tax and superannuation.

We now have 'Practice management reports' which provide a snapshot of how practices are performing against industry benchmarks. Tax agents have found this useful in their practice.

### **Expert advice**

Our average monthly figures for 2006 show we handled 90,000 tax professional website enquiries, 240,000 legal database enquiries, 3000 Register of Private Binding Rulings enquiries and around 150,000 tax practitioner calls to call centres.

We are about to finalise an advice matrix, which outlines our service standards and levels of protection provided by our advice products. It is designed to direct the enquirer to the appropriate advice service for a specific query.

We are also piloting a specialist technical call centre (CGT) with an emphasis on case resolution not escalation as well as a booking service with technical specialist (CGT). Initial

figures on these pilots are most encouraging. We are also investigating a new approach to enable a professional to professional approach based on who is calling not what they are calling on, with an emphasis on account management and practice support.

### **The tax agent portal – more improvements on the way**

The Tax Agent Portal is one of our biggest success stories. The Tax Agent Portal has revolutionised the way we work with tax agents. Over 80% of tax agents say they spend less time contacting us because of the portal.

We have spent over \$40 million on the portal since 2002 when the portal was first released. There have been nine updates with tax agents involved in making improvements for each release.

We have worked very closely with agents on identifying their priorities for the next portal upgrade due in October. The upgrade is expected to resolve irritants and barriers identified by tax agents. Tax agents will be able to download payment slips for a range of obligations. It will also feature a facility to view, vary and lodge quarterly PAYG and GST quarterly instalments.

### **Tax Crime and Aggressive Tax Planning**

We are dealing with tax crime through a range of strategies including improved data matching and profiling, analysis of third party information, participation in multi-agency taskforces such as Project Wickenby, through to enhanced cooperation with foreign tax administrations.

Increasingly, we collaborate at a strategic and tactical level with other agencies to deal with the use of stolen identities, fraudulent behaviour by tax practitioners and refund fraud.

Our main focus in relation to tax exploitation schemes, is on their promoters. In 2007–08 we are focusing on early engagement with professional bodies and intermediaries to influence community standards on the acceptability of abusive schemes. We will also be engaging with known promoters to deter them from promoting abusive schemes.

We are also vigilant for emerging schemes, and will issue taxpayer alerts where they are encountered. In 2007 we have issued 6 taxpayer alerts:

#### *TA 2007/6 - Scholarship Trusts and Education Funding Programs*

This Taxpayer Alert describes an arrangement where a Scholarship Trust is claimed to be established either in Australia or in a foreign country and, in combination with what is described as an 'Education Funding Program', seeks to provide funds to a student which the marketer claims are free of tax.

#### *TA 2007/5 - Arrangements designed to avoid the operation of Division 7A through the use of a Corporate Limited Partnership*

This Taxpayer Alert describes arrangements which attempt to circumvent the application of Division 7A of Part III the Income Tax Assessment Act 1936 (ITAA 1936) through the use of what is claimed to be a Corporate Limited Partnership ('CLP').

*TA 2007/4 - Share options granted under an employee share scheme to a related trust*

This Taxpayer Alert describes an arrangement to avoid tax, through the use of a related trust, by an individual taxpayer in respect of options to acquire shares granted under an employee share scheme.

*TA 2007/3 - Income Tax: Foreign tax credit enhanced return bond investment*

This Taxpayer Alert describes an arrangement where an Australian resident taxpayer seeks to enhance its return on a bond investment, through access to foreign tax credits for withholding tax claimed to be payable under the arrangement. The desired net effect of the arrangement is that neither the bond issuer group, nor the Australian resident taxpayer, bears the economic cost of the tax withheld

*TA 2007/2 - Employee Entitlement Fund*

This alert describes an arrangement where an employee seeks to obtain a deduction for contributions purportedly made to an Employee Entitlement Fund on the basis that the contributions are to meet entitlements that may arise in the future for employees

*TA 2007/1 - Lease by a charitable institution to an associated endorsed charitable institution designed to gain input tax credits.*

Describes an arrangement whereby a charitable institution leases its land and buildings to an associated charitable institution so that a supply of residential accommodation qualifies as GST – free are intended to be an early warning of our concerns about significant and emerging potential aggressive tax planning issues or arrangements that the ATO has under risk assessment.

## CHAPTER 2: SNAPSHOT OF PERFORMANCE IN 2006-07

### OVERVIEW

Overall the Tax Office performed well against our outcome effectiveness measures. We continued with strong delivery of our commitments to government and maintained high levels of community confidence.

Key highlights include:

- Budgeted revenue has been met
- The rate of growth of collectable debt slowed
- Community survey results show significant improvement in levels of community confidence
- Rolled-out significant new capability under Release 2 of the change Program
- Electronic tax returns lodgment for self-preparers exceeded paper returns for 2005-06, with an increase of almost 18% of e-tax users, and
- Our compliance program overall met or exceeded planned activities. However we noted that while the expected level of Super Guarantee liabilities was raised, it was from 7% fewer cases than planned.

There were some areas where we didn't quite achieve intended results but this was mainly restricted to not achieving some service standards. However,, overall the Service Standard index benchmark was met (see below).

### Service standards

Our full-year performance shows that we equalled or exceeded annual benchmarks in 13 of our 23 service standards and achieved an overall index of 1.10 on a benchmark of 1.0.

The overall performance is shown at **Attachment 2**.

Of the service standards that exceeded the annual benchmark, we experienced occasional difficulties in achieving some monthly benchmarks relating to the following service standards:

- 'Registrations'
- 'Refund activity statements – paper'
- 'Refund activity statements –electronic'
- 'Visit general enquiry service'
- 'Objections against private written binding advice', and
- 'Audits finalised advice'.

We did not achieve the annual benchmarks for the following service standards:

- 'Electronic tax returns' (0.3% below benchmark), 'Paper tax returns' (0.3% below benchmark) and 'Electronic amendments' (0.9 % below benchmark) as a result of Income Tax processing being detrimentally impacted by system related issues

- 'Refund of overpaid tax' (6.4% below benchmark), 'General correspondence requiring a response' (5.3% below benchmark), 'Paper amendments' (36.8% below benchmark) and 'Clerical and administrative errors' (6.2% below benchmark). Teething problems associated with the implementation of the Work Management system at the start of the processing year were a significant factor in standards not being met
- Excise fuel schemes – claims (3.7% below benchmark), were impacted by the new workload associated with processing early payment claims of fuel tax credits. This measure was introduced to assist clients to deal with any cash flow impacts arising from the introduction of the new fuel tax credit arrangements. In transition to the new arrangements there was a high exception rate on claims, until clients adjusted to the new process.
- 'Telephone general enquiries' (3.0% below benchmark), with key contributing factors being technology infrastructure and call routing limitations during the peak month of July, and higher than expected call loads across the year, and
- 'Tax practitioners premium telephone service' (3.0% below benchmark), with the key contributing factor being higher than expected calls during the peak month of July, including calls resulting from tax agent portal instability.

## SNAPSHOT OF COMPLIANCE ACTIVITIES FOR 2006-07<sup>1</sup>

### Individuals<sup>2</sup>

- Reviewed 27,100 returns in relation to high-risk refunds, resulting in revenue adjustments of \$27.4 million
- Work-related expenses – wrote to 225,000 people before they lodged resulting in revenue savings of \$22 million, and completed around 15,500 reviews or audits an estimated \$13.1 million in additional revenue
- 1.2 million letters were sent to people who may have lost track of their superannuation
- As part of the Better Super campaign, 1.8 million people were contacted about providing their tax file number to their fund

### Micro enterprises<sup>3</sup>

- Visited or telephoned 27,800 new and established micro enterprises to help them understand their tax obligations and report correct information
- 2,500 field audits, 1,800 outbound phone reviews and 17,000 desk reviews of employers' compliance completed, raising revenue of \$259.9 million
- 3,300 income tax reviews and audits completed, resulting in additional tax and penalties of \$76.4 million

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<sup>1</sup> Results of our activities are based on preliminary data and are indicative only. Final results for 2006-07 will be published in our *Annual report 2006-07*, due for release in October.

<sup>2</sup> Compliance Program 2007-08 page 14

<sup>3</sup> Compliance Program 2007-08 page 22



### Small to Medium Enterprises<sup>4</sup>

- 990 audits, 760 reviews and 1,600 phone and letter-based verification activities completed, raising liabilities of \$338 million and disallowed current year and carried-forward losses of \$288 million
- Reviews of 210 high wealth individuals completed - audits of 22 individuals raised \$280 million
- 321 field audits, 320 outbound phone reviews and 5,726 desk reviews of employers' compliance with PAYG withholding, superannuation guarantee and fringe benefits tax obligations completed, raising revenue of \$73.8 million

### Large Businesses<sup>5</sup>

- 40 compliance audits of large businesses and 170 comprehensive risk reviews resulted in more than \$1.5 billion in additional collections, \$2.2 billion in new income tax liabilities and more than \$1.2 billion in notional tax ( a substantial amount of which is in dispute)
- 275 private binding rulings, 90 class rulings, 10 product rulings and 690 objections completed
- 11 field audits and more than 350 reviews of employers' compliance with their PAYG withholding, superannuation guarantee and fringe benefits tax obligations, raising \$7.8 million for employees
- Compliance GST activities raised more than \$310 million in GST liabilities
- Finalised more than 780 GST compliance audits

### Cross agency

- In May 2007 the Tax Office signed a new memorandum of understanding with ASIC to consolidate and strengthen the working relationship between the two agencies.

### Tax practitioners

- Conducted over 5100 visits to tax agents and helped them with many issues.
- Delivered over 310 presentations to more than 6500 tax agents, and we also did an online presentation through our website.
- Conducted seminars at 212 venues, attracting 17,500 registrations.

### Tax crime and aggressive tax planning<sup>6</sup>

- As at 30 June 2007:
  - 16 criminal investigations led by the ACC or AFP
  - 136 tax audits involving 234 taxpayers
- Raised additional tax, including penalties, of \$54.64 million from over 70 amended assessments and collected \$17.79 million
- Issued 531 notices under section 264

<sup>4</sup> Compliance Program 2007-08 page 35

<sup>5</sup> Compliance Program 2007-08 page 47

<sup>6</sup> Compliance Program 2007-07 page 69 and 71

- \$12.37 million has been restrained under the Proceeds of Crime Act
- Undertook 25 access visits with notice and 62 access visits without notice
- Our preliminary analysis indicates there has been a substantial improvement in post-Wickenby tax compliance by Wickenby participants

## CHAPTER 3: TOPICAL AREAS

### EXTERNAL SCRUTINY

#### Ombudsman

In 2006-07 the Ombudsman completed eight external research projects that related to the Tax Office. Most of these projects related to aspects of our administration of debt collection activities and the reviews found no significant issues. The report on garnishee has been publicly released. At 30 June 2007 two external reviews were in progress.

The Taxation Ombudsman Activities Report 2006 noted that in 2006, the Ombudsman received 1,415 complaints about the ATO, compared with 1,548 in 2005. This suggests a trend in the last few years of a leveling off in ATO complaint numbers in contrast to the period comprising the introduction of the new tax system and the difficulties over the tax treatment of mass-marketed investment schemes.<sup>7</sup>

#### Inspector-General of Taxation

Three reports by the Inspector-General of Taxation were released by the Minister for Revenue and Assistant Treasurer during 2006-07. The reports were:

- Review of Tax Office management of Part IVC litigation
- Review into the Tax Office's ability to identify and deal with major, complex issues within reasonable timeframes: Case study on service entity arrangements
- Review into the Tax Office's ability to identify and deal with major, complex issues within reasonable timeframes: Case study on living away from home allowances

At 30 June 2007 the Inspector-General had five reviews in progress, including a follow-up review of the implementation of recommendations made in his previous six reports.

The Inspector-General of Taxation's final case study on Research & Development syndicates was released by the Minister on 16 August 2007.

#### ANAO

The ANAO tabled five audits specific to the Tax Office and three cross-agency audits involving the Tax Office during 2006-07. At 30 June 2007 four audits were in progress.

The two most recent ANAO audits relating specifically to the Tax Office concerned our administration of debt collection and regulation of self managed superannuation funds.

*The ATO's Administration of Debt Collection-Micro-business (tabled June 2007)*

We agreed with all 6 recommendations are already making progress in addressing them.

The ANAO noted that Australia ranks relatively well in terms of some OECD benchmarks with regard to debt collection and the six recommendations were broadly supportive of the Tax Office's general direction.

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<sup>7</sup> Page 2, Taxation Ombudsman Activities Report 2006

*The Australian Taxation Office's Approach to Regulating and Registering Self Managed Superannuation Funds (tabled June 2007)*

This is the first of two audit reports on the Tax Office's administration of SMSFs. The ANAO noted that since 2003-04 the Tax Office had initiated significant steps to improve administration and costing systems that support its regulation and registration of SMSFs. The ANAO also noted that the Tax Office intends to make further changes to its SMSF administration in implementing the Simplified Superannuation reforms.

## PUBLIC RULINGS

In 2007 (to 12 September 2007) we have issued 229 public rulings. The table below provides a breakdown by ruling type.

Product Rulings	81
Class Rulings	83
Draft Goods and Services Tax Rulings	1
Final Goods and Services Tax Rulings	2
Draft Goods and Services Tax Determinations	1
Draft Taxation Rulings	9
Final Taxation Rulings	7
Draft Taxation Determinations	13
Final Taxation Determinations	26
Luxury Car Tax Determinations	1
Miscellaneous Taxation Rulings	1
Draft Self Managed Superannuation Funds Ruling	1
Draft Self Managed Superannuation Funds Determination	1
Draft Fuel Tax Rulings	1
Final Fuel Tax Rulings	1

A brief summary of the final and draft public rulings that have issued since the last public hearing of the Committee in April 2007 are at **Attachment 3**.

We recently issued the first in a series of draft rulings and determinations on Self Managed Superannuation Funds (SMSFs)<sup>8</sup>. These products will provide better guidance to superannuation professionals and trustees on the Tax Office's view as the regulator. As part of our consultation with the superannuation industry, we were asked to provide more information about the regulatory aspects of SMSFs.

Draft ruling SMSFR 2007/D1 sets out our preliminary view on the nature of the sole purpose test and sets out a number of factors that determine whether or not a benefit will breach the test.

<sup>8</sup> Superannuation rulings are not legally binding on the Commissioner of Taxation.

Draft determination SMSFD 2007/D1 explains our preliminary view on when a dividend or trust distribution is 'received' before the end of 30 June 2009 (for the purposes of paragraph 71D(d) of the *Superannuation Industry (Supervision) Act 1993*).

SMSFR 2007/D1 is available for comment until 19 October 2007 and SMSFD 2007/D1 is available for comment until 5 October 2007.

## RELIANCE CARPET DECISION: GST – SECURITY DEPOSITS

The Tax Office is seeking special leave to appeal to the High Court against a recent decision of the Full Federal Court finding in the *Reliance Carpet* decision<sup>9</sup> that no GST was payable on the forfeiture of a security deposit.

The Full Federal Court's decision is in contrast to the views expressed by the Tax Office in Goods and Services Tax Ruling GSTR 2006/2 entitled *Deposits held as security for the performance of an obligation*.

Both the scope of the definition of supply and the GST treatment of forfeited security deposits are important issues for the community. On this basis we feel it is appropriate to seek to test the views of the Full Court before the High Court.

Our Decision Impact Statement and Media release<sup>10</sup> on the *Reliance Carpet* decision state that anyone seeking a refund for GST paid on a forfeited security deposit should notify the Commissioner in writing of their intention to do so, to ensure that they are not prejudiced by time limits on refunds. Such notification is required within four years of the end of the tax period to which the amount relates. There will also be a requirement that any refunds of GST be passed on to customers where that is required by the law.

Any requests for refunds received will be held pending the outcome of the High Court proceedings.

## MANAGED INVESTMENT SCHEMES

The Tax Office must be responsive to developments in the law and discharge its administrative responsibilities accordingly. At times, legal developments may require the ATO to change its view. One such matter was the deductibility of investments in both forestry and non-forestry managed investment schemes.

As the matter is not free from doubt, it is best clarified by the courts. First however, there needs to be a dispute. While we can offer to fund such a case, it is up to the promoters of these arrangements to find a case and to commence such proceedings.

We have been working closely with industry and affected taxpayers to urgently identify and expedite a test case while not insisting on taxpayers following our view. To expedite matters, we intend to seek (with industry consent) two motions in the Federal Court: an urgency motion to have the test case resolved quickly, and a request for a hearing by the Full Federal Court on the basis of importance and the public interest. In progressing this matter, the promoters could

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<sup>9</sup> 2007 ATC 4650

<sup>10</sup> Media Release 2007/39

use a private binding ruling application on a real project that would be offered in the 2008/9 financial year as the basis for the test case.

## ATTACHMENT 1

## SERVICE STANDARDS 2007-08

## Tax Office service standards performance year to date (to 31 July 2007)

Service Standard	Standard	Benchmark %	July 07 %
<b>Registrations</b>			
Registrations	28 days	85.0*	97.2
<b>Lodgments</b>			
Electronic tax returns	14 days	82.0*	90.1
Paper tax returns	42 days	90.0*	95.2
Refund activity statements - paper	14 days	85.0*	94.4
Refund activity statements - electronic	14 days	90.0*	95.2
Electronic debit activity statements	14 days	90.0*	99.7
Paper debit activity statements	42 days	90.0*	94.8
<b>Refunds and payments</b>			
Refund of overpaid tax	28 days	90.0*	90.4
Superannuation holding accounts special account payment requests.	21 days	80.0*	80.0
Excise fuel schemes - claims	14 days	92.0	90.1
<b>Enquiries</b>			
Automated email response	3 days	90.0	99.7
Inbound correspondence <sup>2</sup>	28 days	80.0*	84.3
Private written binding advice	28 days	80.0*	93.3
Telephone general enquiries	5 min	83.0	72.0
Tax practitioners premium telephone service	2 min	90.0	91.3
Visit general enquiry service	10/15 min	90.0	94.3
<b>Amendments and Objections</b>			
Paper amendments	56 days	85.0*	51.5
Electronic amendments	28 days	85.0*	84.8
Objections against private written binding advice	28 days	85.0*	90.0
Objections other than to private written binding advice	56 days	70.0	82.6
<b>Audits</b>			
Audits finalised advice	7 days	99.0	99.2
<b>Errors</b>			
Clerical and administrative errors	14 days	70.0	38.1
<b>Complaints</b>			
Complaints	3 days	88.0*	93.1
Resolution of complaints	21 days	85.0	87.3

\* We have lowered some service standards for 2007-08 to acknowledge temporary productivity dips caused by

implementing significant changes to our computer systems during the year. There are plans in place to carefully manage any anticipated impacts on taxpayers. We will continue to monitor our progress and review how our service standards might be affected for next year.

Note: Some minor data issues may be experienced throughout the 2007-08 year due to the implementation of significant changes to our computer systems. Any variance in performance will be reported in the Commissioner of Taxation Annual Report.

1. to date (YTD) data is the accumulative total of performance against benchmark from the beginning of the financial year
2. reported as 'General correspondence requiring a response'. The change in title reflects the broader scope of cases to be included in the service standard from 1 July 2007.



## ATTACHMENT 2

## SERVICE STANDARDS 2006 - 07

## Tax Office service standards performance (to 30 June 2007)

Service Standard	Standard	Benchmark %	June 07
<b>Registrations</b>			
Registrations	28 days	93.0	97.2
<b>Lodgments</b>			
Electronic tax returns	14 days	96.0	95.7
Paper tax returns	42 days	92.0	91.7
Refund activity statements - paper	14 days	90.0	92.5
Refund activity statements - electronic	14 days	92.0	95.0
Electronic debit activity statements	14 days	95.0	99.3
Paper debit activity statements	42 days	92.0	98.3
<b>Refunds and payments</b>			
Refund of overpaid tax	28 days	92.0	85.6
Superannuation holding accounts special account payment requests	21 days	85.0	93.9
Excise fuel schemes - claims	14 days	92.0	88.3
<b>Enquiries</b>			
Automated email response	3 days	90.0	99.4
General correspondence requiring a response	28 days	85.0	79.7
Private written binding advice	28 days	83.0	93.3
Telephone general enquiries	5 min	83.0	80.0
Tax practitioners premium telephone service	2 min	90.0	87.0
Visit general enquiry service	10 min/15 min	90.0	92.3
<b>Amendments and Objections</b>			
Paper amendments	56 days	92.0	55.2
Electronic amendments	28 days	92.0	91.1
Objections against private written binding advice	28 days	88.0	90.3
Objections other than to private written binding advice	56 days	70.0	82.0
<b>Audits</b>			
Audits finalised advice	7 days	99.0	99.6
<b>Errors</b>			
Clerical and administrative errors	14 days	70.0	63.8
<b>Complaints</b>			
Complaints	3 days	85.0	94.4
Resolution of complaints	21 days	85.0	90.8

## ATTACHMENT 3:

## SUMMARY OF FINAL AND DRAFT TAXATION RULINGS ISSUED SINCE 20 APRIL 2007

## Taxation Rulings

**TR 2007/2**            **Income tax: application of the same business test to consolidated and MEC groups – principally, the interaction between section 165-210 and section 701-1 of the *Income Tax Assessment Act 1997***

**Issued**            **20 June 2007**

The Taxation Ruling sets out the Commissioner's views on how the 'same business test' (SBT) applies in the context of determining whether tax losses are available to the head company of a consolidated group. The ATO view expressed in the Taxation Ruling is that a head company will be taken to carry on one overall business comprising all of the various activities of its subsidiary members for the purpose of determining whether it carries on the same business after a change in ownership.

As a part of the development of the Consolidation regime, stakeholders identified the application of the SBT to the head company of a consolidated group as a key area for law clarification. The Ruling is intended to set out the issues that have to be considered in determining whether or not the head company of a consolidated group can satisfy the SBT.

**Market segments affected:** Micro Enterprises, Small and Medium Enterprises, Large Business and International.

**TR 2007/3**            **Income tax: effective life of depreciating assets (applicable from 1 July 2007)**

**Issued**            **27 June 2007**

This Ruling discusses the methodology used by the Commissioner in making determinations of the effective life of depreciating assets. The effective life of an asset is used to work out the asset's decline in value. This Ruling reflects new determinations that apply from 1 July 2007.

As part of an ongoing review process, this Ruling is updated bi-annually to add new determinations that apply from 1 January and 1 July each year. From 1 July 2007, new determinations provide 'safe harbour' effective lives for the following industries and assets: aquaculture assets; all terrain vehicles and motorcycles used in primary production; coffee, olive and tree nut assets; dairy cattle assets; harvesters; hydroponics assets; tractors, vegetable and cane assets.

This Ruling replaces TR 2006/15 which was withdrawn from 1 July 2007. The updates are as a result of the ongoing review of the Commissioner's effective life determinations. This review was prompted by the Government's endorsement of Recommendation 8.5 of The Review of Business Taxation's A Tax System Redesigned.

**Market segments affected:** Individual, Micro Enterprises, Small and Medium Enterprises, Large Business and International.

**TR 2007/4**            **Income tax: entitlement to foreign tax credits under Division 18 of Part III of the *Income Tax Assessment Act 1936* when foreign income is included in the net income of a trust estate**

**Issued**            **18 July 2007**

The Ruling explains:

- (i) the application of the foreign tax credit rules to resident taxpayers in receipt of trust income that includes foreign income, and

- (ii) the circumstances under which the trustee of the trust estate is entitled to claim a foreign tax credit and apply an excess foreign tax credit from an earlier year.

Amendments contained in Tax Laws Amendment (2007 Measures No. 4) Bill 2007, introduced into the Parliament on 21 June 2007, will make this Ruling largely redundant after the new rules come into force (if passed by the Parliament). This Ruling, however, will meet industry expectations (expressed through the National Tax Liaison Group Foreign Source Income Sub-Committee) that the Tax Office would clarify and formalise the historical interpretive position and provide guidance for the period until any new rules come into force. It is not intended to update this Ruling to reflect the new law.

**Market segments affected:** Individual, Micro Enterprises, Small and Medium Enterprises, Large Business and International.

**TR 2007/5            Income tax: functional currency – when is an amount not in the ‘applicable functional currency’?**

**Issued                25 July 2007**

The Ruling explains how the ‘applicable functional currency’ translation rules in subsection 960-80(1) and section 960-85 of Subdivision 960-D of the *Income Tax Assessment Act 1997*, will apply to eligible entities who choose to use an ‘applicable functional currency’. Their ‘applicable functional currency’ for income tax purposes is governed by whether or not they use a particular foreign currency in keeping their ‘accounts’.

In particular, the Ruling shows in detail how the transitional translation rule in section 960-85 operates. This rule deals with the translation of prior (that is, pre ‘applicable functional currency’) income tax related amounts (generally being amounts in A\$) to the ‘applicable functional currency’ – upon an effective ‘applicable functional currency’ choice being made by an eligible entity.

The Taxation Ruling will resolve a large number of issues that have been raised by the Forex NTLG; for example how does section 960-85 apply to CGT assets, depreciating assets, trading stock, borrowing expenses, tax losses, bad debts and traditional securities.

**Market segments affected:** Individual, Small Medium Enterprise, Large Business and International.

**TR 2007/6            Income tax: non-commercial business losses: Commissioner’s discretion**

**Issued                25 July 2007**

The Ruling provides guidelines and further guidance on how the Commissioner’s discretion in Division 35 of the *Income Tax Assessment Act 1997* (ITAA 1997) may be exercised to determine that it would be unreasonable for the loss deferral rule in the non-commercial loss provisions to apply to a loss resulting from an individual taxpayer’s business activity.

It updates the Tax Office view previously outlined in Taxation Ruling TR 2001/14 (non-commercial business losses) on when the discretion will be exercised. Relevant paragraphs of TR 2001/14 have been withdrawn, as this Ruling replaces them.

Private and product ruling requests highlighted a number of difficulties that can arise in determining if the Commissioner’s discretion should be exercised. The Board of Taxation recommended that Tax Office rulings on this topic include additional examples to help make the operation of the discretion clearer.

The Ruling seeks to address these concerns. .

It also updates the Tax Office view on the operation of the discretion provisions in the light of recent court and tribunal decisions.

**Market segments affected:** Micro Enterprises.

**TR 2007/7            Income tax: consolidation: errors in tax cost setting amounts of reset cost base assets**

**Issued 1 August 2007**

The Ruling considers the treatment of errors a head company of a consolidated group or multiple entry consolidated (MEC) group makes in working out the tax cost setting amount of an asset of an entity where the tax cost of the asset is required to be reset at the time the entity becomes a subsidiary member of the group.

The Ruling was issued in order to provide an ATO view on issues relating to the error rules. The professional bodies, through the National Tax Liaison Group (NTLG) Consolidation Subcommittee, requested guidance on what would be considered to be an error for the purposes of the error rules.

**Market segments affected:** Small and Medium Enterprises, Large Business and International.

**Taxation Determinations**

**TD 2007/11**      **Income tax: imputation: franked distributions: qualified persons: does an entity have to be a qualified person within the meaning of Division 1A of former Part IIIAA of the *Income Tax Assessment Act 1936* to avoid the application of paragraphs 207-145(1)(a) and 207-150(1)(a) of the *Income Tax Assessment Act 1997* in respect of a franked distribution made directly or indirectly to the entity on or after 1 July 2002?**

**Issued 24 April 2007**

This Determination deals with the question of who is a 'qualified person' in relation to a franked distribution. Passing the 'qualified person' test is important for an entity being able to obtain the franking credit attached to a dividend distribution.

The Determination states that the 'qualified person' test contained in the now repealed Division 1A of former Part IIIAA of the *Income Tax Assessment Act 1936* (ITAA 1936) continues to have relevance to the relevant rules of the Simplified Imputation System.

The Determination says that passage of 2006 legislative amendments does not change the position that an entity must satisfy the 'qualified person' rules of the former Division 1A in order to satisfy paragraphs 207-145(1)(a) and 207-150(1)(a) of the ITAA 1997.

**Market segments affected:** Individual, Micro Enterprises, Small and Medium Enterprises, Large Business and International.

**TD 2007/12**      **Income tax: consolidation: subsidiary in liquidation – for the purposes of subsection 711-45(1) of the *Income Tax Assessment Act 1997*, is the amount of an unsatisfied liability owed to another member of the consolidated group ('intra-group liability') by a subsidiary member at the time it is deregistered equal to the market value of the corresponding asset of that other member?**

**Issued 2 May 2007**

This Determination relates to 1 of 3 Determinations that deal with the tax consequences for a consolidated group when an insolvent subsidiary member is liquidated and deregistered. Together, those Determinations state the Commissioner's view that a subsidiary will cease to be a member of a consolidated group upon deregistration and, to the extent that the group gains an inappropriate tax advantage when the deregistration effectively relieves it of outstanding liabilities owed by the subsidiary to external creditors, the head company of the group will be subject to tax on a capital gain.

This Determination explains what happens when an outstanding liability at deregistration is owed to another member of the consolidated group. For the purposes of the rules relevant to determining whether the head company makes a capital gain, the Determination clarifies that the amount of the intra-group liability will be the market value of the corresponding asset of that other member of the group.

In these circumstances the market value of the corresponding asset is likely to be negligible which means that the head company is less likely to make a capital gain when outstanding liabilities of a subsidiary at the time of deregistration are owed to other members of the consolidated group.

This Determination was issued to provide completeness in the Commissioner's view in respect of the tax effect of liquidating an insolvent subsidiary member of a consolidated group.

**Market segments affected:** Small and Medium Enterprises, Large Business and International, Not for Profit.

**TD 2007/13      Income tax: consolidation: can a head company make a capital gain under CGT event L5 (section 104-520 of the *Income Tax Assessment Act 1997*) when a subsidiary member of the group is deregistered after liquidation?**

**Issued                      2 May 2007**

This is 1 of 3 Determinations dealing with the tax consequences for a consolidated group when an insolvent subsidiary member is liquidated and deregistered. Together, the Determinations state the Commissioner's view that a subsidiary will cease to be a member of a consolidated group upon deregistration and, to the extent that the group gains an inappropriate tax advantage when the deregistration effectively relieves it from outstanding liabilities owed by the subsidiary to external creditors, the head company of the group will be subject to tax on a capital gain.

This Determination explains that the head company of a consolidated group will make a capital gain under CGT event L5 if a subsidiary member of the group has unsatisfied liabilities to external creditors at the time of its deregistration.

This Determination explains that there will be tax consequences (CGT event L5 will apply to the head company) if a subsidiary is deregistered with unsatisfied liabilities and no assets.

**Market segments affected:** Small and Medium Enterprises, Large Business and International, Not for Profit.

**TD 2007/14      Income tax: capital gains: small business concessions: what 'liabilities' are included in the calculation of the 'net value of the CGT assets' of an entity in the context of subsection 152-20(1) of the *Income Tax Assessment Act 1997*?**

**Issued                      9 May 2007**

This Determination examines the meaning of the term 'liabilities' in the context of working out the net value of the CGT assets for the purposes of the maximum net asset test. More generally, the complete suite of Determinations, of which this is the last, deal with a range of issues concerning the small business CGT concessions. Such issues include the active asset test, controlling individual test, maximum net asset value test, small business retirement exemption and small business rollover.

This Determination, like the other Determinations previously issued, consolidate the ATO views contained in earlier ATO IDs.

The Board of Taxation, as part of its Post-Implementation Review of the small business CGT concessions, made recommendations for further ATO guidance by way of Public Rulings/Determinations or other guide material on a range of small business CGT concession issues. The ATO view on most of these issues has previously been set out in ATO IDs. The issue of these Determinations will assist in addressing the Board of Taxation recommendations.

The consolidation of these ATO IDs into a series of taxation determinations will make the ATO view legally binding on the Commissioner.

**Market segments affected:** Micro Enterprises, Small and Medium Enterprises.

**TD 2007/15**      **Income tax: consolidation: if a member of a consolidated group is reinstated under section 601AH of the *Corporations Act 2001* after having been deregistered, will it be taken to have continued to satisfy the membership requirements in section 703-15 of the *Income Tax Assessment Act 1997* during the period between deregistration and reinstatement?**

**Issued**              **9 May 2007**

This Determination is 1 of 3 that deal with the tax consequences for a consolidated group when an insolvent subsidiary member is liquidated and deregistered. Together, those Determinations stated the Commissioner's view that a subsidiary will cease to be a member of a consolidated group upon deregistration and, to the extent that the group gains an inappropriate tax advantage when the deregistration effectively relieves it from outstanding liabilities owed by the subsidiary to external creditors, the head company of the group will be subject to tax on a capital gain.

This Determination is being issued to provide completeness in the Commissioner's view in respect of the tax effects of deregistering a subsidiary member of a consolidated group.

**Market segments affected:** Small and Medium Enterprises, Large Business and International, Not for Profit.

**TD 2007/16**      **Income tax: does the notional assessable income of a controlled foreign company include an amount deemed to be a dividend under section 47A of the *Income Tax Assessment Act 1936*?**

**Issued**              **9 May 2007**

This Taxation Determination explains that an amount deemed to be a dividend under section 47A of the *Income Tax Assessment Act 1936* is not included in notional assessable income under either section 384 (in respect of an unlisted country controlled foreign company (CFC) or section 385 (in respect of a listed country CFC).

In simple terms, the determination clarifies that an amount assessed as a deemed dividend will not also be included as income for a second time by the attribution regime (the CFC rules). That is, it prevents double taxation of the same amount of income.

**Market segments affected:** Small and Medium Enterprises, Large Business and International.

**TD 2007/17**      **Fringe benefits tax: for the purposes of section 39A of the *Fringe Benefits Tax Assessment Act 1986* what is the car parking threshold for the fringe benefits tax year commencing on 1 April 2007?**

**Issued**              **9 May 2007**

This Determination says that the car parking threshold for the fringe benefits tax (FBT) year commencing on 1 April 2007 is \$6.78.

It applies to the FBT year commencing on 1 April 2007.

**TD 2007/18**      **Income tax: consolidation: in applying the statutory cap in section 705-40 (tax cost setting amount for reset cost base assets held on revenue account) of the *Income Tax Assessment Act 1997*, does the definition of revenue asset in section 977-50 of that Act include any CGT asset, a hypothetical realisation of which would have an amount reflected in the joining entity's taxable income (disregarding the single entity rule), otherwise than solely as a capital gain or capital loss?**

**Issued**              **30 May 2007**

The Determination clarifies the meaning of revenue asset in section 977-50 of the *Income Tax Assessment Act 1997* (ITAA 1997), for the purposes of applying the statutory cap in section 705-40 of the ITAA 1997 on tax cost setting amounts for revenue assets.

The view taken in the Determination is that a revenue asset will be any asset where the tax consequences of its realisation would not be dealt with solely under the CGT provisions.

The purpose of section 705-40 is to prevent unrealised capital losses being converted into revenue losses when an entity joins a consolidated group (see paragraph 5.37 of the Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002. However as the definition of revenue asset contains a mixture of legal, economic/commercial and tax concepts, its scope is open to interpretation and requires clarification.

**Market segments affected:** Small and Medium Enterprises, Large Business and International.

**TD 2007/19      Income tax: capital gains: what is the improvement threshold for the 2007-08 income year under section 108-85 of the *Income Tax Assessment Act 1997*?****Issued            23 May 2007**

The improvement threshold under section 108-85 of the *Income Tax Assessment Act 1997* for the 2007-08 income year is \$116,337. This Determination applies for the 2007-08 income year.

**TD 2007/20      Income tax: can the attribution regime relating to controlled foreign companies apply to an Australian entity that is a member of a foreign company limited by guarantee?****Issued            27 June 2007**

This Determination considers whether the controlled foreign company (CFC) attribution regime applies to an Australian entity that is a member of a foreign company limited by guarantee. A company limited by guarantee has no share capital. Under the *Corporations Act 2001*, a company limited by guarantee is defined as a company formed on the principle of having the liability of its members limited to the respective amounts that the members undertake to contribute to the company if it is wound up.

The Determination focuses upon the preliminary question of whether such an Australian entity is a 'shareholder' for income tax purposes, as this is relevant in determining whether an entity has an associate inclusive control interest, or an attribution interest in a foreign company.

In turn, these interests are crucial in determining whether the Australian entity will be subject to attribution under the CFC regime.

The Board of Taxation's 2003 report recommended that the Tax Office clarify its position on this issue through a public ruling.

**Market segments affected:** Individual, Micro Enterprises, Small and Medium Enterprises, Large Business and International.

**TD 2007/21      Income tax: what are the reasonable travel and meal allowance expense amounts for 2007-2008?****Issued            27 June 2007**

This Determination sets out the amounts that the Commissioner of Taxation considers are reasonable ('the reasonable amounts') for the 2007-2008 year of income in relation to claims made for:

- overtime meal allowance expenses
- domestic travel allowance expenses
- travel allowance expenses for employee truck drivers, and
- overseas travel allowance expenses,

that are work related losses or outgoings incurred and are covered by award overtime meal allowances, domestic travel allowances and overseas travel allowances.

The Determination is updated annually with new rates based on surveys of actual costs, produced by the Department of Employment and Workplace Relations and other organisations. For the past two years the reasonable amounts have been published in a Tax Determination separate from the Taxation Ruling TR 2004/6, which still discusses the substantiation provisions and the exceptions to the substantiation requirements.

**Market segments affected:** Individual.

**TD 2007/22      Income tax: what is the car limit for the 2007-2008 financial year?****Issued            27 June 2007**



This Determination concludes that the car limit for the 2007-2008 financial year is \$57,123.

This Determination applies for the financial year commencing on 1 July 2007.

**TD 2007/23**      **Income tax: what is the benchmark interest rate applicable for the year of income that commenced on 1 July 2007 for the purposes of Division 7A of Part III of the *Income Tax Assessment Act 1936* and how is it used?**

**Issued**              **4 July 2007**

This Determination concludes that for the income year that commenced on 1 July 2007, the benchmark interest rate for the purposes of sections 109N and 109E of the *Income Tax Assessment Act 1936* is 8.05% per annum.

This Determination applies to the income year commencing on 1 July 2007.

**TD 2007/24**      **Income tax: is the 'applicable functional currency' for the head company of a consolidated group determined by looking at the 'accounts' of all the members of the consolidated group, for the purposes of item 1 of subsection 960-60(1) of the *Income Tax Assessment Act 1997*?**

**Issued**              **25 July 2007**

This Determination concerns the choice by a head company of a tax consolidated group to use a particular foreign currency (referred to as the 'applicable functional currency'), rather than Australian currency, in working out annual income tax liability. The question answered arose in connection with the issue of Taxation Determination TD 2006/7, which says that a head company can make such a choice.

The Determination says that the tax group's 'accounts' as a whole (that is, the 'accounts' of every member of the tax consolidated group) should be reviewed to identify what, if any, is the 'applicable functional currency' that the head company can choose. The Determination also confirms that, in determining whether there is a predominant foreign currency for a tax consolidated group, no reliance is placed upon 'accounts' kept by entities that are not members of the tax consolidated group.

This Determination follows on from TD 2006/7 (and to a lesser extent TD 2006/8) in dealing with certain interactions between the consolidation and applicable functional currency provisions. These were issues raised by the Finance and Investment Subcommittee of the National Tax Liaison Group (Forex NTLG), and several other externals.

**Market segments affected:** Small and Medium Enterprises, Large Business and International.

**TD 2007/25**      **Income tax: can section 160ZZZJ of Part IIIB of the *Income Tax Assessment Act 1936* apply to interest entered in the accounting records of an Australian branch of a foreign bank if the interest relates to a borrowing the branch has obtained from a third party?**

**Issued**              **22 August 2007**

This Determination concerns when interest paid by an Australian branch of a foreign bank will be subject to withholding tax under the foreign bank branch provisions in Part IIIB of the ITAA 1936 and when it will be subject to withholding tax under the ordinary withholding tax provisions of Division 11A of the ITAA 1936.

In particular, the Determination confirms that where an Australian branch of a foreign bank has obtained a borrowing directly from a third party non-resident, any interest payable on the loan will be subject to withholding tax under Division 11A rather than under Part IIIB.

The Determination will address the issue raised in a joint submission received from professional bodies following the release of Draft Taxation Ruling TR 2005/D1 Income tax: branch funding for multinational banks, namely the operation of section 160ZZZJ where a transfer of funds may be traced to a third party.

**Market segments affected:** Large Business and International.

**TD 2007/26**      **Income tax: can a share in a company be a convertible interest by satisfying item 4 of the table in subsection 974-75(1) of the *Income Tax Assessment Act 1997*?**

**Issued**                      **22 August 2007**

This Determination explains the ATO view established in Class Ruling CR 2005/30 prior to its withdrawal that a share which converts into another share qualifies as a convertible interest. Being a convertible interest means among other things, that under the current law, certain capital gains tax roll-over relief is available.

It confirms and explains the view expressed in Class Ruling CR 2005/30. That Class Ruling was withdrawn on 15 June 2005 as the arrangement described in the Class Ruling was no longer in serious contemplation.

**Market segments affected:** Small and Medium Enterprises, Large Business and International, Government.

### Fuel Tax Rulings

**FTR 2007/1**      **Fuel tax: the meaning of 'acquire', 'manufacture' and 'import' in the expression 'taxable fuel that you acquire or manufacture in, or import into, Australia to the extent that you do so for use in carrying on your enterprise' in the *Fuel Tax Act 2006***

**Issued**                      **12 September 2007**

This Ruling explains the Commissioner's view on the meaning of 'acquire', 'manufacture', and 'import' in the expression 'taxable fuel that you acquire or manufacture in, or import into, Australia to the extent you do so for use in carrying on your enterprise' in the *Fuel Tax Act 2006* (FT Act).

The Ruling also explains:

- the context of the fuel tax credit system
- the meaning of 'taxable fuel'
- the meaning of 'Australia', and
- the attribution rules in Division 65 of the FT Act.

The previous system of energy grants for off-road and on-road credits and rebates has been replaced by the fuel tax credit system. Under the fuel tax credit system, all taxable fuel acquired or manufactured in, or imported into, Australia for use (other than for travel on a public road) in carrying on an enterprise will become tax-free over time.

**Market segments affected:** Individual, Micro Enterprises, Small and Medium Enterprises, Large Business and International, Not for Profit, Government.

### Miscellaneous Taxation Rulings

**MT 2007/1**      **Miscellaneous taxes: does paragraph 284-220(1)(e) of Schedule 1 to the *Taxation Administration Act 1953* apply to increase the base penalty amount applicable to a subsection 284-75(3) penalty where the entity was liable to the same penalty for a previous accounting period?**

**Issued**                      **4 July 2007**

This Miscellaneous Taxation Ruling explains the Commissioner's view on the operation of paragraph 284-220(1)(e) of Schedule 1 to the *Taxation Administration Act 1953* (TAA). It explains that the provision applies to increase the penalty imposed under subsection 284-75(3) by 20% if taxpayers have previously been liable to the same type of penalty. Taxpayers are liable for a penalty under subsection 284-75(3) when they fail to give a return, statement or other document in which a statement can be made about a tax-related liability.

This Ruling is being issued to clarify the operation of subsection 284-220(1) of Schedule 1 to the TAA.

**Market segments affected:** Individual, Micro Enterprises, Small and Medium Enterprises, Large Business and International, Not for Profit, Government.

### GST rulings

#### GSTR 2007/2

**Goods and services tax: in the application of paragraph (b) of item 3 in the table in subsection 38-190(1) of the *A New Tax System (Goods and Services Tax) Act 1999* to a supply, when does 'effective use or enjoyment' of the supply 'take place outside Australia'?**

#### Issued

**24 April 2007**

This Ruling explains when effective use or enjoyment of a supply takes place outside Australia, as required by paragraph (b) of item 3 in the table in subsection 38-190(1) of the GST Act. The Ruling is applicable to both resident and non-resident entities. The GST treatment of supplies made to non-residents under this Ruling is typically the same as that under GSTR 2005/6 (which concerned supplies to non-residents outside Australia).

For a supply to be GST-free under item 3, that supply must be used or enjoyed outside Australia. If a supply is provided to an entity outside Australia, it is effectively used or enjoyed outside Australia. However, if a supply is provided to an entity in Australia, that supply is not effectively used or enjoyed outside Australia. We determine whether there is provision of a supply to an entity in Australia consistent with the approach taken in GSTR 2005/6.

This Ruling is the final ruling to issue as part of a suite of foundation public rulings which together explain the GST treatment of services and things, other than goods, that are for export.

**Market segments affected:** Individual, Micro Enterprises, Small and Medium Enterprises, Large Business and International, Not for Profit, Government

The Ruling potentially affects any supplier that exports services and other things (other than goods).

### Luxury Car Tax Determinations

#### LCTD 2007/1

**Luxury car tax: what is the luxury car tax threshold for the 2007-2008 financial year?**

#### Issued

**27 June 2007**

The luxury car tax threshold for the 2007-2008 financial year is equal to the car limit and is used to determine if luxury car tax is payable.

The car limit for the 2007-2008 financial year is \$57,123. This limit is indexed annually in line with movements in the motor vehicle purchase sub-group of the Consumer Price Index.

This Determination applies to the financial year commencing 1 July 2007.

### Draft Taxation Rulings

#### TR 2007/D4

**Income tax: the circumstances when an item used to create a particular atmosphere or ambience for premises used in a cafe, restaurant, licensed club, hotel, motel or retail shopping business constitutes an item of plant**

#### Issued

**13 June 2007**

This Draft Taxation Ruling sets out circumstances where an item used to create a particular atmosphere in a cafe, restaurant, licensed club, hotel, motel, or retail shopping business constitutes an item of plant.

This is relevant in determining whether a deduction is available in relation to the item under Division 40 (decline in value for depreciating assets) or under Division 43 (for capital works) of the *Income Tax Assessment Act 1997*.

The deductions for capital works (including buildings) are based upon original expenditure and allowed over 40 years. Deductions for depreciating assets including plant are based upon actual cost and the effective life of the asset.

If an item attached to a commercial property is, broadly speaking, part of or an improvement to the building or other structure and otherwise eligible for a capital works deduction it must be plant to be eligible for a deduction under Division 40.

This Draft Taxation Ruling will supplement Taxation Ruling TR 2004/16, which applies to residential rental property owners in relation to the deductions available for items commonly found in those properties. Requests were made in the course of consultation on residential rental properties to extend that review to depreciating assets in commercial properties in certain industries.

**Market segments affected:** Micro Enterprises, Small and Medium Enterprises, Large Business and International.

**TR 2007/D5            Income tax: royalty withholding tax and the assignment of copyright**

**Issued                    27 June 2007**

The Draft Ruling considers:

- whether an amount or amounts paid or credited as consideration for the assignment of copyright is a 'royalty' or are 'royalties' under subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997), and
- whether such an amount or amounts are subject to withholding tax under Division 11A of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936).

The Draft Ruling is intended to provide guidance concerning the circumstances in which payments made under an assignment of copyright will be royalties.

**Market segments affected:** Micro Enterprises, Small and Medium Enterprises, and Large Business and International

**TR 2007/D6            Fringe benefits tax: minor benefits exemption**

**Issued                    27 June 2007**

This Draft Taxation Ruling explains the operation of the minor benefits exemption under section 58P of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA). The ruling clarifies that there is a requirement under the legislation to consider more factors than simply applying a less than \$300 threshold. The draft ruling discusses the term 'infrequent and irregular', which is one of five criteria which must be considered before any conclusion can be reached that a particular benefit is an exempt benefit. The 'infrequent and irregular' criterion requires that benefits that are identical or similar to the minor benefit, or identical or similar to benefits provided in connection with the minor benefit, are provided infrequently and irregularly.

The FBT National Tax Liaison Group (NTLG) Subcommittee and the FBT States & Territories Industry Partnership sought the views of the Tax Office on the application of the minor benefits exemption due to the increase in the threshold test.

**Market segments affected:** Individual, Micro, Small and Medium Enterprises, Large Business and International, Not for Profit, Government.

**TR 2007/D7            Income tax: application of Part IVA of the *Income Tax Assessment Act 1936* to 'wash sale' arrangements**

**Issued                    11 July 2007**

This draft Taxation Ruling considers the circumstances in which the anti-avoidance provisions (Part IVA) of the *Income Tax Assessment Act 1936* (ITAA 1936) might apply to certain 'wash sale' arrangements. A wash sale is an arrangement under which the taxpayer disposes of an asset where in substance there is no significant change in the taxpayer's economic exposure to, or interest in, the asset, or where that

exposure may be reinstated by the taxpayer, in order to generate a capital loss or allowable deduction to be applied against a capital gain or assessable income.

The draft Taxation Ruling provides that Part IVA may apply to cancel a capital loss or allowable deduction under a wash sale scheme if certain features or matters are present. It also provides that certain features or matters might lead to the conclusion that Part IVA does not apply. The draft Taxation Ruling does not definitively address every possible wash sale arrangement. Rather, six examples are provided outlining the Commissioner's view of how Part IVA applies in each of those situations.

Certain rulings have included general comments on the possible application of the Part IVA to wash sales but the draft Taxation Ruling provides a more comprehensive ATO view of how Part IVA applies to wash sales.

**Market segments affected:** Individual, Micro Enterprises, Small and Medium Enterprises

**TR 2007/D8      Income tax: application of transferor trust and controlled foreign company measures where property or services are transferred to a non-resident company owned by a non-resident trustee**

**Issued            22 August 2007**

The draft Ruling addresses arrangements where an Australian resident entity has transferred property or services to a non-resident company, the issued shares in which are wholly or partly owned, either directly or indirectly, by a non-resident trustee.

The draft Ruling clarifies that, for the purposes of the tax law dealing with foreign trusts and foreign companies controlled by Australian residents, these types of transfers are treated as having been made by the resident entity to the non-resident trustee.

The effect of the draft Ruling is that if the other requirements of the relevant transferor trust and controlled foreign company (CFC) provisions are satisfied, those provisions will operate to attribute income derived by a non-resident company or trustee to the Australian resident entity. The draft Ruling also provides guidance for the resident entity on the circumstances under which these other requirements of the transferor trusts and CFC provisions will be satisfied.

**Market segments affected:** Individual, Micro Enterprises, Small and Medium Enterprises, Large Business and International.

**TR 2007/D9      Income tax: various income tax issues relating to the horse industry including whether racing, training and/or breeding activities carried out (as stand-alone activities or in combination) amount to the carrying on of a business**

**Issued            22 August 2007**

This draft Ruling considers whether horse related activities amount to the carrying on of a business; in particular, whether racing, training or breeding may be carried out as stand-alone activities or in combination with other activities to constitute the carrying on of a business. The draft Ruling acknowledges that this will be a question of fact and addresses the issue under the following parts.

- Part A of the draft Ruling provides general guidance on this question
- Part B of the draft Ruling considers whether specific activities, such as racing activities, can, on their own, constitute the carrying on of a business and when they can be considered an integral part of the carrying on of a business of horse training and/or horse breeding
- Part C of the draft Ruling examines specific issues for horse breeding activities, and
- Part D of the draft Ruling makes some general observations about horse training activities.

Specific industry issues such as foal share arrangements and stallion syndicate arrangements are not dealt with in this draft Ruling. Currently, Taxation Ruling TR 93/26: *Income tax: issues relating to the horse industry* provides guidance on the issues dealt with in the draft Ruling and on stallion syndicate arrangements.

As mentioned TR 93/26, provides guidance on the issues dealt with in this draft. but the industry has indicated that TR 93/26 is overly prescriptive.

Further, there have been changes to the law on the income tax consequences of whether a racing, training and/or breeding business is being carried on. One of the more important changes is the interaction between the depreciating asset regime and the capital gains tax regime. As TR 93/26 does not deal with this change to the law and other changes it is no longer current.

*Whilst this draft Ruling takes the view that the racing of horses conducted as a separate activity will rarely amount to the carrying on of a business, it focuses more on the question of fact and general indicia for carrying on a business. Such indicia include whether the activity has a significant commercial purpose or character and whether the taxpayer has more than an intention to engage in business or to commence in the future.*

**Market segments affected:** Individual, Micro Enterprises, Small and Medium Enterprises

## Draft Taxation Determinations

**TD 2007/D6**      **Income tax: do the active assets of a partnership, in which a foreign company is a partner, constitute active foreign business assets of the foreign company for the purposes of the capital gains tax participation exemption provisions contained in Subdivision 768-G of the *Income Tax Assessment Act 1997*?**

**Issued**              **24 April 2007**

The draft Determination deals with the application of the capital gains tax (CGT) participation exemption provisions in the tax law. Broadly, the CGT participation exemption rules reduce a capital gain or loss by the 'active foreign business percentage', made by an Australian resident company and its controlled foreign companies ('the holding company') when certain CGT events happen to shares that the holding company owns in a foreign company.

The draft states that the active assets of a partnership, in which a foreign company is a partner, do not constitute 'active foreign business assets' of the foreign company for the purposes of calculating the foreign company's 'active foreign business asset percentage'. Therefore, the partnership's active assets cannot be taken into account to increase the foreign company's 'active foreign business percentage', and in turn reduce a foreign company's capital gain or loss that will be attributed to an Australian company.

The question posed in this draft Taxation Determination was raised by external members of the National Tax Liaison Group (NTLG) Foreign Source Income (FSI) Sub-committee at a number of NTLG FSI SC meetings in 2005 and 2006.

In September 2005 the ATO agreed to issue a public ruling on how the CGT participation exemption measure applies where a foreign company has an interest in a partnership that carries on an active business, subject to the NTLG sub-committee confirming that the issue was a high priority technical issue. The NTLG sub-committee ultimately confirmed the need for a public statement, and as a consequence ATO resources were allocated to this issue.

**Market segments affected:** Micro Enterprises, Small and Medium Enterprises, Large Business and International.

**TD 2007/D7**      **Income tax: are bees kept for use in a honey production business trading stock as defined in section 70-10 of the *Income Tax Assessment Act 1997*?**

**Issued**              **2 May 2007**

The draft Determination confirms that bees kept for use in a honey production business are livestock and thus trading stock as defined in the tax law.

The industry has been proactive in seeking the Tax Office's assistance in addressing the tax treatment of bees as trading stock. Anecdotal evidence from the beekeeping industry indicates that there is a general lack of awareness that, at law, bees kept for use in a honey production business are trading stock. The

draft Determination supports the concurrent issue of a Law Administration Practice Statement (LAPS) (General Administration) which includes guiding principles on how to calculate the value of bees held as trading stock to reduce taxpayer compliance costs and enable them to meet their legal obligations.

**Market segments affected:** Micro Enterprises, Small and Medium Enterprises.

**TD 2007/D8**      **Income tax: what is a 'present legal obligation' of a private company for the purposes of subsection 109Y(2) of Division 7A of Part III of the *Income Tax Assessment Act 1936*?**

**Issued**              **23 May 2007**

A 'present legal obligation' is an input to the *net assets* part of the formula that determines a private company's distributable surplus. A private company's distributable surplus is the limit of the amount that may be taken to be a dividend under Division 7A. In effect, the greater a private company's present legal obligations, the lesser is its distributable surplus and therefore the total amounts that may be treated as dividends under Division 7A.

The draft Taxation Determination explains that a 'present legal obligation' is an immediate obligation binding at law, whether payable and enforceable presently or at a future time. Future provisions and contingencies are not included unless they are one of the accounting provisions specifically prescribed in paragraph 109Y(2)(b).

The draft Taxation Determination forms part of the Division 7A law clarification project which arose out of submissions made to the Commissioner by professional bodies.

**Market segments affected:** Micro Enterprises, Small and Medium Enterprises, Large Business and International

**TD 2007/D9**      **Income tax: is income tax of a private company properly payable for an income year, but unpaid at the end of that year, a 'present legal obligation' for the purposes of the distributable surplus calculation under subsection 109Y(2) of Division 7A of Part III of the *Income Tax Assessment Act 1936*?**

**Issued**              **23 May 2007**

A 'present legal obligation' is an input to the *net assets* part of the formula that determines a private company's distributable surplus. A private company's distributable surplus is the limit of the amount that may be taken to be a dividend under Division 7A. In effect, the greater a private company's present legal obligations, the lesser is its distributable surplus and therefore the total amounts which may be treated as dividends under Division 7A.

The draft Taxation Determination explains that income tax of a private company properly payable for an income year, but unpaid at the end that year, is a 'present legal obligation' of the private company for the purposes of the distributable surplus calculation under Division 7A.

This approach produces the same tax outcome for shareholders (and their associates) notwithstanding when a private company pays its income tax properly payable for the income year.

The view expressed in the draft Taxation Determination is favourable to taxpayers and reflects the decision in *Fresta v. FC of T* [2002] AATA 337; 2002 ATC 2061; (2002) 49 ATR 1212.

**Market segments affected:** Micro Enterprises, Small and Medium Enterprises, Large Business and International.

**TD 2007/D10**      **Fringe benefits tax: in determining whether a charitable institution is a rebatable employer for the purposes of paragraph 65J(1)(baa) of the *Fringe Benefits Tax Assessment Act 1986*, is the institution 'established by a law of the Commonwealth, a State or a Territory' under subsection 65J(3) of that Act when it is incorporated under either the *Corporations Act 2001* or under a law of a State or Territory which relates to the incorporation of Associations?**

**Issued 30 May 2007**

This draft Taxation Determination explains that a charity which is incorporated under the *Corporations Act 2001* or a law of a State or Territory which relates to the incorporation of Associations will not be denied the FBT rebate merely because the law which incorporates them is a 'law of the Commonwealth, a State or a Territory'. The draft Determination explains that such a law does not of itself 'establish' the charity.

The Fringe Benefits Tax (FBT) rebate is available to certain non-profit employers including 'charitable institutions (other than institutions of the Commonwealth, a State or a Territory)'. The caveat precluding charitable institutions 'established by a law of the Commonwealth, a State or a Territory' is because their overriding purpose is considered to be to carry out the functions or responsibilities of government.

Members of the Charities Consultative Committee (CCC) sought clarification on this issue.

**Market segments affected:** Not for Profit, Government.



**TD 2007/D11 Income tax: will the hire of substantial equipment in Australia under a hire-purchase agreement create a deemed permanent establishment for a Singaporean resident hirer under Article 4(3)(b) of the tax treaty between Australia and Singapore as a result of the decision in *McDermott Industries (Aust) Pty Ltd v. Federal Commissioner of Taxation* [2005] FCAFC 67?**

**Issued 6 June 2007**

The Draft Taxation Determination clarifies that the hire of substantial equipment in Australia under a hire-purchase agreement creates a deemed permanent establishment for a Singaporean resident hirer under Article 4(3)(b) of the Singapore tax treaty.

The ATO view is consistent with the Full Federal Court decision in *McDermott Industries (Aust) Pty Ltd v. Federal Commissioner of Taxation* [2005] FCAFC 67 (*McDermott's case*) which considered the treaty provision and held that a Singaporean bare boat lessor of substantial equipment had a deemed permanent establishment in Australia.

While *McDermott's case* involved a standard leasing arrangement rather than a hire-purchase agreement, the Commissioner considers that the same outcome arises in both types of circumstances.

For completeness, the Draft Taxation Determination lists the other Australian tax treaties containing corresponding provisions to Article 4(3)(b) of the Singapore Agreement where this ATO view would also apply.

This Draft Taxation Determination was issued to address concerns raised by industry and tax professionals regarding the scope of the application of the Full Federal Court judgment in *McDermott's case*.

**Market segments affected:** Small and Medium Enterprises, Large Business and International

**TD 2007/D12 Income tax: is a non-resident head lessor of substantial equipment liable for royalty withholding tax under subsection 128B(5A) of the *Income Tax Assessment Act 1936* on lease payments it receives from a Singaporean resident who subleases that same equipment to an entity which operates it in Australia?**

**Issued 6 June 2007**

The Draft Taxation Determination clarifies that, except in certain circumstances, a non-resident head lessor of substantial equipment will be liable for royalty withholding tax on lease payments it receives from a Singaporean resident who subleases that equipment to an entity which operates the equipment in Australia.

Royalty withholding tax applies to the lease payment (the royalty) derived by the head lessor because the Singapore sublessor satisfies the requirements of the withholding tax provisions in the *Income Tax Assessment Act 1936* (ITAA 1936), in particular, the sublessor carries on a business in Australia at or through a permanent establishment in Australia. The conclusion that the Singapore sublessor has a permanent establishment in Australia is consistent with the Full Federal Court decision in *McDermott Industries (Aust) Pty Ltd v. Federal Commissioner of Taxation* [2005] FCAFC 67.

The interpretation in the Draft Taxation Determination can also apply in instances where the sublessor is a resident of a country other than Singapore.

The Determination also clarifies the exception that a head lessor that is resident in a treaty country will not be liable for royalty withholding tax where that head lessor:

- is a resident of the United States or the United Kingdom, or
- has a permanent establishment in Australia under one of Australia's tax treaties.

**Market segments affected:** Small Medium Enterprises, Large Business and International

**TD 2007/D13**      **Income tax: holding period rule: is an embedded share option a position in relation to the share if it is exercisable by or against a party other than the issuer of the share?**

**Issued**                      **29 August 2007**

The draft Determination explains when an option in respect of a share (or other equity interest) in a company is taken to be 'a position' in the share. It is important to determine this because a position in a share can diminish the risk associated with holding the share and there is a broad position in the tax law of ensuring imputation benefits (franking credits and franking tax offsets) are only secured by shareholders that hold their shares at risk for the requisite period of time.

The draft Determination adopts the view that any rights and obligations as against a third party (for example, the parent company of the issuer) can be distinguished from those as between the shareholder and the issuer, and should be recognised as a separate position.

Therefore, where an option in respect of a share is granted to a party other than the issuer of the share, the option will constitute a separate position in regards to the share, and can result in a diminution of risk. This is the case even if the option is granted as part of the issue terms of the share. In some circumstances, the risk may be diminished to such an extent that imputation benefits are disallowed.

The draft Determination is in response to a question which was canvassed in a product ruling application in early 2006. The issue was subsequently raised at a National Tax Liaison Group (NTLG) Finance and Investment Subcommittee meeting and the Tax Office's view of the law was sought.

**Market segments affected:** Individuals, Micro Enterprises, Large Business and International, Superannuation.

### **Draft Goods and Services Tax Rulings**

**GSTR 2007/D1**      **Goods and services tax: when do you acquire anything or import goods solely or partly for a creditable purpose?**

**Issued**                      **24 April 2007**

The Ruling explains the principles to be applied in determining whether an acquisition is made for a creditable purpose. This in turn determines whether the taxpayer is entitled to an input tax credit. The Ruling explains that an acquisition is for a creditable purpose if the acquisition is made for the purposes of carrying on the enterprise and is not private or domestic in nature and is not made for the purposes of making input taxed supplies.

The issue of creditable purpose has been the subject of significant compliance activity. This activity, together with the fact that it affects all taxpayers registered for GST, indicated that there was a need for a product to provide guidance on how to establish whether an acquisition is made for a creditable purpose. This Ruling complements two other Rulings (GSTR 2006/3 and GSTR 2006/4) which explain how to work out the extent of creditable purpose.

**Market segments affected:** Individual, Micro Enterprises, Small Medium Enterprises, Large Business and International

## Draft Goods and Services Tax Determinations

**GSTD 2007/D1 Goods and services tax: is a credit card provider entitled to a reduced input tax credit under item 27 of the table in subregulation 70-5.02(2) of the A New Tax System (Goods and Services Tax) Regulations 1999 for the acquisition of services from a co-branding partner where it pays commission for those services?**

**Issued 27 June 2007**

The Determination discusses when Reduced Input Tax Credits (RITCs) are available in 'co-branded credit card arrangements'. Broadly, it concludes that a credit card provider is entitled to a RITC for the acquisition of services from a co-branding partner where it pays commission for those services and the nature of the services acquired means the partner is a financial supply facilitator (as defined in the GST Regulations). The Determination sets out relevant principles and provides examples of their application.

Compliance activities have highlighted the need to clarify when RITCs will be available for supplies made in the context of 'co-branded' credit card arrangements. The Determination will provide certainty of GST treatment for entities.

**Market segments affected:** Large Business and International

## Self Managed Superannuation Funds Rulings

**SMSFR 2007/D1 Self Managed Superannuation Funds: the application of the sole purpose test in section 62 of the Superannuation Industry (Supervision) Act 1993 to the provision of benefits other than retirement, employment termination or death benefits**

**Issued 5 September 2007**

The draft Ruling clarifies that a self managed superannuation fund (SMSF) trustee will not breach the sole purpose test if benefits other than those specified in the test are provided by the fund and the provision of these benefits is incidental to activities that are consistent with the required purposes or is isolated or insignificant when considered in the overall context of the fund's maintenance.

The sole purpose test requires that a regulated superannuation fund be maintained only for the purposes listed in the test. These purposes are broadly for the provision of benefits on the retirement, termination of employment or death of a fund member.

More broadly, the draft Ruling explains the nature of the sole purpose test. In particular, the question of whether an SMSF is meeting the sole purpose test requires an examination of all circumstances relating to the maintenance of the fund. To assist SMSF trustees, the draft Ruling sets out a number of factors that are indicative of whether or not a provision of a benefit outside of those specified in the test gives rise to a breach of the sole purpose test.

This is the first time the Tax Office has issued a draft Ruling under the SMSFR series. Previously the ATO view was outlined in a publication of the Australian Prudential Regulation Authority (APRA).

The draft Ruling does not change the ATO view, rather it consolidates the ATO view as previously outlined in the APRA Circular and ATO IDs 2002/381 and 2004/249. These ATO IDs will be withdrawn upon the issue of the final Ruling. Note that APRA also intends to replace its Circulars.

**Market segments affected:** Superannuation Funds.

## Self Managed Superannuation Funds Determinations

**SMSFD 2007/D1 Self Managed Superannuation Funds: when is a dividend or trust distribution 'received' before the end of 30 June 2009 for the purposes of paragraph 71D(d) of the *Superannuation Industry (Supervision) Act 1993*?**

**Issued 5 September 2007**

The draft Determination explains the meaning of 'received' for the purposes of the specific provision in the superannuation law. If a Self Managed Superannuation Fund (SMSF) invested in a company or unit trust on or before 11 August 1999, the meaning of 'received' is relevant for determining the amount that a SMSF can reinvest in that company or trust during the transitional period 12 August 1999 to 30 June 2009 without that further investment being an in-house asset of the SMSF. Broadly, an SMSF's investments in in-house assets cannot exceed 5% of the value of all the assets of the SMSF.

The view expressed in the draft Determination is that 'received' means paid and that an entitlement to a dividend or trust distribution, by itself, is not sufficient. The draft Determination then explains when an amount is paid under different payment options, namely where dividends or trust distributions are paid by way of cash, cheque or direct credit to a nominated account with a financial institution or are applied or dealt with in some way on the SMSF's behalf, for example, reinvested in further shares or units.

This is also the first time the Tax Office has issued a draft Determination under the SMSFD series.

This draft Determination is being issued to address the concern raised by external members of the National Tax Liaison Group Superannuation Subcommittee in September 2006 that the meaning of 'received' in the provisions could be seen as ambiguous and in need of clarification.

**Market segments affected:** Superannuation Funds.