The Senate

Standing Committee on Economics

Tax Laws Amendment (2007 Measures No. 4) Bill 2007 [Provisions]

Taxation (Trustee Beneficiary Non–disclosure Tax) Bill (No. 1) 2007 [Provisions]

Taxation (Trustee Beneficiary Non–disclosure Tax) Bill (No. 2) 2007 [Provisions]

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Senate Standing Committee on Economics

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Chapter 1

Introduction

Reference

1.1 On Thursday 21 June 2007, the Senate referred the provisions of Tax Laws Amendment (2007 Measures No. 4) Bill 2007, and two complementary Bills; the Taxation (Trustee Beneficiary Non-Disclosure Tax) Bill (No. 1) 2007, and the Taxation (Trustee Beneficiary Non- Disclosure Tax) Bill (No. 2) 2007 to the Senate Standing Committee on Economics for report by 31 July 2007.

1.2 In accordance with the usual practice, the committee advertised the inquiry in *The Australian* on Wednesday 27 June 2007, calling for submissions by Monday 9 July 2007. The committee also directly contacted a number of relevant organisations and individuals to invite submissions.

1.3 Submissions were received from four organisations and individuals, as listed in Appendix 1. A public hearing was held on Friday 27 July 2007. Treasury representatives gave evidence and addressed the concerns raised in the submissions via teleconference.

Acknowledgments

1.4 The committee thanks all those who contributed to its inquiry by preparing written submissions. Their work has been of considerable value to the committee.

Background to the bill

1.5 The Tax Laws Amendment (2007 Measures No. 4) Bill 2007 is an omnibus bill containing 8 Schedules. The two other bills introduce amendments to complement the proposed changes in Schedule 4 by providing mechanisms to introduce a 46.5% non-disclosure tax on certain income.

Outline of the bill

1.6 The Bill will implement changes to Australia's taxation system in the following areas:

- Schedule 1 amends the income tax law to abolish foreign loss and foreign tax credit quarantining and to streamline the remaining foreign tax credit rules. These amendments include transitional rules for the treatment of existing quarantined foreign losses and credits.
- Schedule 2 amends the *Income Tax Assessment Act 1997* to provide a capital gains tax roll-over for membership interests in medical defence organisations.
- Schedule 3 amends the borrowing restriction contained in the *Superannuation Industry (Supervision) Act 1993* to allow superannuation funds to invest in

instalment warrants of a limited recourse nature over any asset a fund would be permitted to invest in directly.

- Schedule 4 amends the *Income Tax Assessment Act 1936* so that trustees of closely held trusts are not required to report the details of the ultimate beneficiaries of trust income to the Commissioner of Taxation.
- Schedule 5 amends various Acts to assist in the smooth transition to the *Simplified Superannuation* regime. This Schedule limits strategies which could circumvent the minimum drawdown requirements for account-based pensions, facilitates the provision of tax file numbers to superannuation and retirement savings account providers, and revises the application provision for small business capital gains tax relief.
- Schedule 6 amends the *Income Tax Assessment Act 1997* to update the list of deductible gift recipients.
- Schedule 7 makes technical corrections and other minor amendments to the taxation laws.
- Schedule 8 amends the trust loss regime in the *Income Tax Assessment Act 1936* to allow family trust elections and interposed entity elections to be revoked or varied in certain limited circumstances.

Chapter 2

The bill

Schedule 1—Foreign loss and foreign tax credit amendments

Overview

2.1 Schedule 1 amends the income tax law to abolish foreign loss and foreign tax credit quarantining and to streamline the remaining foreign tax credit rules. These amendments include transitional rules for the treatment of existing quarantined foreign losses and credits.[1]

Background and Summary

2.2 The 1986 tax reforms introduced foreign tax credit and foreign loss quarantining rules aimed at protecting Australia's tax base. Since 1986, there has been a shift towards a participation exemption system that has removed the tax asymmetries that were the original reason for quarantining foreign losses and foreign tax credits.

2.3 Under the new law, taxpayers will be entitled to a non-refundable tax offset for foreign income tax paid. This aims to reduce double-taxation on assessable income. The potential Australian tax will be reduced by the amount of foreign income tax already paid on those double-taxed amounts, or reduced to zero where the foreign income tax paid exceeds the potential Australian tax payable.[2]

Intended benefits of changes

2.4 Theses changes are intended to provide the following benefits:

(a) provide greater certainty to taxpayers, and reduce compliance and administration costs;

(b) assist small and medium enterprises looking to expand offshore by removing the need to implement systems to perform the tracking and collection of different classes of income, deductions and taxes when they try to penetrate a foreign market;

(c) improve the relative attractiveness of Australia as a destination for international capital;

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1 Explanatory Memorandum. (EM), p. 3.

2 EM, p. 14.

(i) The regional headquarters of a foreign group will no longer need to establish and maintain costly systems to comply with the redundant quarantining rules[3]; and

(d) enhance the competitiveness and reduce the compliance costs of Australian based managed funds.

(i) The removal of quarantining will assist Australians in using Australian managed funds to diversify their investments overseas.

(ii) It will also improve the competitiveness of Australian managed funds in attracting the management of funds from other countries.[4]

Schedule 2—Capital gains tax roll-over provisions

Overview

2.5 Schedule 2 amends the *Income Tax Assessment Act 1997* (ITAA 1997) to provide a capital gains tax (CGT) roll-over for membership interests in medical defence organisations (MDO).[5]

Background and Summary

2.6 This Schedule amends Division 124 of the ITAA 1997 by inserting Subdivision 124-P which provides a CGT roll-over when a membership interest in an MDO is replaced with a similar membership interest in another MDO and both MDOs where companies limited by guarantee.[6]

2.7 This roll-over ensures that any capital gain made on the exchange of the original shares or trust interests is deferred until after the exchange and a further transaction generating CGT happens to the replacement shares or trust interests.[7]

Intended benefits of changes

2.8 This roll-over aims to provide a better allocation of the nation's capital resources by removing CGT as an impediment to mergers and takeovers.[8]

Schedule 3—Superannuation investment amendments

Overview

2.9 Schedule 3 amends the borrowing restriction contained in the *Superannuation Industry (Supervision) Act 1993* to allow superannuation funds to invest in instalment

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3 EM, p. 13.

4 EM, p. 13.

5 EM, p. 4.

6 EM, p. 114.

7 EM, p. 113.

8 EM, p. 113.

warrants of a limited recourse nature over any asset a fund would be permitted to invest in directly.[9]

Background and Summary

2.10 Although there are some exceptions, Section 67 of the *Superannuation Industry (Supervision) Act 1993* prohibits superannuation fund trustees from borrowing money. This prohibition has been in place since the 1980s, and is one of a number of rules in superannuation legislation designed to limit risk in superannuation fund investment.[10]

2.11 The proposed changes in Schedule 3 will allow superannuation funds to invest in instalment warrants of a limited recourse nature over any asset a fund would be permitted to invest in directly. As explained in the Explanatory Memorandum:

- Instalment warrants are a derivative-based investment product; they derive their value from the underlying asset. Traditionally, such arrangements provide the investor with the right, but not the obligation, to buy the underlying asset through instalments. Once the investor has made the first instalment they are likely to be entitled to income from the underlying asset.[11]

Intended benefits of changes

2.12 These changes are intended to provide superannuation funds with greater flexibility in their investment options, while still maintaining the integrity of the risk provisions that apply to superannuation funds.

Schedule 4—Trust disclosure reforms

Overview

2.13 Schedule 4 amends the *Income Tax Assessment Act 1936* (ITAA 1936) so that trustees of closely held trusts are not required to report the details of the ultimate beneficiaries of trust income to the Commissioner of Taxation.[12]

Background and Summary

2.14 In 1999 amendments were introduced to the ITAA 1936 regarding the ultimate beneficiary rules. The aim was to prevent complex chains of trusts being used to avoid or indefinitely defer tax.

2.15 Ultimate beneficiary statements will be replaced by trustee beneficiary statements. A trustee of a closely held trust must make a correct trustee beneficiary statement to the Commissioner in respect of each trustee beneficiary who has a share

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9 EM, p. 4.

10 EM, p. 121.

11 EM. p. 122.

12 EM, p. 5.

of the trust's net income or is presently entitled to tax-preferred amounts. Trustee beneficiary statements must be provided by the due date for the trust's tax return or at the Commissioner's discretion.[13]

2.16 Trusts that are covered by a family trust election, or an interposed entity election, or wholly-owned by the family trust are not covered by these trustee beneficiary reporting requirements as these trusts are restricted in the range of beneficiaries they can distribute to without penalty tax.[14]

Complementary Bills

2.17 Two complementary Bills – the Taxation (Trustee Beneficiary Non-Disclosure Tax) Bill (No. 1) 2007, and the Taxation (Trustee Beneficiary Non-Disclosure Tax) Bill (No. 2) 2007 – were introduced with the Tax Laws Amendment (2007 Measures No. 4) Bill 2007. The two bills introduce amendments to complement the proposed changes in Schedule 4 by providing mechanisms to introduce a 46.5% non-disclosure tax. The Explanatory Memorandum explains the purposes of the bills:

(a) The Taxation (Trustee Beneficiary Non-Disclosure Tax) Bill (No. 1) 2007 introduces a provision where if the trustee of the closely held trust does not make a correct trustee beneficiary statement within the specified period in respect of a trustee beneficiary's share of the trust's net income, the trustee is liable for a 46.5 per cent trustee beneficiary non-disclosure tax on the trustee beneficiary's share of that net income.[15]

(b) The Taxation (Trustee Beneficiary Non- Disclosure Tax) Bill (No. 2) 2007 introduces a penalty tax of 46.5 per cent where a share of the net income of a closely held trust is included in the assessable income of a trustee beneficiary and the share, or part of it, 'comes back' to the closely held trust.[16]

Intended benefits of changes

2.18 The amendments proposed in Schedule 4 will reduce the costs of complying with the ultimate beneficiary rules by requiring trustees of closely held trusts to only report to the Commissioner details of trustee beneficiaries, rather than trace benefits through to the ultimate beneficiaries.[17]

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13 EM, p. 128.

14 EM, p. 128.

15 EM, p. 129.

16 EM, p. 129.

17 EM, p. 127.

Schedule 5—Transitional *Simplified Superannuation* amendments

Overview

2.19 Schedule 5 amends various Acts to assist in the smooth transition to the *Simplified Superannuation* regime.[18]

Background and Summary

2.20 This Schedule limits strategies which could be used to evade the minimum drawdown requirements for account-based pensions, facilitates the provision of tax file numbers (TFN) to superannuation and retirement savings account (RSA) providers, and revises the application provision for small business capital gains tax (CGT) relief.[19]

Tax File Numbers and Pay As You Go (PAYG)

2.21 The *Tax Laws Amendment (Simplified Superannuation) Act 2007* amended the ITAA 1997 to establish a new category of income for superannuation and RSA providers. This consists of superannuation contributions which are included in their assessable income where no TFN is attached to the receiving member's account. Such income is known as no-TFN contributions income and is taxed at a higher rate than if a TFN is quoted.

2.22 The amendments also ensure that where the Commissioner of Taxation gives notice of a TFN to a superannuation or RSA provider, it is taken to have been quoted by the individual. The higher rate of tax does not then apply. The Commissioner may provide a TFN to a superannuation or RSA provider under the general administration provisions of existing legislation. These amendments will ensure that superannuation and RSA providers do not need to take account of their no-TFN contributions income when working out their PAYG instalments.[20]

Segregated pension assets

2.23 Pensions receive concessional tax treatment in the form of a tax-exemption for income derived from the assets supporting that pension. The ITAA 1997 gives complying superannuation funds an exemption for income derived from assets which, at the time of derivation, are segregated current pension assets.

2.24 In return for this concessional tax treatment, pensions are subject to rules designed to ensure that the capital in the pension is drawn down over time. The amendments in this Schedule clarify that, in the case of account-based pensions, assets which are not included in the income stream account balance will be ineligible for the tax concession available to segregated current pension assets.[21]

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18 EM, p. 7

19 EM, p. 7

20 EM, pp 149 – 150.

21 EM, p. 150.

Capital gains tax business relief

2.25 Relief from CGT is available for qualifying small businesses on proceeds of transactions generating CGT that are used for retirement. Under *Simplified Superannuation* reforms, the relevant CGT provisions were amended to exclude references to eligible termination payments and allow for the payment of a contribution to a complying superannuation fund or RSA. These changes applied to transactions generating CGT occurring during financial year 2007-08 or later financial years.

2.26 The application provision is amended to provide for transactions generating CGT which occur before 2007-08 where an individual chooses either to take advantage of this relief, or the proceeds from the CGT events are received after 30 June 2007. The provisions are also amended to apply to a company or trust that makes a payment to a CGT concession stakeholder after 30 June 2007.

2.27 These amendments are to the application provisions which incorporate new CGT concepts introduced by the *Tax Laws Amendment (2006 Measures No. 7) Act 2007* that apply to transactions generating CGT happening in the 2006-07 financial year and beyond.[22]

Rewrite of superannuation law

2.28 As part of the *Simplified Superannuation* reforms, the provisions dealing with the taxation of superannuation in the ITAA 1936 were rewritten and consolidated into the ITAA 1997 by the *Tax Laws Amendment (Simplified Superannuation) Act 2007.*

2.29 These amendments ensure the rewritten provisions operate in a manner consistent with the original policy.[23]

Intended benefits of changes

2.30 These amendments contribute to the preservation of the tax system's integrity, and streamline tax reporting requirements.

2.31 These amendments also improve the readability of provisions rewritten as part of the *Simplified Superannuation* reforms and clarify their intended operation.

Schedule 6—Deductible gift recipients

Overview

2.32 Schedule 6 amends the *Income Tax Assessment Act 1997* (ITAA 1997) to update the list of deductible gift recipients (DGR) to include two new organisations.[24]

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22 EM, p. 151.

23 EM, p. 151.

24 EM, p. 8.

Background and Summary

2.33 DGR status assists relevant funds and organisations to attract public support for their activities. The income tax law allows taxpayers to deduct gifts of $2 or more made to DGRs. To be a DGR, an organisation must fall within a category of organisations set out in the ITAA 1997, or be listed by name under its provisions.

2.34 These amendments add a further two names to the DGR list. They are:

- the Australian Peacekeeping Memorial Project Incorporated; and
- Social Ventures Australia Ltd.

Intended benefits of changes

2.35 These amendments will assist the Australian Peacekeeping Memorial Project to construct a national memorial in Canberra to commemorate and celebrate Australian peacekeeping, and assist Social Ventures Australia Ltd to improve the effectiveness of other charitable organisations by providing a tailored combination of financial support, business skills development and mentoring.[25]

Schedule 7—Miscellaneous amendments

Overview

2.36 Schedule 7 makes technical corrections and other minor amendments to the taxation laws.[26]

Background and Summary

2.37 Through the introduction of long and complex amendments, occasionally the definitions and prose of amendments leave the final legislation difficult to read and understand. This Schedule clarifies the language on a variety of Bills.

Intended benefits of changes

2.38 The amendments rectify errors such as duplicate definitions, missing asterisks from defined terms, and inoperative references. The aim to clarify the relevant laws, and make the laws more readable.[27] For a full list of the proposed changes, see the Explanatory Memorandum.[28]

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25 EM, p. 170.

26 EM, p. 8.

27 EM, p. 170.

28 EM, pp 172 – 191.

Schedule 8—Family trust loss regime amendments

Overview

2.39 Schedule 8 amends the trust loss regime in the *Income Tax Assessment Act 1936* to allow family trust elections and interposed entity elections to be revoked or varied in certain limited circumstances.[29]

Background and Summary

2.40 These amendments provide more flexibility to family trusts in relation to the trust and company tax loss, bad debt deductions and franking credit trading rules. They allow family trust elections and interposed entity elections to be revoked or varied in certain circumstances, and they broaden the definition of 'family' and 'family group'.[30]

2.41 These amendments will allow a family trust election to be revoked unless tax losses have been recouped or bad debt deductions or franking credits have been claimed, during a specified period where the recoupment or claim was only possible because of the family trust election.[31]

2.42 The trust loss rules protect the integrity of the income tax system by preventing the tax benefits arising from the recoupment of trust losses and bad debt deductions being transferred to persons who did not bear these losses or debts when they were incurred. These measures achieve this aim by examining whether there has been a change in underlying ownership or control of a trust or whether certain schemes have been entered into to take advantage of a trust's losses.[32]

Intended benefits of changes

2.43 These amendments increase flexibility for taxpayers with family trusts while maintaining the integrity of the income tax system by:

- allowing family trust elections and interposed entity elections to be revoked in certain limited circumstances;
- allowing the test individual specified in a family trust election to be changed in certain limited circumstances;
- broadening the definition of 'family' to include lineal descendants of family members;
- ensuring that the death of a family member does not by itself result in another family member ceasing to be a member of the family; and

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29 EM, p. 9.

30 EM, p. 193.

31 EM, p. 194.

32 EM, p. 193.

- exempting distributions made to former spouses, former widows/widowers and former step-children from family trust distribution tax by including them within the definition of 'family group'.[33]

33 EM, p. 194.

Chapter 3

Issues

Introduction

3.1 The Committee received four submissions on the Tax Laws Amendment (2007 Measures No. 4) Bill 2007, and its two complementary Bills; the Taxation (Trustee Beneficiary Non-Disclosure Tax) Bill (No. 1) 2007, and the Taxation (Trustee Beneficiary Non- Disclosure Tax) Bill (No. 2) 2007. Each commented on a different Schedule.

Responses to the Bill

Schedule 1—Foreign loss and foreign tax credit amendments

3.2 The Australian Bankers Association (ABA) provided a submission concentrating on Schedule 1. The Association expressed in principle support with the proposed amendments, but expressed concern that they were unintentionally undermining the desired intent of strengthening Australia's attractiveness as a financial centre, and that the proposed amendments create inconsistencies between the way double taxation is relieved with respect to offshore banking and non-offshore banking income. The ABA summarised its concerns in the following manner:

> The calculation of the foreign tax offset limit has been drafted to allow greater averaging capacity to taxpayers, minimising the foreign income tax that goes unrelieved. As a result, the carry forward of excess foreign tax credits will no longer be available. This averaging capacity should also be extended to offshore banking income, but in such a way that the offshore banking unit is not able to use additional foreign tax to shelter no offshore banking foreign source income;
>
> The transitional provisions in relation to the utilisation of carried forward offshore banking foreign tax credits needs to be amended on a similar basis, to provide consistency between offshore banking and non-offshore banking income, but in such a way that the offshore banking unit is not able to use carried forward off shore banking foreign tax credits to shelter non-offshore banking foreign source income;
>
> Clarification is required in the drafting of the foreign tax offset limit to ensure that the legislation is consistency with the policy intent…; and
>
> Amendment is required to the anti-avoidance provisions which are drafted very widely, potentially applying to normal financing arrangements that include a standard gross-up clause. As drafted these provisions put

> Australian lenders at a commercial disadvantage when participating in genuine overseas financing arrangements. [1]

3.3 The Australian Financial Markets Association (AFMA) lodged a supplementary submission in support of ABA's arguments.[2]

Schedule 3— Superannuation investment amendments

3.4 AFMA also provided a submission on Schedule 3. AFMA supports the introduction of Schedule 3's provisions as they offer clarity and certainty for the market, while still maintaining a high level of regulatory protection for superannuation fund investors.[3] AFMA also supports the amendment to the in-house asset rules, it did suggest a further amendment:

> The proposed legislation, by adding clauses 8 and 9 to section 71, creates an exception to the in-house assets rule for instalment warrants that incorporate a borrowing and previously gave the regulators cause for concern under section 67. This creates an exception for instalment warrants that involve investments of any type that the superannuation fund would otherwise be permitted to invest in. As such, these investments may include equity assets that are unlisted as well as other asset classes, such as property, that are also unlisted.
>
> Instalment-style investments that are structured so they do not feature a borrowing (and, hence, are already compliant with section 67) cannot access this exception under the current wording. Instead, they must rely on the Excluded Instalment Trust exception which is limited under the subsection 10(1) definition to listed securities.
>
> It seems strange that instalment arrangements that feature a borrowing enjoy a broader exception than those which do not. Accordingly we recommend the subsection 10(1) definition be expanded.[4]

Schedule 8—Family trust loss regime amendments

3.5 Pitcher Partners Advisory Propriety Limited (PPAP) lodged a submission regarding Schedule 8. Although PPAP supported the provisions, the submission stated that this is on a 'something is better than nothing' basis.[5]

3.6 Through its submission, PPAP expressed its disappointment in the lack of scope in the provisions. PPAP believe that many more substantial amendments are required to lesson the practical difficulties encountered by taxpayers in their attempts to comply with the law in this area, and it provided a list of submissions PPAP

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1 Australian Bankers Association, *Submission 1*, pp 1-2.

2 The Australian Financial Markets Association (AFMA), *Submission 3a*, p. 1.

3 AFMA, *Submission 3*, pp 1 – 2.

4 AFMA, *Submission 3*, p. 2.

5 Pitcher Partners Advisory Propriety Limited (PPAP), *Submission 2*, p; 1

previously provided to Treasury on an exposure draft of the Bill.[6] PPAP argued that very few of its proposals were adopted.[7]

3.7 PPAP argued strongly that "the amendments proposed in the Bill represent only a small part of the changes that are necessary".[8]

Treasury responses

3.8 Treasury responded to the ABA's comments on Schedule 1, but limited their comments to the anti-avoidance rule. Treasury's view is that the new anti avoidance provisions are essentially a re-write of the current rules, and that their scope has not been materially affected by the proposed changes.[9]

3.9 With regard to AFMA's comments on Schedule 3, Treasury explained that these amendments had their genesis in the government's decision to allow what is already a long-standing industry practice to continue. Both the Commissioner of Taxation and APRA had previously concluded that instalment warrants constituted borrowing. Officers explained that Treasury had not formulated a position on the issues raised by AFMA about instalments with no borrowing because

(a) these issues are essentially outside the scope of the bill; and

(b) that particular part of the market appears to be small.[10]

3.10 On Schedule 8, Treasury responded to the Pitcher Partners Advisory Propriety Limited (PPAP) submission by saying that while many of PPAP's proposed changes had not been implemented, they had been considered through the consultation process. With regard to one of PPAP's key submissions – the revocation of a family trust election if a trust no longer has tax losses – Treasury argued that a family trust election is a choice that trusts and their members have to make.

3.11 A family trust election allows a trust to access losses it would not normally be able to access because it does not meet the normal rules for deducting tax losses. By opting into it, it allows the trust to utilise the losses and keep them within the family group. However there is also a penalty if the trust distributes the losses outside the family group. These are tax losses and benefits a trust wouldn't normally be able to utilise but for being able to elect into the regime. A trust and its members need to consider the advantages and disadvantages of these rules before making the decision to opt into the family trust election regime.[11]

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6 PPAP, *Submission 2*, p. 2.

7 PPAP, *Submission 2,* pp 3 – 8.

8 PPAP, *Submission 2,* p. 1.

9 Treasury, Proof *Committee Hansard,* 27 July 2007, p. 49.

10 Treasury, Proof *Committee Hansard,* 27 July 2007, pp 50-51.

11 Treasury, Proof *Committee Hansard,* 27 July 2007, p. 50.

Committee conclusions

3.12 Having examined the limited number of submissions raising concerns over the bill and heard Treasury's responses to those issues, the Committee is satisfied that the bills' provisions are appropriate.

Recommendation 1

3.13 The committee recommends that the bill be passed.

Senator the Hon. Michael Ronaldson
Chair

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Australian Bankers Association
2	Pitcher Partners Advisory Proprietary Limited
3	Australian Financial Markets Association (AFMA)
4	Confidential

APPENDIX 2

Public Hearing and Witnesses

Friday, 27 July 2007 – Melbourne

CICCHINI, Mr Raphael, Manager, Small Business and Trusts
Department of the Treasury

GRAZIANI, Mr Robert, Advisor, International Tax Unit, International Tax and Treaties Division
Department of the Treasury