the Spry Roughley report

explanatory memorandum

February 2012

CURRENCY: This issue takes into account all developments up to and including 16 January 2012.

2011–12 MYEFO: tax and super changes, deferral of proposal

In releasing the 2011–12 Mid-Year Economic and Fiscal Outlook (MYEFO) on 29 November 2011, the Treasurer said that GDP growth would not grow as strongly as forecast and that forecast tax receipts had been written down by more than $20 billion over the forward estimates. He said global economic and financial conditions had "deteriorated markedly in recent months".

Super contributions caps – more tinkering of rules

The Government said it will pause the indexation of the general superannuation concessional contributions cap for one year in 2013–14, so that it will remain at $25,000. Indexation of the cap will be deferred until 2014–15, when it is expected to rise to $30,000. The Government said this will also result in a pause in the indexation of the concessional contributions cap for individuals aged 50 and over and the non-concessional contributions cap.

Tax discount for interest income deferred

The start date of the proposed 50% tax discount for interest income will be deferred by 12 months until 1 July 2013. (This was originally announced in the 2010–11 Federal Budget to start from 1 July 2011 and with a cap of $1,000. After the 2010 election, it was deferred to 1 July 2012 and the cap reduced to $500 but increasing to $1,000 from 1 July 2013.)

Other important tax and super changes

In addition to the above, the Government also announced a number of other significant tax and other changes.

Tax changes

Important tax announcements include the following:

- The Government announced that it will make changes to tighten access to the living-away-from-home allowance (LAFHA) for certain temporary residents. The main changes proposed are as follows:
  - access to the LAFHA tax exemption for temporary residents will be limited to those who maintain a residence for their own use in Australia, which they are living away from for work purposes, such as "fly-in fly-out" workers:
  - individuals will be required to substantiate their actual expenditure on accommodation and food beyond a statutory amount; and
  - these changes will apply from 1 July 2012 and a consultation paper has been released (www.treasury.gov.au/contentitem.asp?NavId=002&ContentID=2235).
- The Government said it will restrict the Dependent Spouse Tax Offset to those with spouses born before 1 July 1952.

- The start date of the proposed standard deduction for work-related expenses will be deferred until 1 July 2013.

Superannuation announcements

Other important superannuation-related announcements are as follows:

- In response to industry feedback, the Assistant Treasurer said the Government would undertake further consultation on compliance cost issues raised by industry in relation to the higher concessional contributions cap for those aged 50 and over.
- The Government will streamline the low income superannuation contribution (LISC) so that individuals automatically benefit from it without being burdened with extra paperwork. Rather than requiring eligible workers to fill out a tax return or other type of form, the Australian Taxation Office (ATO) will verify an individual's income using available data. Note:
    - Individuals who receive less than 10% of their income through employment or business will not be eligible.
    - Individuals will only receive a payment if their LISC entitlement is at least $20, to reduce administration costs. (The announcements concerning LISC appear to have been introduced in the *Tax Laws Amendment (Stronger, Fairer, Simpler and Other Measures)* Bill 2011 which is still before Parliament.)
- The Government will reduce the matching rate and maximum payment of the voluntary superannuation co-contribution from 1 July 2012, when the new LISC commences. Under this change, the matching rate will be reduced to 50%, with a maximum co-contribution of $500 for people with incomes up to $31,920 in 2012–13 (with the amount available phasing down for incomes up to $46,920).
- The Government will extend to the 2012–13 year the current drawdown relief for minimum payment amounts for account-based, allocated and market linked pensions. (This means the minimum drawdown for these pensions will be 75% of the required amount for the 2011–12 and 2012–13 years ie a 25% reduction in the minimum drawdown amounts.) Regulations giving effect to this change will be made before the new financial year.

The 2011–12 MYEFO is available on the Government Budget 2011–12 website at: http://www.budget.gov.au/2011-12/content/myefo/html/index.htm

Source: Treasurer's press release Nos 148 and 149
www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/148.htm&pageID=003&min=wms&Year=&DocType=>;
www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/149.htm&pageID=003&min=wms&Year=&DocType=>
Assistant Treasurer's press release Nos 160 and 162
http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/160.htm&pageID=003&min=brs&Year=&DocType=>
http://assistant.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/162.htm&pageID=003&min=brs&Year=&DocType=>, 29 November 2011

ATO eye on education tax refund claims

The ATO has advised that it will request and collect from Centrelink the names and addresses of taxpayers eligible for the Family Tax Benefit Part A for the financial years 2009, 2010, and 2011. The ATO says the records relating to approximately two million individuals will be collected and electronically matched with certain sections of ATO data holdings. It says the program's aim is to identify and address potential non-compliance with taxation obligations in relation to taxpayers claiming the education tax refund.

TIP: The ATO has updated its guide for tax professionals on the education tax refund. The guide is available on the ATO website at www.ato.gov.au/individuals/content.aspx?doc=/content/00211954.htm.

TIP: The ATO has recently warned parents of suspected refund scams involving the education tax refund. One alleged scam identified by the ATO involved submitting fraudulent education tax refund claims for non-existent children or in the name of students not entitled to the claim. The ATO said one alleged promoter used a social networking site to entice students to provide their TFN, address and date of birth in connection with the scam.

Source: Commonwealth Gazette No GN 42, 26 October 2011 [p 2570] www.ag.gov.au/portal/govgazonline.nsf/98624e1d72c56173ca256cf4001cc123/c6aa1a56fe20a1b4ca257935000332b2!OpenDocument; ATO media release No 2011/55, 1 December 2011 www.ato.gov.au/corporate/content.aspx?doc=/content/00300729.htm

Pleasurecraft and the "wealthy"

The ATO has gazetted a notice advising that it will request and collect information from 13 marine insurance companies relating to the ownership of pleasurecraft. The ATO says the data-matching process will be applied to around 110,000 insurance records supplied by marine insurance companies. It says the program's aim is to identify individuals who have insured a pleasurecraft with a value of $25,000 or more. It says this information when combined with additional wealth indicators will assist the ATO in identifying high net worth taxpayers whose affairs should be reviewed under the "highly wealthy individuals" or "wealthy Australians" programs.

Source: Commonwealth Gazette No GN 48, 7 December 2011 [p 2940] www.ag.gov.au/portal/govgazonline.nsf/98624e1d72c56173ca256cf4001cc123/d124b30783024edeca25796d00219216!OpenDocument

Court denies franking credits linked to "debt-like" securities

In a majority decision (Edmonds J dissenting), the Full Federal Court has confirmed that the "imputation benefit" scheme provisions in s 177EA of the ITAA 1936 applied to cancel franking credits that arose to a taxpayer from distributions paid on "debt-like" securities he had subscribed for in an Australian bank. The majority arrived at its decision essentially on the basis of finding that in the absence of the franking credit, the distribution rate would be quite unattractive to investors and therefore the "enabling of franking benefits" was something more than an incidental purpose of the scheme.

Background

The Commonwealth Bank offered the relevant securities (Perpetual Exchangeable Resaleable Listed Securities V (PERLS V Securities)) for subscription in a prospectus issued in 2009. The securities consisted of a stapled unsecured note issued by the New Zealand branch of the bank and preference shares issued by the bank. The Court said it was common ground that the securities were an equity interest under Div 974 of the ITAA 1997. Importantly, the offer was only made to Australian investors and shareholders in the bank.

Prior to the issue of the securities, the bank sought the Commissioner's view on the treatment of any imputation credits paid on distributions. The Commissioner indicated that the imputation credits may be denied. As a result, a "compromise deed" was entered into between the bank and the Commissioner whereby if this occurred, the bank would challenge the matter in relation to a "nominated investor" (the taxpayer), but only in respect of any denial of the imputation credits to the investors under s 177EA(5)(b). Furthermore, the bank agreed to compensate the Commissioner for the amount of tax liability that would arise from the denial of the imputation credits, so that the bank would bear the liability rather than investors.

The Commissioner subsequently denied franking credits of $65.70 to the taxpayer under s 177EA(5)(b) and issued Class Ruling CR 2009/78 in which he expressed his view that the conditions in s 177EA(3)(a) to (d) were satisfied, namely, that:

- there was a scheme for a disposition of membership interests in a corporate tax entity;

- a frankable distribution was paid to a person in respect of the membership interests;
- the distribution was a franked distribution; and
- the relevant taxpayer would receive imputation benefits as a result of the distribution.

However, the Ruling expressed reservations as to whether the final requirement that the scheme was entered into for the purpose (other than an incidental purpose) of securing imputation benefits for the investors had been satisfied. The bank claimed that the only "non-incidental purpose" for the issue of the securities was to meet its capital adequacy requirements in view of its need for such capital. It also claimed that the objects of s 177EA were to prevent "franking credit trading" or "dividend streaming" and that the payment of the distribution did not involve either of these transactions.

The Commissioner argued that in terms of its broader policy purpose, s 177EA applied in these circumstances. In effect, he argued that the bank could not "have its cake and eat it too" in terms of being able to claim a deduction for the payment of the distribution (in terms of the way it was structured and paid out of New Zealand) and at the same time claim it was a frankable distribution, given the overriding principles that applied to the imputation provisions, and the intention and effect of s 177EA. Note that the taxpayer was the "representative" taxpayer of some 33,000 investors who had received franking credits totalling some $24.2m.

Previous decision

At first instance, in Mills v FCT [2011] FCA 205, the Federal Court held that s 177EA applied to cancel the franking credits. In doing so, the Court found that the bank had carried out the scheme for the purpose (other than an incidental purpose) of enabling the taxpayer to obtain an imputation benefit as, on balance, the relevant factors pointed to this purpose. These included the fact that the securities were only offered to Australian residents who could use franking credits, the distributions were sourced from untaxed profits, the distributions were similar in nature to interest and the bank was entitled to a deduction for the distributions in New Zealand. The Court also held that the Commissioner was entitled to exercise his discretion to cancel the imputation credit in the hands of the taxpayer under s 177EA(5)(b).

On appeal, the taxpayer argued that it was necessary there be a general purpose of tax avoidance before the Commissioner's power to make a determination under s 177EA(5)(b) could be invoked and that the primary judge had decided the case without any genuine assessment of the Bank's purpose from a broad perspective. The taxpayer also argued that it was irrelevant that the Bank obtained a tax deduction in New Zealand in respect of the distributions under the securities in relation to whether an imputation benefit was obtained. Finally, the taxpayer contested the adverse finding made in relation to each of the relevant factors in s 177EA(17).

Decision

The majority of the Full Federal Court (Dowsett and Jessup JJ) concluded that the issue for determination was not so much whether the securities were issued for purposes which included that of "enabling the taxpayer to obtain an imputation benefit", but rather whether that purpose was more than merely incidental to some other purpose.

In deciding this issue, the majority first found that a general purpose of tax avoidance was not necessary to apply s 177EA as the section "unlike both s 177D and s 177E operated without any ostensible requirement of [such] purpose at all". Furthermore, they said that it would be quite at odds with the express words of the provisions to "engraft upon s 177EA" such a requirement as to purpose. Likewise, the majority dismissed the claim that the primary judge had decided the case without any genuine assessment of the Bank's purpose from a broad perspective.

In relation to the taxpayer's claim that the primary judge had over-emphasised the fact that the Bank had obtained a tax deduction in New Zealand in respect of the distributions, the majority found that this was in fact a relevant circumstance, but one that had to be taken into account with all the other relevant factors in s 177EA(17) in determining the bank's purpose (of which the majority was not always in

agreement with the primary judge). For example, in relation to the primary judge's finding that the offer of securities to residents only pointed to the purpose of enabling the taxpayer to "obtain a greater benefit from the franking credits than other entities", the majority noted there were other explanations for this, in particular the regularity requirements surrounding public offerings. In other words, the majority found there were other valid reasons why the offering was only made to residents.

In relation to the s 177EA(f) factor of whether any consideration paid or given was calculated by reference to the imputation benefits to be received, the majority emphasised that it was a term of the offering that in return for the contribution of their capital, the securities holders were guaranteed that distributions would be franked, and if not, an equivalent adjustment to the distribution rate would be made. Moreover, the majority emphasised that this was a central element of the scheme that was not merely an "incidental purpose" and was not purely explicable by capital raising requirements.

Nevertheless, the majority had trouble with the primary judge's finding that the distribution was paid out of untaxed profits in view of their concerns over the primary judge's departure from the conventional meaning of the word "profits". Likewise, they had difficulty with the finding that the return on the securities was in the "nature of interest" (despite exhibiting such features). This was because of the fact that the bank was never going to the market for debt finance, but rather to raise "Tier 1" capital of which the payment of franked distribution, was an incidental purpose.

However, in terms of the s 177D(b) factors that were required to be considered, the majority found there was a clear distinction between the form and substance of the arrangement in that the Bank's outlays would be both deductible and frankable. Accordingly, the majority emphasised (at [215]) that when "the substance of the scheme is looked at as such, the proposition that the Bank's admitted purpose of enabling the appellant to obtain an imputation benefit was more than merely incidental is ... a rather obvious one".

As a result, the majority dismissed the taxpayer's appeal and concluded (at [220]): "Under the scheme in the present case, the delivery of imputation benefits to the appellant was not simply something that happened as the natural incident of the capital raising undertaken by the Bank. It was intended by the Bank. The architecture of [the scheme] – specifically the rewards made available to the appellant in return for his investment – included the fact of franking as a specific component. Absent franking, the distribution rate would... be quite unattractive to the appellant."

In dissent, Edmonds J concluded that the "relevant circumstances seem to me to strongly point to the objective conclusion that the issue of the ... securities was simply an issue of Tier 1 capital on terms that it would be franked to the same extent as all other capital of the Bank, unattended by any such device or scheme as it is the purpose of the general anti-avoidance provisions of s 177EA to negate." (at [117])

Appeals update

The taxpayer has lodged an application for special leave to appeal to the High Court against the decision of the Full Federal Court.

Mills v FCT [2011] FCAFC 158, Full Federal Court, Dowsett, Edmonds and Jessup JJ, 8 December 2011
www.austlii.edu.au/au/cases/cth/FCAFC/2011/158.html

ATO valuation blocks CGT small business concessions

The AAT has confirmed that a taxpayer was not eligible for the CGT small business concessions in relation to a property sold in 2005 as it failed the (then) $5 million maximum net asset value test. The matter turned on the valuation by the taxpayer's valuer and the Commissioner's valuer of one industrial and two residential blocks of units owned by related entities. The Commissioner's valuer used the "direct comparison", the "capitalisation" and the "summation" methods of valuation. The summation methodology adds the estimated value of the land to the estimated value of the improvements on it, to produce an estimated value of the property as a whole.

In preferring the Commissioner's valuer, the AAT found that the taxpayer's valuations were not reasonable in the circumstances, despite concerns with various aspects of the Commissioner's valuations (eg assumptions made by the valuer). However, among other things, the AAT found the following problems with the approach adopted by the taxpayer's valuer:

- the lack of suitability of the comparison properties selected;
- the lack of evidence of recent sales for the direct comparison method;
- the use of estimates of income-generating potential for one of the properties rather than actual figures that were available;
- an inappropriate hybrid use of "comparable sales" with the "summation" methodology;
- the application of the comparable sales method was not transparent; and
- failure to explain why he used a particular value per square metre for the land of one of the properties.

Accordingly, the AAT concluded that the valuations relied on by the taxpayer were not reasonable. It also rejected the taxpayer's submission that the Commissioner's valuer was not truthful in giving his evidence.

The AAT also emphasised that it was not enough for the taxpayer to undermine the valuations offered by the Commissioner. This was because the taxpayer bore the burden of proving that the Commissioner's assessments were excessive, and in cases where valuations were at issue, a taxpayer could not do this by simply proving that the valuations relied on by the Commissioner were wrong. Rather, the AAT said a taxpayer must positively establish that its own valuations are right, or at least more reasonable than the Commissioner's valuations.

AAT Case [2011] AATA 857, Re M & T Properties Pty Ltd and FCT, AAT, Ref No 2010/2839, Frost SM, 2 December 2011, www.austlii.edu.au/au/cases/cth/AATA/2011/857.html

GST treatment of new residential premises

The *Tax Laws Amendment (2011 Measures No 9) Bill 2011* was introduced in the House of Representatives on 23 November 2011. Among other things, the Bill proposes to amend the GST Act to ensure that sales or long-term leases of new residential premises by a registered entity are taxable supplies and that sales or long-term leases of residential premises (other than new residential premises) are input taxed supplies.

The proposals are in response to the Full Federal Court's decision in *FCT v Gloxinia Investments (Trustee)* (2010) 75 ATR 806. In Gloxinia, the Full Court held that a developer's sales of newly constructed residential premises (constructed under a "development lease" arrangement) were input taxed supplies under Subdiv 40-C of the GST Act. The Government said the outcome of the case was contrary to the policy intent of the GST legislation and therefore amendments to the GST law were required.

The amendments would ensure that premises that became new residential premises because of substantial renovations or because they have been built to replace demolished premises cease to be new residential premises once they are sold or supplied by way of long-term lease. The Bill indicates this would be achieved by amending s 40-75(1) of the GST Act.

Date of effect: The amendments will apply in relation to supplies of residential premises on or after the date of Royal Assent.

Other related amendments

Other amendments contained in the Bill would also ensure that:

- residential premises would not be new residential premises if they are created from residential premises that became the subject of a "property subdivision plan" and the residential premises were not new residential premises immediately before they became the subject of that plan;
- a "wholesale supply" of residential premises would be disregarded in certain circumstances for the purposes of determining whether a subsequent supply of residential premises is a supply of new premises (ie if the residential premises have been constructed pursuant to a particular arrangement or an agreement);
- the earlier "wholesale supply" would also be a supply of new residential premises. Consideration for the supply would include the GST-inclusive market value of the specified building or renovation work prior to the transfer of the premises; and
- the supply of premises by a government body as a direct result of the lodgment of a property subdivision plan (eg granting of strata-lot leases for residential premises) would be disregarded for the purposes of determining whether a supply of premises is s supply of new residential premises.

Date of effect: The amendments would apply to supplies of residential premises on or after 27 January 2011 (the date of the Government's announcement that it would amend the law).

Transitional provisions

The Bill indicates that sales of residential premises after 27 January 2011 would not be subject to the above amendments if they relate to a wholesale supply of residential premises and certain conditions were satisfied:

- the premises from which the residential premises were created had earlier been supplied to the recipient of the wholesale supply or one or more of its associates;
- immediately before 27 January 2011, the recipient of the wholesale supply or one or more of its associates were commercially committed to an arrangement;
- under the arrangement, the wholesale supply was conditional on specified building or renovation work being undertaken by the recipient of the wholesale supply or by one of more of its associates; and
- no GST return (as amended) given to the Commissioner reports a net amount for a tax period that includes amounts equivalent to the input tax credits that the recipient of the wholesale supply would have been entitled to if its acquisitions relating to the next sale or long-term lease of the residential premises were creditable acquisitions.

The amendments also do not apply to a supply of residential premises on or after 27 January 2011 if the supply is made because a property subdivision plan relating to the premises was lodged for registration before the recipient of the supply or the recipient's associate.

Other tax and miscellaneous amendments

It should be noted the Bill also contains other tax amendments: CGT rollovers and business restructures; GST-financial supply provisions; consolidating super; deductible gift recipients; miscellaneous amendments (eg deceased estates and CGT main residence exemption, continuity of ownership test).

Source: Tax Laws Amendment (2011 Measures No 9) Bill 2011 and Explanatory Memorandum
http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22legislation%2Fbillhome%2Fr4714%22

Director penalty notice regime under review

The Tax Laws Amendment (2011 Measures No 8) Bill 2011 and the *Pay As You Go Withholding Non-compliance Tax Bill 2011*, as originally introduced, proposed to increase directors' obligations by:

- extending the director penalty regime to unpaid superannuation guarantee amounts;

- allowing the Commissioner to commence proceedings to recover director penalties three months after the company's due day where the company debt remains unpaid and unreported after the three months pass, without first issuing a director penalty notice; and
- in some instances, making directors and their associates liable to PAYG withholding non-compliance tax where the company has failed to pay amounts withheld to the Commissioner. In this regard, the tax on directors and their associates to give effect to denying their credits would be imposed by the PAYG Withholding Non-compliance Tax Bill.

The No 8 Bill also introduces a Commissioner's discretion to ignore certain disentitling events relating to a beneficiary of a primary production trust. Other amendments concern the Petroleum Resource Rent Tax and the fuel tax regime.

Following calls by the House of Representatives Standing Committee on Economics for the Government to further investigate the provisions concerning directors' obligations, those amendments were removed from the No 8 Bill. The Government confirmed, as part of the 2011–12 MYEFO, that it intends to reintroduce the Bill this year and for the measure to have effect from the day after Royal Assent to avoid retrospectivity. Further, the PAYG Non-compliance Tax Bill remains in the House of Representatives. But in the meantime, the rest of No 8 Bill has been formally enacted.

Source: House of Representatives Standing Committee on Economics report www.aph.gov.au/house/committee/economics/Tax%20Laws/report.htm ; 2011–12 MYEFO Report http://www.budget.gov.au/2011-12/content/myefo/html/index.htm