

1994

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

SENATE

TAXATION LAWS AMENDMENT BILL (NO. 4) 1993

SUPPLEMENTARY EXPLANATORY MEMORANDUM

Amendments and requests for amendments to be moved by the Government

(Circulated by the authority of the Treasurer the Hon Ralph Willis, M.P.)



General Outline and Financial Impact

Amendments

Leases of luxury cars

Omits from the Bill the amendments designed to ensure that the luxury car depreciation limits were not avoided by the use of the "finance method" to return lease income from the leasing of luxury motor vehicles, as the Commissioner of Taxation has succeeded in challenging this particular arrangement in the courts.

Date of effect: No longer relevant.

Proposal announced: Not previously announced.

Financial Impact: None.

Penalties for over-franking dividends

Amends the provisions of the Bill relating to penalties for over-franking dividends) to ensure the amendments proposed will operate entirely on a prospective basis.

Date of effect: 14 December 1993.

Proposal announced: Not previously announced.

Financial Impact: None.

Heritage conservation rebate

Amends the heritage conservation rebate provisions to reflect the changed administrative arrangements by replacing references to the Minister for

and the Department of the Arts and Administrative Services with the Minister for and the Department of Communications and the Arts.

Date of effect: Royal Assent.

Proposal announced: Not previously announced.

Financial Impact: None.

Superannuation Guarantee amendments - Seafarers' Retirement Fund

Amends the Bill to ensure that all employers in the maritime industry who contribute to the Seafarers' Retirement Fund can use the Benchmark Rate specified in the Fund's trust deed as a notional earnings base.

Date of effect: 1 July 1992.

Proposal announced: Not previously announced.

Financial impact: None.

Requests for amendments

Payment of instalments by companies and certain trustees

Amends the Bill to provide that the grouping rules for the new company tax instalment regime commence from the 1995-96 year of income.

Date of effect: Royal Assent.

Proposal announced: Not previously announced.

Financial impact: None.

Deductions allowable to life insurance companies and registered organisations

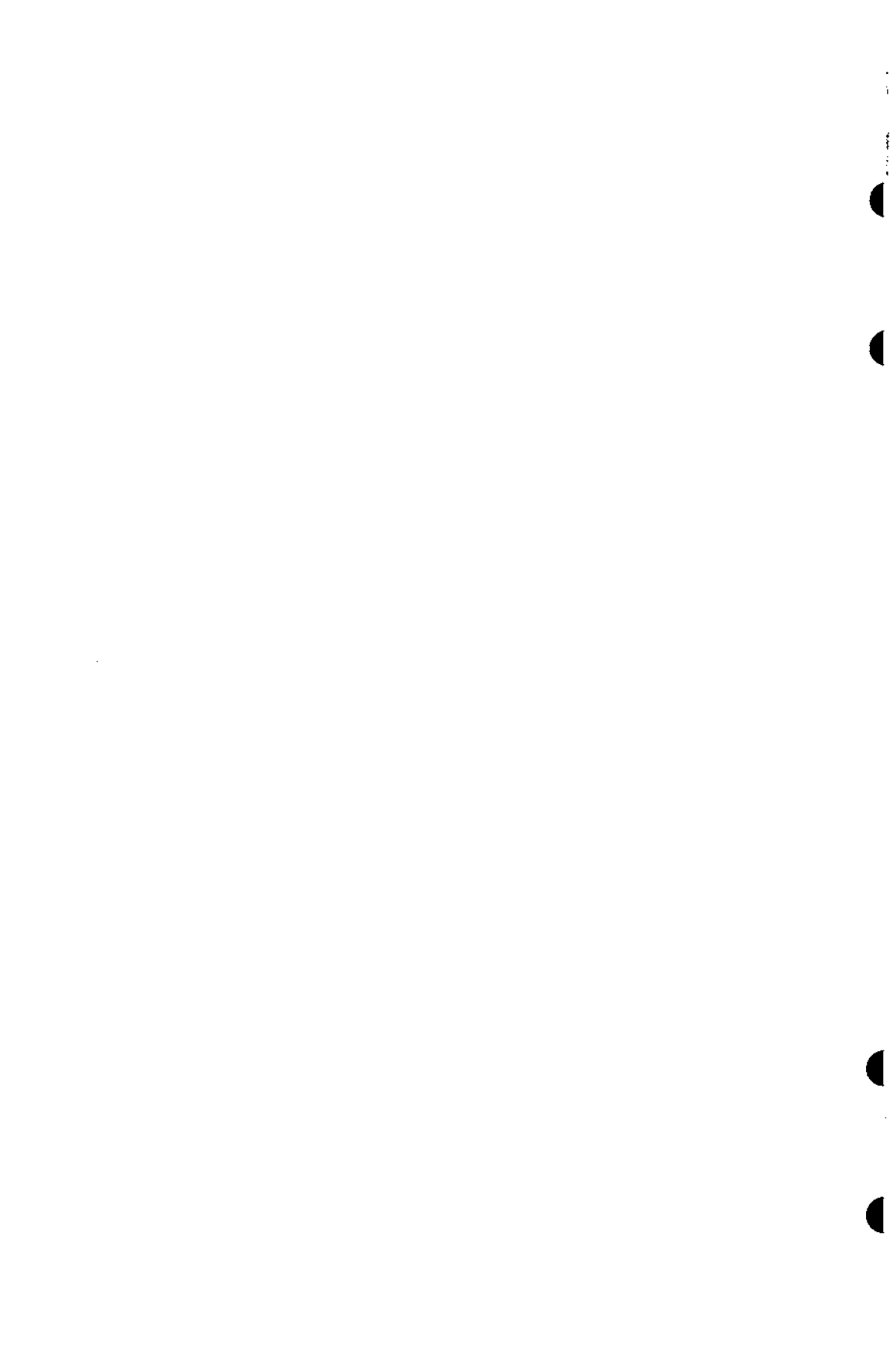
Amends the income tax provisions that provide deductions for expenditure incurred by life insurance companies and registered organisations in obtaining premiums which are excluded from assessable income. The amendments will limit deductions to expenses incurred

directly in getting in Australian premiums which are invested to produce assessable income.

Date of effect: The amendments will take effect from either the year of income in which 1 July 1988 occurred or from 1 January 1990 or 1 July 1994.

Proposal announced: Treasurer Press Release of 2 December 1993.

Financial impact: The amendments protect revenue of approximately \$3.8 billion up to the year ended 30 June 1993 as well as future revenue of approximately \$0.9 billion per year.



Amendment

1

Leases of luxury cars

- 1.1 This amendment removes clauses 24 and 25 from the Bill [*Amendment 1*].
- 1.2 These clauses were introduced to prevent the use of the *Citibank* decision to avoid the depreciation limit on luxury cars.
- 1.3 Section 57AF of the *Income Tax Assessment Act* limits the depreciable cost of motor cars and station wagons to a certain price for taxation purposes. The depreciation cost limit, which is indexed each year, is \$48,415 for the year ending 30 June 1994.
- 1.4 When a car is leased, the lessor, being the owner of the car, normally claims depreciation on that car, subject to the depreciation limits, as a deduction against the lease payments received from the lessee. However, Justice Beaumont of the Federal Court decided in the case of *Citibank Ltd. v. Federal Commissioner of Taxation*, that Citibank Ltd. could use the finance method to return lease income received from finance leases of luxury cars, without adjusting its assessable income to reflect the section 57AF depreciation cost limit. Under the finance method, the lease is treated as if it were a loan from the lessor to the lessee, with lease payments dissected on an actuarial basis into a principal component and an interest component. Only the interest component is brought to account as income in the lessor's hands.
- 1.5 To counter this decision, the Treasurer announced on 8 July 1993 that the legislation would be amended.
- 1.6 The Full Federal Court overturned the decision of Justice Beaumont in September 1993, holding that the lessor should treat the gross rentals as assessable income and deduct depreciation from assessable income. The Court accepted that the same result could be achieved by adding an additional amount to income returned using the finance method.
- 1.7 As Citibank was seeking leave to appeal against the decision to the High Court, clauses 24 and 25 were inserted into Taxation Laws Amendment Bill (No. 4) 1993, which was introduced in December 1993. Special leave to appeal to the High Court was denied on 11 February 1994.
- 1.8 As the final legal position requires lessors who use the finance method to account for lease income to take account of the depreciation

limit on luxury cars in returning their taxable income, the proposed amendment is no longer considered to be necessary.

Amendment

2 Penalties for over-franking dividends

Overview

2.1 Division 7 of the Bill proposes amendments to the calculation of franking additional tax (FAT), which is the penalty for deliberate over-franking of dividends. As they stand the amendments will apply where an over-franked dividend is paid after 14 December 1993, the date of introduction of the Bill.

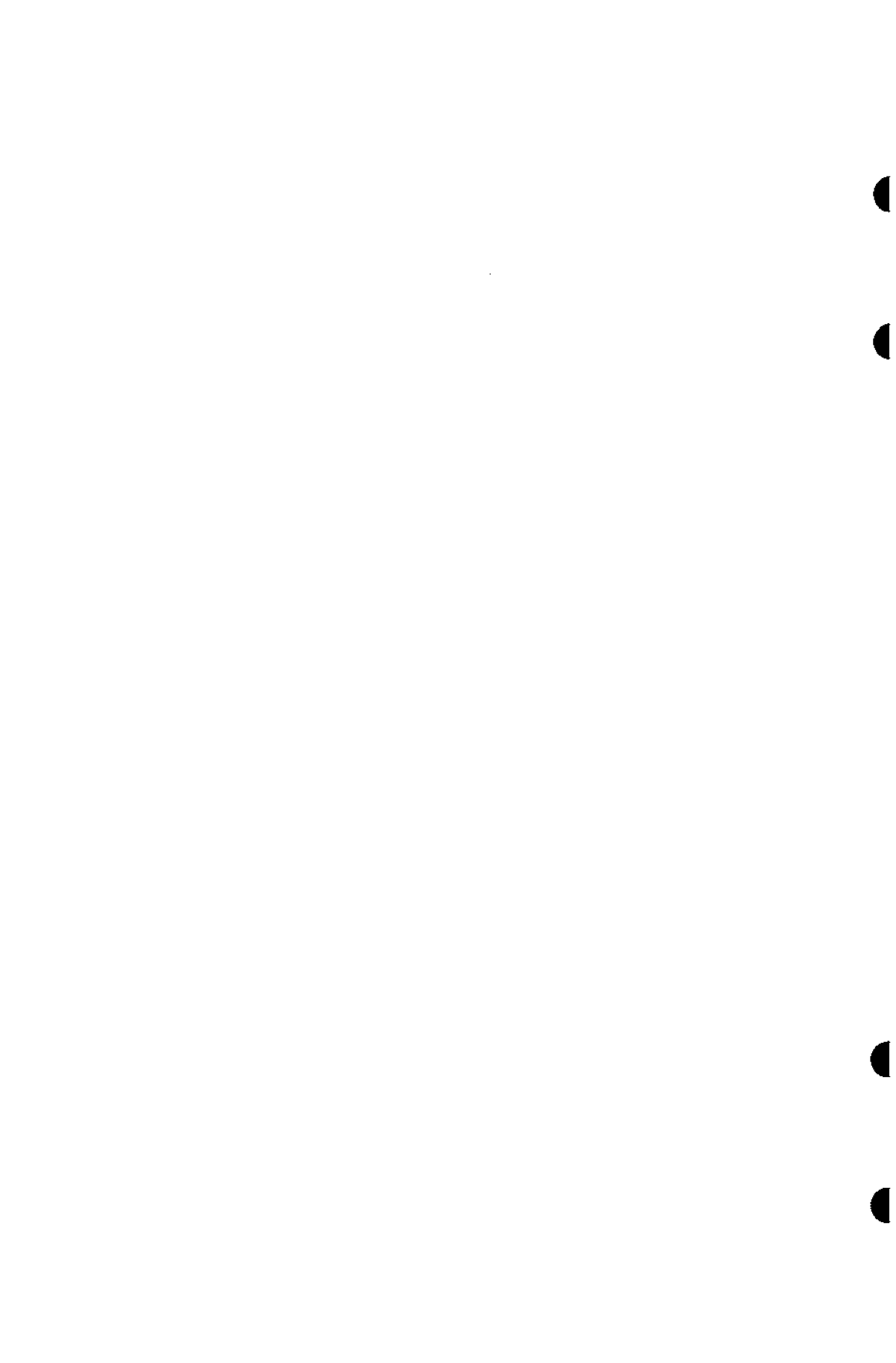
2.2 As a result of these amendments to the Bill, the proposed amendments contained in Division 7 will now apply where an over-franked dividend is declared after 14 December 1993 and also paid after that date.

2.3 Clause 51 contains the application provision for the Division 7 amendments. It is now proposed that clause 51 will operate in the following way:

- The amendments contained in Division 7 will apply to FAT calculations for the franking year during which the Bill was introduced and for all later franking years.
- In relation to the franking year during which the Bill was introduced, which is the 1993-94 franking year, the proposed amendments will only apply in cases where
 - the declaration in respect of an over-franked dividend was made after 14 December 1993; and
 - the dividend was paid after that date [*Amendments 2 to 6*].

2.4 A declaration is required to be made under section 160AQF as to the extent to which a dividend is franked and is made on a day before the dividend is paid.

2.5 If an over-franked dividend is declared before 14 December 1993 and paid after that date the proposed amendments will not apply.



Amendment

3

Heritage conservation rebate

Overview

3.1 These two minor technical amendments to the Bill will change references to the Minister for and Department of the Arts and Administrative Services to the Minister for and Department of Communications and the Arts. These amendments are necessary because of the changes made to the Ministerial arrangements since the Bill was introduced into Parliament [*Amendments 7 and 8*].

Explanation of the proposed amendments

3.2 Division 8 of the Bill (clauses 52 to 56) contains amendments that will provide a rebate of 20 cents in the dollar for expenditure on approved conservation work on buildings listed in Commonwealth, State or Territory heritage registers. The Bill provides that the scheme for allowing the rebate will be administered by the Minister for the Arts and Administrative Services (Subdivision AAD of Division 17 of Part III of the Act). The Bill also allows the Minister to delegate certain powers in relation to the administration of the scheme to the Secretary to the Department of the Arts and Administrative Services.

3.3 Since the Bill was introduced into Parliament changes have been made to the administrative arrangements. Under these changes the Arts portfolio has been transferred from the Minister for the Arts and Administrative Services to the Minister for Communications and the Arts. Hence, the Minister who will be responsible for the administration of the heritage conservation rebate scheme will be the Minister for Communications and the Arts.

3.4 The Bill provides for the Minister to delegate some of his powers under the proposed Subdivision AAD to officers of the Minister's Department who hold an office that has a classification declared by the Public Service Commissioner to be a Senior Executive classification. As a result of the changes to the administrative arrangements the Minister's Departments will be the Department of Communications and the Arts -

not the Department of the Arts and Administrative Services as provided in the Bill.

3.5 The proposed amendments to the Bill will amend the definitions of "Minister" and "Secretary" in new section 159UB (clause 53) to change references to the Minister for and Department of the Arts and Administrative Services to the Minister for and Department of Communications and the Arts.

4

Amendment **Superannuation Guarantee amendments Seafarers' Retirement Fund**

Explanation of proposed amendments

Purpose of the amendment

4.1 The amendment will ensure that all employers in the maritime industry who contribute to the Seafarers' Retirement Fund are able to use the Benchmark Rate specified in the Fund's trust deed as a notional earnings base [*Amendment 9*].

Background to the legislation

4.2 The earnings base is the level of earnings of an employee which is used to measure an employer's minimum superannuation contribution required to satisfy his or her Superannuation Guarantee obligations. In certain circumstances an employer is able to use a notional earnings base specified in an award, under a law or in a superannuation scheme's trust deed as the earnings base. Alternatively, the earnings base is the ordinary time earnings of an employee.

4.3 Clauses 78 and 79 of the Bill proposed to amend the definition of *industrial award* in subsection 6(1) of the *Superannuation Guarantee (Administration) Act 1992* to allow the Benchmark Rate specified in the trust deed for the Seafarers' Retirement Fund to be used as an acceptable notional earnings base for employers in the maritime industry. Representatives of the maritime industry have expressed concern that the proposed amendment is not broad enough to ensure that all employers in the maritime industry who contribute to the Seafarers' Retirement Fund can use the Benchmark Rate as an acceptable notional earnings base.

Explanation of the Amendment

4.4 The Seafarers' Retirement Fund is a defined benefit fund which qualifies as a *superannuation scheme* as defined in subsection 6(1). Therefore, if an employer was contributing for the benefit of an employee

to the Fund before 21 August 1991, he or she can use the *reference earnings* as a standard notional earnings base.

4.5 The definition of *reference earnings* in subsection 13(5) will be amended so that an employer in the maritime industry who is contributing for the benefit of an employee in relation to a contribution period to the Seafarers' Retirement Fund can use the Benchmark Rate specified in the trust deed of the Fund as a notional earnings base. [*New Clause 79; New paragraph 13(5)(aa)*]

4.6 New *section 13A* provides that an employer in the maritime industry who is contributing for the benefit of an employee in relation to a contribution period to the Seafarers' Retirement Fund can use the notional earnings base specified in section 13 even if they were not contributing to the Fund before 21 August 1991. [*Clause 79A; New section 13A*]

4.7 The amendments will ensure that all employers in the maritime industry who contribute to the Seafarers' Retirement Fund are able to use the Benchmark Rate specified in the Fund's trust deed as a notional earnings base.

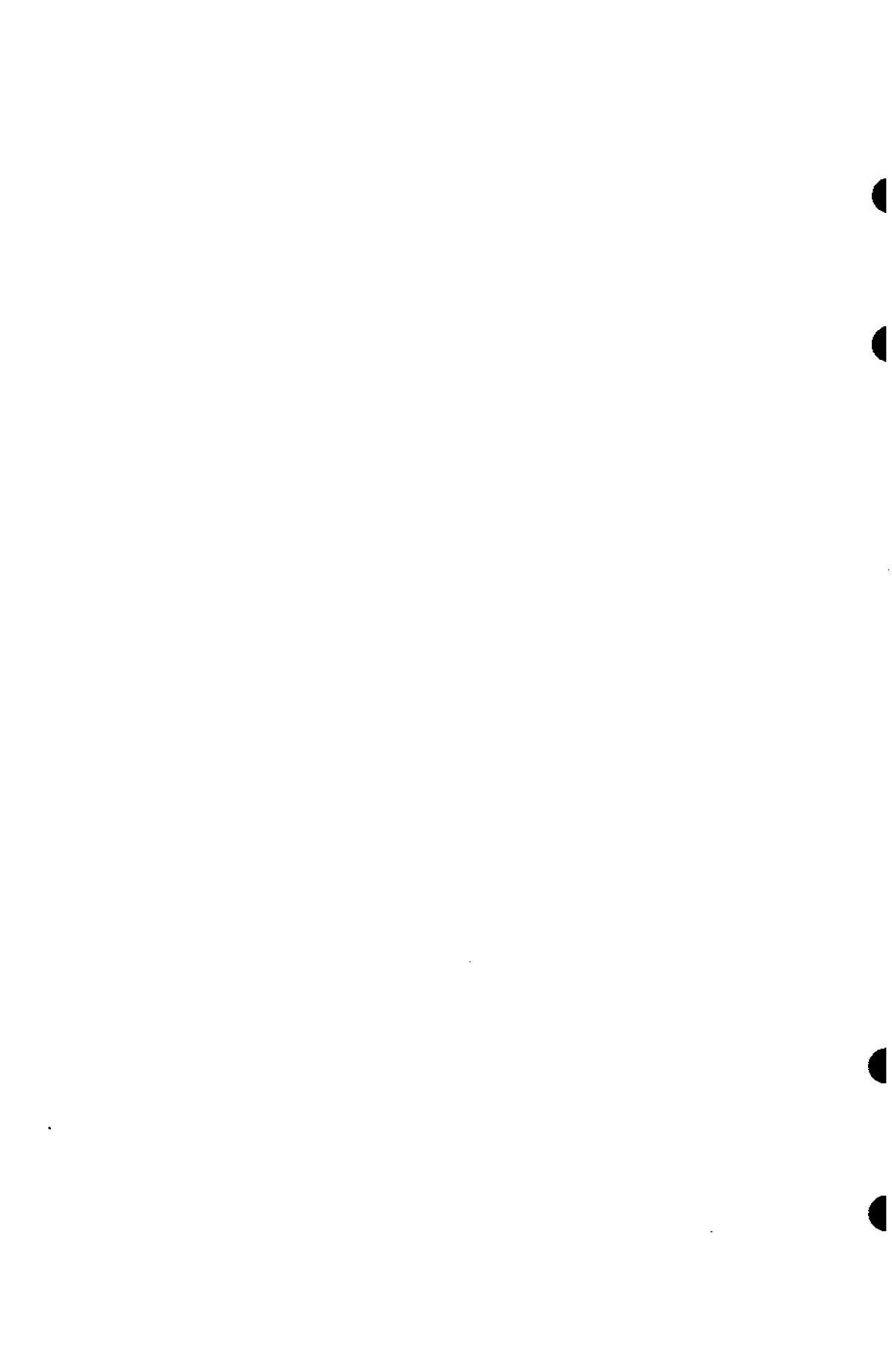
Request for amendment

5

Payments of instalments by companies and certain trustees

5.1 Clause 48 of the Bill provides that Division 6 of that Bill will apply from the 1994-95 year of income [*Request for amendment 2*].

5.2 As mentioned at paragraph 8.6 of the Explanatory Memorandum to the Bill, the grouping rules, contained in Division 6, should only apply from the 1995-96 year of income. This amendment to the Bill ensures that the grouping rules will only apply from the 1995-96 years of income.



Request for amendment

6 **Deductions allowable to life companies and registered organisations**

Overview

6.1 The amendments will amend the income tax provisions that provide deductions for expenditure incurred by life insurance companies and registered organisations in obtaining premiums which are excluded from assessable income. The amendments will limit deductions to expenses incurred directly in getting in Australian premiums which are invested to produce assessable income [*Requests for amendments 1, 3 and 4*].

Summary of the amendments

Purpose of the amendments

6.2 Life insurance companies and registered organisations are allowed special deductions for the costs of getting in premiums which are excluded from assessable income. The intention of these special deduction provisions is to allow life insurance companies and registered organisations deductions which are consistent with the deductions available on general principles to deposit takers (such as banks) for the costs of getting in their investments.

6.3 However, due to a possible defect in the legislation, life insurance companies and registered organisations may be able to claim deductions under these provisions for a range of expenditures which were never intended to be deductible; for example, benefits paid, increases in claims reserves on account of benefits to be paid and expenses of raising foreign premiums before 1990-91 (before the application of the controlled foreign corporations measures).

6.4 Accordingly, these special deduction provisions are to be amended to limit the deductions allowed under the provisions to the direct costs of getting in Australian premiums which are invested to produce assessable income. Essentially, the amendments will confirm the original policy intention of the deduction provisions.

Date of Effect

6.5 The amendments will take effect from the original date of effect, or the proposed date of effect, of the original provisions (ie, the year of income in which 1 July 1988 occurred or from 1 January 1990 or 1 July 1994).

Background to the legislation

6.6 Life insurance companies and registered organisations (friendly societies, unions and employee associations which are otherwise tax exempt) pay tax on their income from investment of premiums. They do not pay tax on the premiums they receive and they are not meant to be allowed deductions for benefits which they pay out. In contrast, general insurers are taxed on a basis that includes the whole of their business of insurance, taking into account the premiums they receive and the benefits they pay out.

6.7 Although premiums are excluded from the assessable income of life insurance companies and registered organisations, they are allowed a special deduction for the costs of getting in Australian premiums which are invested to produce assessable income (for example, costs such as commissions and product advertising). The provisions of the Act allowing these deductions were introduced by the Government at the request of the life insurance industry. The provisions are section 111A, for life insurance company superannuation business (effective from the year of income which included 1 July 1988); section 111AA, for certain other life insurance company business (effective from 1 January 1990); section 116HA, for superannuation business of registered organisations (effective from the year of income which included 1 July 1988); and section 116HAA, for certain life insurance business of registered organisations (effective from 1 July 1994).

6.8 These special deduction provisions operate by treating premiums as assessable income for the purpose of determining the deductions allowable to life insurance companies and registered organisations. The provisions do not expressly state the specific expenses which are allowable. However, it is clear from the explanatory material relating to the introduction of the provisions that Parliament intended to give deductions for no more than the cost of getting in premiums, consistent with the deductions available to banks and other financial intermediaries for the costs of getting in investments.

6.9 A few life insurance companies have claimed that treating their premiums as assessable income for the purpose of calculating deductions entitles them to the same deductions as general insurers. Amongst these deductions are benefits paid and increases in claims reserves on account of benefits to be paid. This goes far beyond the deductions the provisions intended to allow life insurance companies and registered organisations.

6.10 These life insurance companies also argue that by deeming premiums to be assessable income for determining deductions, foreign premiums have also been included. They conclude that foreign costs incurred in deriving those foreign premiums are also deductible even though the income from their investment would not have been taxable in Australia. This was never the intention of the legislation. Since the 1991-92 year of income these costs have been excluded by express provisions relating to eligible non-resident policies (which were inserted, not because it was considered necessary specifically to preclude such claims, but as part of the controlled foreign corporations measures).

6.11 The Commissioner has not allowed any of the claims now being made by life insurance companies. Given the clear policy intention at the time of the introduction of the special deduction provisions, the Commissioner would contest any such claims in the courts as vigorously as possible. If the claims now being made were allowable Division 8 of the Act would not tax any life insurance company, and similarly Division 8A would not tax any registered organisation. This would be an absurd result.

6.12 Nevertheless because of the serious revenue threat posed by an adverse court decision (up to \$3.8 billion of tax is at risk as at 30 June 1993 as well as future revenue of approximately \$0.9 billion per year) the Government has decided to resolve the uncertainty by introducing legislation to confirm the original policy intention of the special deduction provisions. Given the clear policy intention of the provisions, the amending legislation will take effect from the date of effect, or the intended date of effect, of the original provisions (ie, the year of income which included 1 July 1988 or from 1 January 1990 or 1 July 1994).

Explanation of the amendments

6.13 The possible deficiency in the provisions relating to life insurance companies and registered organisations, which may allow deductions for a range of expenditures which were never intended to be deductible, is to be remedied for both past and future years of income.

6.14 In consultation with the Life Insurance Federation of Australia (LIFA) and the Australian Friendly Societies Association (AFSA) two different legislative approaches have been developed to achieve this. The first approach will apply for the period prior to 1 January 1994; the second will apply from 1 January 1994 onwards.

6.15 For the period prior to 1 January 1994 the existing provisions deeming premiums to be assessable income will be retained but a new list of non-deductible expenses will be included in the Act. This list will be backdated to apply from the year of income which included 1 July 1988. From 1 January 1994 onwards the provisions which deem premiums to be assessable income will no longer operate. They will be replaced with

new provisions which specify the deductions allowed to life insurance companies and registered organisations in obtaining premiums.

6.16 The 1 January 1994 date was chosen (instead of the date of the Treasurer's announcement, ie 2 December 1993) as the appropriate cut off date for the different approaches to apply. This was done at the request of the life insurance industry in order to reduce compliance costs for those life insurance companies which balance on 31 December and have already finalised their accounts to 31 December 1993.

Life insurance companies - Prior to 1 January 1994

Overview

6.17 The existing provisions which deem superannuation premiums and the investment component of certain life insurance premiums to be assessable income when calculating deductions (ie, sections 111A and 111AA) continue to apply prior to 1 January 1994. However, new provisions will be inserted in the Act to:

- expressly deny deductions for a range of expenditures which were never intended to be deductible, for example benefits paid, increases in claims reserves on account of benefits to be paid, reinsurance premiums, etc; and ***[Clause 70J, new section 112BA]***
- deny deductions for expenses incurred in gaining foreign premiums. ***[Clauses 70B and 70C, new subsections 111A(1A) and (3) and new subsections 111AA(1A) and (1B)]***

Deductions not allowed for benefits

6.18 A new provision will be inserted into the Act to ensure that a life insurance company is not allowed deductions for benefits paid or payable under a life insurance policy; or for an amount included in a life insurance company's reserves for the purpose of meeting any future liability, including a contingent liability, to pay benefits under a life insurance policy. ***[Clause 70J, new paragraphs 112BA(1)(a) and (b)]***

6.19 Benefits paid or payable under a life insurance policy include -

- any amount paid or payable in respect of a claim under the policy;
 - any amount paid or payable as consideration for, or in connection with, or as a consequence of, the surrender, cancellation, forfeiture, termination or disposal of the policy or of any rights under the policy;
 - any amount paid or payable in respect of a bonus under the policy;
- any amount paid or payable in respect of an annuity under the policy;
or

any amount that is a refund of premiums that are excluded from the assessable income of the life insurance company by section 111; or any amount that is in the nature of a refund of such premiums.

[Clause 70J, new paragraph 112BA(2)(a)]

6.20 Benefits paid or payable under a life insurance policy do not include:

- a supplementary benefit (known as a rider benefit) attached to the life insurance policy, which is paid in respect of a non-life insurance risk, where the premiums received for the rider benefit are assessable to the company. Examples of these excluded benefits include accident and disability benefits, sickness benefits and trauma benefits. These supplementary benefits are not considered to be life insurance policies for the purposes of Division 8 of the Act. However, this provision, excluding these benefits from being included as benefits payable under a life insurance policy, is included in the Bill at the request of the life insurance industry to remove any doubt; and
- any interest payable in respect of a late claim or benefit under section 57 of the *Insurance Contracts Act 1984*.

[Clause 70J, new subsection 112BA(3) and new paragraph 112BA(2)(b)]

6.21 The amendments also ensure that if there is a dispute over a life insurance company's liability under a life insurance policy, and the matter is settled by the company paying an amount under a settlement agreement to the policyholder or an associate of the policyholder (see the meaning below), then no deduction is allowed to the life insurance company for that payment. ***[Clause 70J, new paragraph 112BA(1)(d) and new subsection 112BA(4)]***

6.22 These provisions which deny deductions for benefits paid under a life insurance policy and for settlement payments apply to assessments for the year of income in which 1 July 1988 occurred and to all later years of income. ***[Clause 70J, new subsection 112BA(5)]***

Meaning of "associate"

6.23 The term "associate" in section 112BA has the same meaning as in subsection 26AAB(14) of the Act. The meaning of the term is summarised below in paragraphs 6.24 to 6.27.

6.24 If the policyholder is a natural person (other than a trustee) the following are associates:

- a relative;
- a partner;

the spouse or a child of a partner;

a trustee of a trust estate where the policyholder or an associate benefits or is capable of benefiting under the trust either directly or indirectly;

- a company where either:
 - the company is, or its directors are, accustomed or under an obligation (whether formal or informal) to act in accordance with the directions, instructions or wishes of the policyholder and/or an associate or associates (including a company which is an associate by virtue of this subparagraph), or
 - the policyholder is and/or persons who are associates of the policyholder (including a company which is an associate by virtue of the subparagraph above) are, in a position to cast, or control the casting of, more than 50% of the maximum number of votes that might be cast at a general meeting.

6.25 If the policyholder is a company (other than a trustee) the following are associates:

- a partner;
- the spouse or a child of a partner;
- a trustee of a trust estate where the policyholder or an associate benefits or is capable of benefiting under the trust either directly or indirectly;
- another person where either:
 - the policyholder company is, or its directors are, accustomed or under an obligation (whether formal or informal) to act in accordance with the directions, instructions or wishes of that person or of that person and another person or other persons, or
 - that person is, or that person and his or her associates are, in a position to cast, or control the casting of, more than 50% of the maximum number of votes that might be cast at a general meeting of the policyholder company;
- another company where either:
 - the other company is, or its directors are, accustomed or under an obligation (whether formal or informal) to act in accordance with the directions, instructions or wishes of the policyholder company and/or an associate or associates of the policyholder company, or

- the policyholder company is, and/or the persons who are associates of the policyholder company are, in a position to cast, or control the casting of, more than 50% of the maximum number of votes that might be cast at a general meeting of the other company;
- a person who is an associate of the other person referred to in the fourth subparagraph above.

6.26 If the policyholder is a trustee of a trust estate the following are associates:

- any person who benefits or is capable of benefiting under the trust estate either directly or indirectly;
- any associate of a natural person who is an associate by virtue of the subparagraph above;
- if a company is an associate by virtue of either of the two subparagraphs above, any associate of the company.

6.27 If the policyholder is a partnership the following are associates:

- a partner;
- any associate of a partner.

Meaning of "relative" and "child"

6.28 A "relative" in relation to a person means any of the following:

- the parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendant or adopted child of that person or his or her spouse; and
- the spouse of that person or any other person specified in the subparagraph above.

6.29 A "child" in relation to a person includes an adopted child, a step-child or an ex-nuptial child of that person.

6.30 These definitions are contained in subsection 6(1) of the Act.

Deductions not allowed for reinsurance

6.31 The proposed amendments also provide that a deduction is not allowed to a life insurance company for a premium paid or payable by the company in respect of the reinsurance of the whole or any part of a life insurance policy. This is because the premiums received by the life insurance company in respect of life insurance policies are excluded from the company's assessable income, so it is appropriate that any reinsurance

premiums paid out by the company are not deductible. *[Clause 70J, new paragraph 112BA(1)(c)]*

6.32 The amendments also provide that if:

- a life insurance company has entered into a reinsurance contract in respect of the whole or part of a life insurance policy; and
- the premiums paid under the reinsurance contract were not deductible because of paragraph 112BA(1)(c) - see paragraph 6.31 above;

then the assessable income of the company does not include:

- any amount recovered by the life insurance company under the reinsurance contract in respect of the life insurance company's liability under the policy, or the part of the policy, that was reinsured; and
- any amount received by the life insurance company that is a refund, or in the nature of a refund, of the whole or part of those premiums.

[Clause 70E, subsection 111AB(1)]

6.33 These provisions relating to reinsurance apply to assessments for the year of income in which 1 July 1988 occurred and all later years of income. *[Clause 70J, new subsection 112BA(5) and Clause 70E, new subsection 111AB(2)]*

Deductions not allowable for expenses incurred in gaining foreign premiums

6.34 Subsection 111A(1) of the Act deems all superannuation premiums to be assessable income for the purpose of determining the deductions allowed to life insurance companies. As explained in paragraph 6.10, there is an argument that by deeming all superannuation premiums to be assessable income for determining deductions, foreign superannuation premiums have also been included. This could mean that foreign costs incurred in deriving those foreign superannuation premiums are deductible even though the income from their investment would not have been taxable in Australia. This was never the intention of the legislation.

6.35 Section 111A will be amended to exclude foreign superannuation premiums. The superannuation premiums referred to in subsection 111A(1) will exclude superannuation premiums received in respect of a superannuation policy issued by a life insurance company in the course of a business carried on at or through a permanent establishment in a foreign country. This amendment will apply for the year of income in which 1 July 1988 occurred up to the end of the 1989-90 year of income. *[Clause 70B, new paragraph 111A(1A)(a)]*

6.36 The amendments will also cover non-resident life insurance companies which may have derived foreign superannuation premiums which, together with the foreign income that the premiums generate, are exempt from tax in Australia by paragraph 23(r) of the Act. There is an argument that under section 111A non-resident life insurance companies may be able to claim deductions against their Australian source income for foreign expenses incurred in gaining these exempt foreign superannuation premiums. The Commissioner does not accept this argument. However, an amendment will be made to section 111A to make the position absolutely clear. The amendment will ensure that these exempt foreign superannuation premiums are excluded from the superannuation premiums to which subsection 111A(1) applies. This will mean that deductions are denied for foreign expenses incurred in deriving exempt foreign premium income. This amendment will also apply to assessments for the year of income in which 1 July 1988 occurred up to the end of the 1989-90 year of income. **[Clause 70B, new paragraph 111A(1A)(b)]**

6.37 For assessments for the 1990-91 year of income up until 1 January 1994, a further amendment will ensure that the superannuation premiums to which subsection 111A(1) applies do not include:

- superannuation premiums received in respect of eligible non-resident policies; that is, superannuation premiums included in the foreign branch income of an Australian life insurance company which relate to the provision of superannuation benefits for unrelated policyholders who are not residents of Australia;
- superannuation premiums which are exempt from tax under section 23AH; that is, superannuation premiums derived by a resident company from carrying on business at or through a permanent establishment of that company in a foreign ('listed') country. (Broadly, listed countries are those that have comparable rates of tax to Australia's.); and
- foreign superannuation premiums received by a non-resident life insurance company which are exempt from tax in Australia under paragraph 23(r) - see paragraph 6.36 above.

[Clause 70B, new subsection 111A(3)]

6.38 Section 111AA deems the investment component of premiums received in respect of certain life insurance policies to be assessable income for the purpose of determining the deductions allowable to life insurance companies. Again there is an argument that in deeming these life insurance premiums to be assessable income for determining deductions, foreign premiums have been included in section 111AA. This was never the intention of the legislation.

6.39 Section 111AA will be amended to exclude foreign life insurance premiums. Premiums received in respect of a life insurance policy issued

by a life insurance company in the course of a business carried on by it at or through a permanent establishment in a foreign country will not be covered by section 111AA. This amendment applies to premiums received on or after 1 January 1990 and before the end of the 1989-90 year of income. **[Clause 70C, new paragraph 111AA(1A)(a)]**

6.40 The amendment will extend to non-resident life insurance companies which have derived foreign life insurance premiums that are exempt from tax in Australia under paragraph 23(r). These foreign life insurance premiums will be excluded from the premiums to which section 111AA applies. This amendment will also apply to premiums received on or after 1 January 1990 and before the end of the 1989-90 year of income. **[Clause 70C, new paragraph 111AA(1A)(b)]**

6.41 For assessments for the 1990-91 year of income up until 1 January 1994, a further amendment will ensure that the life insurance premiums to which section 111AA applies exclude:

- life insurance premiums received in respect of eligible non-resident policies; that is, life insurance premiums included in the foreign branch income of an Australian life insurance company which relate to the provision of life insurance for the benefit of unrelated policyholders who are not residents of Australia;
- life insurance premiums which are exempt from tax under section 23AH; that is, life insurance premiums derived by a resident company from carrying on business at or through a permanent establishment of that company in a foreign ('listed') country. (Broadly, listed countries are those that have comparable rates of tax to Australia's.); and
- foreign life insurance premiums received by a non-resident life insurance company which are exempt from tax in Australia by paragraph 23(r) - see paragraph 6.36 above.

[Clause 70C, new subsection 111AA(1B)]

6.42 A consequential amendment will be made which effects the application of existing subsection 111AA(3). Subsection 111AA(3) requires an actuary to certify, among other things, the investment component of the life insurance premiums to which section 111AA applies. The consequential amendment provides that if:

- the life insurance premiums to which section 111AA applies are altered by these amendments (that is, if prior to these amendments the life insurance company included certain foreign life insurance premiums in the premiums to which section 111AA applied and claimed deductions in a tax return on that basis); and

the life insurance company obtained a certificate from an actuary under subsection 111AA(3) in relation to those premiums;

then section 111AA is taken not to have applied to the life insurance premiums derived by the company in that year of income. However, if the life insurance company lodges an amended return after the date of commencement of these amendments and obtains a new certificate from an actuary in relation to the operation of section 111AA, as amended by these provisions, then section 111AA will apply to the investment component of "relevant life assurance premiums". [*Subclause 70C(4)*]

Life insurance companies - From 1 January 1994 onwards

Overview

6.43 From 1 January 1994 onwards, the provisions which deem superannuation and life insurance premiums to be assessable income when working out deductions, ie sections 111A and 111AA, will no longer operate. (These sections of the Act will be repealed from the date the Bill receives Royal Assent). [*Clause 70D*]

6.44 Replacement provisions will be inserted into the Act, ie new sections 111AC and 111AD. These provisions list the specific expenses or the categories of expenses incurred in obtaining superannuation premiums and the investment component of certain life insurance premiums which will be allowed as deductions. In addition, a new provision will allow deductions for expenditure incurred in the general management of the business of the life insurance company to the extent the expenditure relates to gaining superannuation premiums or the investment component of "relevant life assurance premiums". (This new section, section 113A, is an extension of the existing general management expenses provision in section 113). [*Clauses 70E and 70L*]

Deductions allowed for expenditure incurred in obtaining superannuation premiums

6.45 New section 111AC provides that certain expenses incurred by a life insurance company in connection with obtaining superannuation premiums are allowable deductions to the company. The expenses to which the section applies are:

- salaries, wages, bonuses, commissions, allowances and similar benefits paid or payable to a salesperson or a life insurance agent for the sale of superannuation policies. (The expenses covered by this provision include amounts incurred in obtaining future sales of superannuation policies for the life insurance company.) Where any of these expenses are paid on the renewal of a policy (eg renewal commissions), or on continuation of a policy, a deduction is also allowable;

expenditure incurred in recruiting and training people who are engaged in selling superannuation policies;

salaries, wages, allowances and similar benefits paid or payable to employees of the life insurance company to the extent to which the salaries, wages, allowances and similar benefits relate to the provision of administrative, technical or similar assistance or support to salespeople or life insurance agents in their work;

- expenditure incurred in developing superannuation policies or expenditure on research in connection with superannuation policies;
- any other losses or outgoing incurred by the life insurance company in preparing, selling or issuing superannuation policies (eg product advertising expenses). Losses or outgoing incurred in collecting premiums are also deductible.

[Clause 70E, new subsections 111AC(1) and (2)]

6.46 Any of the expenses listed above:

- which are expenses of a capital nature (for example, capital research and development costs, or capital payments in respect of restrictive covenants or restraint of trade agreements); or
- which qualify as general management expenses under sections 113 or 113A;

are not allowable deductions under the new provisions of section 111AC.

[Clause 70E, new subsections 111AC(4) and (5)]

6.47 The amendments also provide that if:

- a deduction is allowed to a taxpayer in respect of a loss, outgoing or expenditure under a specific provision of the Act (other than sections 51, 111AC or 111AD); and
- that provision applies to life insurance companies;

then in working out the deduction allowable to the life insurance company under that provision, references to assessable income include superannuation premiums to which new section 111AC applies.

6.48 The effect of this provision is to continue to treat superannuation premiums as assessable income for the purpose of working out the deductions allowable under the *specific* deduction provisions of the Act. This ensures, for example, that deductions such as, depreciation under sections 54 to 62AAV, repairs under section 53, rates under section 72, superannuation contributions for employees under section 82AAC, capital write-offs for the cost of certain buildings under Division 10B, etc, continue to be allowable to life insurance companies. ***[Clause 70E, new subsection 111AC(3)]***

6.49 Subsection 111AC(3) does not apply if another subsection of 111AC applies. This means that where an expense is deductible under a

specific provision of the Act (other than section 51, 111AC or 111AD) when read with subsection 111AC(3), and a deduction is also allowable under another subsection of 111AC, then that other subsection applies (and new subsection 111AC(3) does not).

6.50 There is also a provision in new section 111AC to ensure that if a deduction is not allowable for an expense under the existing law, then no deduction is allowable under new section 111AC. This amendment is designed to ensure that restrictions which operate under the existing provision of the Act, such as the restrictions on deductions for entertainment expenses and club fees, continue to apply after the introduction of the new provisions of section 111AC. **[Clause 70E, new subsection 111AC(6)]**

6.51 This is achieved by new subsection 111AC(6) which operates in the following way. First it is assumed that -

- this Bill was not enacted; and
- a life insurance company's assessable income includes superannuation premiums received by the company.

Then, *on the basis of these assumptions*, if a deduction is not allowable to the life insurance company under the Act in respect of a loss outgoing or expenditure, no deduction is allowable under new section 111AC. If only part of a deduction is allowable, section 111AC allows a deduction for that part only. **[Clause 70E, new subsection 111AC(6)]**

6.52 The amendments also ensure that a deduction which is based on, or calculated by reference to, all or a portion of a loss, outgoing or expenditure (for example, depreciation, deductions for capital expenditure on buildings, etc.) is treated as a deduction in respect of a loss, outgoing or expenditure for the purpose of section 111AC. **[Clause 70E, new subsection 111AC(7)]**

6.53 The new provisions will also ensure that references to superannuation premiums in new subsection 111AC do not include:

- superannuation premiums received in respect of eligible non-resident policies; that is, superannuation premiums included in the foreign branch income of an Australian life insurance company which relate to the provision of superannuation benefits for unrelated policyholders who are not residents of Australia;
- superannuation premiums which are exempt from tax under section 23AH; that is, superannuation premiums derived by a resident company from carrying on business at or through a permanent establishment of that company in a foreign ('listed') country. (Broadly, listed countries are those that have comparable rates of tax to Australia's.); and

foreign superannuation premiums received by a non-resident life insurance company which are exempt from tax in Australia under paragraph 23(r) - see paragraph 6.36.

This new provision, subsection 111AC(8), ensures that the expenses covered by new section 111AC are limited to expenses incurred in obtaining superannuation premiums which, apart from the general life insurance premium exempting provision (section 111), would constitute assessable income of the life insurance company in Australia. [*Clause 70E, new subsection 111AC(8)*]

6.54 These new provisions in relation to superannuation premiums apply to expenses incurred, or to deductions in respect of a loss, outgoing or expenditure incurred, on or after 1 January 1994. [*Clause 70E, new subsection 111AC(9)*]

Deductions allowed for expenditure incurred in obtaining the investment component of certain life insurance premiums

6.55 New section 111AD replaces section 111AA from 1 January 1994 onwards. The section allows deductions for expenditure incurred in connection with obtaining the investment component of "relevant life assurance premiums". "Relevant life assurance premiums" are premiums received in respect of life insurance policies other than:

- superannuation premiums (these premiums are covered by new section 111AC);
- premiums received in respect of exempt policies. (Section 112A of the Act exempts from tax that part of the income derived from assets included in the insurance funds of a life insurance company that are referable to exempt policies. Accordingly, premiums received in respect of exempt policies are excluded from the operation of section 111AD.);
- specified roll-over amounts. (These premiums are defined by subsection 110(1) to mean amounts paid to the company on or after 1 July 1988 that constitute a roll-over of untaxed elements of eligible termination payments. These amounts are included in the assessable income of a life insurance company and therefore are not addressed by section 111AD.);
- premiums received in respect of eligible non-resident policies; that is, premiums included in the foreign branch income of an Australian life insurance company which relate to the provision of life insurance benefits for unrelated policyholders who are not residents of Australia;

premiums exempt from tax under section 23AH; that is, life insurance premiums derived by a resident company from carrying on business at or through a permanent establishment of that company in

a foreign ('listed') country. (Broadly, listed countries are those that have comparable rates of tax to Australia's.); and

- foreign life insurance premiums received by a non-resident life insurance company which are exempt from tax in Australia under paragraph 23(r) - see paragraph 6.36.

Where the premiums received in respect of a life insurance policy qualify as "relevant life assurance premiums", the life insurance policy is a "relevant life assurance policy". [*Clause 70E, new subsection 111AD(1)*]

6.56 In new section 111AD "investment component" and "risk component" are the terms used to describe the components of a premium received under a life insurance policy (see the definitions in subsection 110(1)). The risk component of a premium is calculated using the basis specified in the regulations and represents the cost of risk under the policy. The investment component is defined as the premium remaining after deducting the risk component.

6.57 New section 111AD provides that certain expenses incurred by a life insurance company in connection with obtaining the investment component of "relevant life assurance premiums" are allowable deductions to the company. The expenses to which the section applies are:

- salaries, wages, bonuses, commissions, allowances and similar benefits paid or payable to a salesperson or a life insurance agent for the sale of relevant life insurance policies. (The expenses covered by this provision include amounts incurred in obtaining future sales of life insurance policies for the life insurance company.) Where any of these expenses are paid on the renewal of a policy (eg renewal commissions), or on continuation of a policy, a deduction is also allowable;
- expenditure incurred in recruiting and training people who are engaged in selling relevant life insurance policies;
- salaries, wages, allowances and similar benefits paid or payable to employees of the life insurance company to the extent to which the salaries, wages, allowances and similar benefits relate to the provision of administrative, technical or similar assistance or support to salespeople or life insurance agents in their work;
- expenditure incurred in developing relevant life insurance policies or expenditure on research in connection with relevant life insurance policies;

any other losses or outgoing incurred by the life insurance company in preparing, selling or issuing relevant life insurance policies (eg product advertising expenses). Losses or outgoing incurred in collecting premiums are also deductible.

[Clause 70E, new subsections 111AD(2) and (3)]

6.58 Any of the expenses listed above:

- which are expenses of a capital nature (for example, capital research and development costs, or capital payments in respect of restrictive covenants or restraint of trade agreements); or
- which qualify as general management expenses under sections 113 or 113A;

are not allowable deductions under the new provisions of section 111AD.

[Clause 70E, new subsections 111AD(5) and (6)]

6.59 The amendments also provide that if:

- a deduction is allowed to a taxpayer in respect of a loss, outgoing or expenditure under a specific provision of the Act (other than sections 51, 111AC or 111AD); and
- that provision applies to life insurance companies;

then in working out the deduction allowable to the life insurance company under that provision, references to assessable income include the investment component of "relevant life assurance premiums" to which new section 111AD applies.

6.60 The effect of this provision is to continue to treat the investment component of "relevant life assurance premiums" as assessable income for the purpose of working out the deductions allowable under the *specific* deduction provisions of the Act. This ensures, for example, that deductions such as, depreciation under sections 54 to 62AAV, repairs under section 53, rates under section 72, superannuation contributions for employees under section 82AAC, capital write-offs for the cost of certain buildings under Division 10B, etc, continue to be allowable to life insurance companies. **[Clause 70E, new subsection 111AD(4)]**

6.61 Subsection 111AD(4) does not apply if another subsection of 111AD applies. This means that where an expense is deductible under a specific provision of the Act (other than section 51, 111AC or 111AD) when read with subsection 111AD(4), and a deduction is also allowable under another subsection of 111AD, then that other subsection applies (and new subsection 111AD(4) does not).

6.62 There is also a provision in new section 111AD to ensure that if a deduction is not allowable for an expense under the existing law, then no deduction is allowable under new section 111AD. This amendment is designed to ensure that restrictions which operate under the existing provision of the Act, such as the restrictions on deductions for entertainment expenses and club fees, continue to apply after the

introduction of the new provisions of section 111AD. **[Clause 70E, new subsection 111AD(7)]**

6.63 This is achieved by new subsection 111AD(7) which operates in the following way. First it is assumed that -

- this Bill was not enacted; and
- a life insurance company's assessable income includes the investment component of "relevant life assurance premiums" received by the company.

Then, *on the basis of these assumptions*, if a deduction is not allowable to the life insurance company under the Act in respect of a loss outgoing or expenditure, no deduction is allowable under new section 111AD. If only part of a deduction is allowable, section 111AD allows a deduction for that part only. **[Clause 70E, new subsection 111AD(7)]**

6.64 Existing section 111AA does not apply unless a life insurance company obtains a certificate by an authorised actuary in relation to the operation of the section (subsection 111AA(3)). The certificate was required to ensure that a sound and consistent basis was used for calculating the investment component of premiums for which deductions were allowable by section 111AA. This requirement is to remain for new section 111AD. **[Clause 70E, new subsection 111AD(8)]**

6.65 The amendments also ensure that a deduction which is based on, or calculated by reference to, all or a portion of a loss, outgoing or expenditure (for example, depreciation, deductions for capital expenditure on buildings, etc.) is treated as a deduction in respect of a loss, outgoing or expenditure for the purpose of section 111AD. **[Clause 70E, new subsection 111AD(9)]**

6.66 These new provisions in relation to "relevant life assurance premiums" apply to expenses incurred, or to deductions in respect of a loss, outgoing or expenditure incurred, on or after 1 January 1994. **[Clause 70E, new subsection 111AD(10)]**

Deduction for expenses of general management incurred in obtaining certain premiums.

6.67 Under the existing law expenditure incurred in the general management of the business of the life insurance company which relates exclusively to superannuation premiums and/or the investment component of certain life insurance premiums (which for deduction purposes are deemed to be assessable income under sections 111A and 111AA) are not deductible under section 113. The expenses are deductible, by reason of sections 111A and 111AA, under the ordinary provisions of the Act. However, with the removal of sections 111A and 111AA, these expenses would no longer be deductible.

6.68 To overcome this problem a new provision, section 113A, will operate where expenditure incurred on or after 1 January 1994 in the general management of the business of the life insurance company is not an allowable deduction under section 113 because it relates exclusively to gaining assessable income. (Assessable income in section 113 means actual assessable income plus deemed assessable income, ie superannuation premiums and the investment component of "relevant life assurance premiums" to which sections 111AC and 111AD apply - see paragraph 6.86) Where this occurs the expenditure incurred in the general management of the business of the company is an allowable deduction under new section 113A to the extent it was incurred in gaining or producing:

- superannuation premiums to which new section 111AC applies; or
- the investment component of "relevant life assurance premiums" to which new section 111AD applies.

A deduction for the remainder of the expenditure relating to actual assessable income is allowable under the ordinary provisions of the Act. *[Clause 70L, new subsection 113A(1)]*

6.69 Again, there is a provision in new section 113A to ensure that if a deduction is not allowable for a particular expense (including a deduction in respect of a loss, outgoing or expenditure) under the existing law, then no deduction is allowable under new section 113A for the expense. This amendment is designed to ensure that restrictions which operate under the existing provisions of the Act, such as the restrictions on deductions for entertainment expenses and club fees, continue to apply under the new provisions of section 113A. *[Clause 70L, new subsection 113A(2)]*

6.70 This is achieved by new subsection 113A(2). This subsection operates by assuming that -

- this Bill was not enacted; and
- a life insurance company's assessable income includes superannuation premiums and the investment component of "relevant life assurance premiums" received by the company.

Then, *on the basis of these assumptions*, if a deduction is not allowed to the life insurance company under the Act in respect of a loss outgoing or expenditure, no deduction is allowable under new section 113A. If only part of a deduction is allowable, section 113A allows a deduction for that part only. *[Clause 70L, new subsection 113A(2)]*

6.71 For the purposes of new section 113A, a deduction based on or calculated by reference to all or a portion of a loss, outgoing or expenditure (eg, depreciation, deductions for capital expenditure on buildings, etc) is taken to be a deduction in respect of a loss, outgoing or expenditure. *[Clause 70L, new subsection 113A(4)]*

6.72 Expenditure of a capital nature is excluded from the meaning of expenditure incurred in the general management of the business of the company for the purposes of section 113A. *[Clause 70L, new subsection 113A(3)]*

6.73 For the purposes of new section 113A, "relevant life assurance premiums" are defined to mean premiums received in respect of life insurance policies other than:

- superannuation premiums;
- premiums received in respect of exempt policies;
- specified roll-over amounts;
- premiums received in respect of eligible non-resident policies; that is, premiums included in the foreign branch income of an Australian life insurance company which relate to the provision of life insurance benefits for unrelated policyholders who are not residents of Australia;
- premiums exempt from tax under section 23AH; that is, life premiums derived by a resident company from carrying on business at or through a permanent establishment of that company in a foreign ('listed') country. (Broadly, listed countries are those that have comparable rates of tax to Australia's.); and
- foreign life insurance premiums received by a non-resident life insurance company which are exempt from tax in Australia under paragraph 23(r) - see paragraph 6.36.

For further details see the explanation in paragraph 6.55. These new provisions in relation to general management expenses apply to expenditure incurred, or to deductions in respect of a loss, outgoing or expenditure incurred, on or after 1 January 1994. *[Clause 70L, new subsections 113A(5) and (6)]*

Consequential amendments to Division 8

6.74 By repealing existing sections 111A and 111AA (as amended by these amendments) and replacing them with new sections 111AC and 111AD, consequential amendments need to be made to various sections in Division 8. These consequential amendments are discussed in paragraph 6.75 to 6.87 below. *[Clauses 70F, 70G, 70H, 70K, 70M and Clauses 92 to 94]*

Section 111C - Reduction in deductions that do not relate exclusively to assessable income

6.75 The first consequential amendment relates to section 111C. Subsection 111C(1) will be amended to exclude new sections 111AC and

111AD (other than subsections 111AC(3) and 111AD(4)) from the application of section 111C. The references to these new sections in subsection 111C(1) will ensure that deductions allowable under these sections (other than deductions allowable under subsections 111AC(3) and 111AD(4)) and are not reduced by section 111C. **[Clause 70F, new paragraph 111C(1)(a)]**

6.76 This amendment will apply to deductions in respect of losses, outgoing or expenditure (including deductions based on or calculated by reference to all or part of losses, outgoing or expenditures) incurred on or after 1 January 1994. **[Subclause 70F(2)]**

6.77 Another amendment to section 111C removes the existing definitions of 'Deduction', 'Assessable income' and 'Total income' contained in subsection 111C(2) and inserts new definitions of these terms in new subsection 111C(4). The new definitions of 'Deduction' and 'Total income' are the same as the existing definitions; only the definition of 'Assessable income' has changed. This amendment will ensure that premiums (other than foreign premiums) which for deduction purposes are deemed to be assessable income under sections 111A and 111AA (as amended by these amendments), but which will no longer be deemed to be assessable income when these sections are repealed, remain included in assessable income for the purposes of section 111C. **[Clause 70F, new subsection 111C(4)]**

6.78 This amendment will apply to premiums received on or after 1 January 1994. **[Subclause 70F(3)]**

Section 112 - Deductions not allowed for expenditure incurred in gaining certain premium income

6.79 From the year of income in which 1 July 1988 occurred, foreign superannuation premiums will be excluded from those premiums which are deemed to be assessable income (see discussion in paragraphs 6.34 to 6.37). This will result in consequential amendments to section 112.

6.80 Existing section 112 provides, among other things, that deductions are not allowable for expenses incurred in gaining premiums other than superannuation premiums. There is an argument that the term superannuation premiums in section 112 includes foreign superannuation premiums (see the discussion in paragraph 6.10). By these amendments the reference to superannuation premiums in section 112 will be amended to apply only to superannuation premiums to which section 111A (as amended by these amendments) applies, that is, superannuation premiums other than foreign superannuation premiums.

6.81 Because of previous amendments to section 112, these new amendments relating to foreign superannuation premiums will apply in three stages. **[Clauses 70G, 70H and 92 to 94]**

6.82 The first amendment relates to a former provision of the Act which operated from the year of income in which 1 July 1988 occurred but was repealed with effect from 1 January 1990. The provision was previously contained in subsection 112(2) and was inserted by section 17 of *Taxation Laws Amendment (Superannuation) Act 1989*. It provided that section 112 did not apply to superannuation premiums. By these amendments the reference to superannuation premiums in former subsection 112(2) as inserted by section 17 will be amended to apply only to superannuation premiums to which section 111A (as amended by these amendments) applies, that is, superannuation premiums other than foreign superannuation premiums. [*Clauses 92 to 94*]

6.83 Additional provisions have been included in the Bill to ensure that there is no doubt about the intended effects of the amendment to be made to section 17 of *Taxation Laws Amendment (Superannuation) Act 1989*. [*Subclauses 94(2) and (3)*]

6.84 The second amendment applies in respect of expenditure incurred on or after 1 January 1990. Superannuation premiums in subparagraph 112(1)(a)(i) will be amended to refer only to superannuation premiums to which section 111A (as amended by these amendments) applies, that is, superannuation premiums other than foreign superannuation premiums. [*Clause 70G, new subparagraph 112(1)(a)(i)*]

6.85 The final amendment relates to the replacement of existing sections 111A and 111AA (as amended by these amendments) with new sections 111AC and 111AD. This amendment repeals existing section 112 (as amended above) and inserts a new section 112. New section 112 will ensure that the superannuation premiums referred to in the section are the superannuation premiums to which new section 111AC applies. The amendment will also ensure that the investment component of life insurance premiums referred to in the section is the investment component of "relevant life assurance premiums" to which new section 111AD applies. The effect of this amendment is to deny deductions for expenses incurred in gaining premiums, other than premiums to which new sections 111AC and 111AD apply. This means that deductions will not be allowable for expenses incurred in gaining foreign superannuation or life insurance premiums. [*Clause 70H, new section 112*]

Section 113 - Expenses of general management

6.86 A consequential amendment is also necessary to section 113. Because of the repeal of existing sections 111A and 111AA (as amended by these amendments), which for deduction purposes deem certain premiums to be assessable income, a new definition of 'assessable income' will be inserted in section 113. This will ensure that the percentage of general management expenses allowed as a deduction to a life insurance company is not affected by the replacement of existing sections 111A and 111AA (as amended by these amendments) with new sections 111AC and 111AD. The definition, which applies to expenditure incurred on or after

1 January 1994, provides that the superannuation premiums to which section 111AC applies and the investment component of "relevant life assurance premiums" to which section 111AD applies, are to be included in assessable income for the purposes of section 113. [*Clause 70K, new subsection 113(5)*]

Section 116CF - Apportionment or current year deduction between classes

6.87 References in section 116CF to existing sections 111A and 111AA (as amended by these amendments) will be replaced with references to new sections 111AC and 111AD. These are consequential amendments to maintain the operation of section 116CF. The amendments operate in respect of premiums received on or after 1 January 1994. [*Clause 70M, new section 116CF*]

Registered Organisations - Prior to 1 January 1994

Overview

6.88 The existing provision which deems superannuation premiums to be assessable income when calculating deductions allowed to registered organisations (ie, section 116HA) will continue to apply prior to 1 January 1994. However, new provisions will be inserted in the Act to:

- expressly deny deductions for a range of expenditures which were never intended to be deductible, for example benefits paid, increases in claims reserves on account of benefits to be paid, reinsurance premiums, etc; and [*Clause 70S, new section 116HAD*]
- deny deductions for expenses incurred in gaining foreign superannuation premiums. [*Clause 70Q, new subsections 116HA(2) and (3)*]

Deductions not allowed for benefits

6.89 A new provision will be inserted into the Act to ensure that a registered organisation is not allowed deductions for benefits paid or payable under a life insurance policy; or for an amount included in a registered organisation's reserves for the purpose of meeting any future liability, including a contingent liability, to pay benefits under a life insurance policy. [*Clause 70S, new paragraphs 116HAD(1)(a) and (b)*]

6.90 Benefits paid or payable under a life insurance policy include -

- any amount paid or payable in respect of a claim under the policy;
- any amount paid or payable as consideration for, or in connection with, or as a consequence of, the surrender, cancellation, forfeiture, termination or disposal of the policy or of any rights under the policy;

any amount paid or payable in respect of a bonus under the policy;

any amount paid or payable in respect of an annuity under the policy;
or

- any amount that is a refund of premiums that are not included in the assessable income of the registered organisation; or any amount that is in the nature of a refund of such premiums.

[Clause 70S, new subsection 116HAD(2)]

6.91 Benefits paid or payable under a life insurance policy do not include:

- a supplementary benefit (known as a rider benefit) attached to the life insurance policy, which is paid in respect of a non-life insurance risk, where the premiums received for the rider benefit are assessable to the organisation. Examples of these excluded benefits include accident and disability benefits, sickness benefits and trauma benefits. These supplementary benefits are not considered to be life insurance policies for the purposes of Division 8A of the Act. However, this provision, excluding these benefits from being included as benefits payable under a life insurance policy, is included in the Bill to remove any doubt; and
- any interest paid or payable by a registered organisation in consequence of the late payment by the organisation of a claim or benefit for which it is liable under, or in relation to, a life insurance policy.

[Clause 70S, new subsections 116HAD(3) and (4)]

6.92 The amendments also ensure that if there is a dispute over the registered organisation's liability under a life insurance policy, and the matter is settled by the organisation paying an amount under a settlement agreement to the policyholder or an associate of the policyholder (see the meaning below), then no deduction is allowed to the registered organisation for that payment. ***[Clause 70S, paragraph 116HAD(1)(d) and subsection 116HAD(5)]***

6.93 These provisions which deny deductions for benefits paid under a life insurance policy and for settlement payments apply to assessments for the year of income in which 1 July 1988 occurred and to all later years of income. ***[Clause 70S, new subsection 116HAD(6)]***

Meaning of "associate"

6.94 The term "associate" in section 116HAD has the same meaning as in subsection 26AAB(14) of the Act. The meaning of the term is summarised below in paragraphs 6.95 to 6.98.

6.95 If the policyholder is a natural person (other than a trustee) the following are associates:

- a relative;
- a partner;
- the spouse or a child of a partner;
- a trustee of a trust estate where the policyholder or an associate benefits or is capable of benefiting under the trust either directly or indirectly;
- a company where either:
 - the company is, or its directors are, accustomed or under an obligation (whether formal or informal) to act in accordance with the directions, instructions or wishes of the policyholder and/or an associate or associates (including a company which is an associate by virtue of this subparagraph), or
 - the policyholder is and/or persons who are associates of the policyholder (including a company which is an associate by virtue of the subparagraph above) are, in a position to cast, or control the casting of, more than 50% of the maximum number of votes that might be cast at a general meeting.

6.96 If the policyholder is a company (other than a trustee) the following are associates:

- a partner;
- the spouse or a child of a partner;
- a trustee of a trust estate where the policyholder or an associate benefits or is capable of benefiting under the trust either directly or indirectly;
- another person where either:
 - the policyholder company is, or its directors are, accustomed or under an obligation (whether formal or informal) to act in accordance with the directions, instructions or wishes of that person or of that person and another person or other persons, or
 - that person is, or that person and his or her associates are, in a position to cast, or control the casting of, more than 50% of the maximum number of votes that might be cast at a general meeting of the policyholder company;
- another company where either:

- the other company is, or its directors are, accustomed or under an obligation (whether formal or informal) to act in accordance with the directions, instructions or wishes of the policyholder company and/or an associate or associates of the policyholder company, or
- the policyholder company is, and/or the persons who are associates of the policyholder company are, in a position to cast, or control the casting of, more than 50% of the maximum number of votes that might be cast at a general meeting of the other company;
- a person who is an associate of the other person referred to in the fourth subparagraph above.

6.97 If the policyholder is a trustee of a trust estate the following are associates:

- any person who benefits or is capable of benefiting under the trust estate either directly or indirectly;
- any associate of a natural person who is an associate by virtue of the subparagraph above;
- if a company is an associate by virtue of either of the two subparagraphs above, any associate of the company.

6.98 If the policyholder is a partnership the following are associates:

- a partner;
- any associate of a partner.

Meaning of "relative" and "child"

6.99 A "relative" in relation to a person means any of the following:

- the parent, grandparent, brother, sister, uncle, aunt, nephew, niece, lineal descendant or adopted child of that person or his or her spouse; and
- the spouse of that person or any other person specified in the subparagraph above.

6.100 A "child" in relation to a person includes an adopted child, a step-child or an ex-nuptial child of that person.

6.101 These definitions are contained in subsection 6(1) of the Act.

Deductions not allowed for reinsurance

6.102 The proposed amendments also provide that a deduction is not allowed to a registered organisation for a premium paid or payable by the organisation in respect of the reinsurance of the whole or any part of a life insurance policy. This is because the premiums received by the registered organisation in respect of life insurance policies are excluded from the organisation's assessable income, so it is appropriate that any reinsurance premiums paid out by the organisation are not deductible. ***[Clause 70S, new paragraph 116HAD(1)(c)]***

6.103 The amendments also provide that if:

- a registered organisation has entered into a reinsurance contract in respect of the whole or part of a life assurance policy; and
- the premiums paid under the reinsurance contract were not deductible because of paragraph 116HAD(1)(c) - see paragraph 6.102 above;

then the assessable income of the organisation does not include:

- any amount recovered by the registered organisation under the reinsurance contract in respect of the organisation's liability under the policy, or the part of the policy, that was reinsured; and
- any amount received by the registered organisation that is a refund, or in the nature of a refund, of the whole or part of those premiums.

[Clause 70N, new subsection 116GE(1)]

6.104 These provisions relating to reinsurance apply to assessments for the year of income in which 1 July 1988 occurred and all later years of income. ***[Clause 70S, new subsection 116HAD(6) and Clause 70N, new subsection 116GE(2)]***

Deductions not allowable for expenses incurred in gaining foreign premiums

6.105 Subsection 116HA of the Act deems all superannuation premiums to be assessable income for the purpose of determining the deductions allowed to registered organisations. As explained in paragraph 6.10, there is an argument that by deeming all superannuation premiums to be assessable income for determining deductions, foreign superannuation premiums have also been included. This could mean that foreign costs incurred in deriving those foreign superannuation premiums are deductible even though the income from their investment may not have been taxable in Australia. This was never the intention of the legislation.

6.106 Section 116HA will be amended to exclude certain foreign superannuation premiums. The superannuation premiums referred to in

subsection 116HA(1) will now exclude superannuation premiums received in respect of a superannuation policy issued by a registered organisation in the course of a business carried on at or through a permanent establishment of the organisation in a foreign country, where the income that those premiums generate would not be included in assessable income of the registered organisation. This amendment will apply for the year of income in which 1 July 1988 occurred up to the end of the 1989-90 year of income. *{Clause 70Q, subsection 116HA(2)}*

6.107 For assessments for the 1990-91 year of income up until 1 January 1994, a further amendment will ensure that the superannuation premiums to which subsection 116HA(1) applies do not include superannuation premiums which, together with the income that those premiums generate, are exempt from tax under section 23AH; that is, superannuation premiums derived by a resident registered organisation from carrying on business at or through a permanent establishment of that organisation in a foreign ('listed') country. (Broadly, listed countries are those that have comparable rates of tax to Australia's.). *{Clause 70Q, new subsection 116HA(3)}*

Registered organisations - From 1 January 1994 onwards

Overview

6.108 From 1 January 1994 onwards, the provision which deems superannuation premiums to be assessable income when working out deductions, ie section 116HA, will no longer operate. Section 116HAA, which deems certain life insurance premiums received on or after 1 July 1994 to be assessable income for the purpose of determining deductions allowable to registered organisations will never operate. (These sections will be repealed from the date the Bill receives Royal Assent). *{Clause 70R}*

6.109 Replacement provisions will be inserted into the Act, ie new sections 116HAB and 116HAC. These provisions list the specific expenses or the categories of expenses incurred in obtaining superannuation premiums and the investment component of certain life insurance premiums which will be allowed as deductions *{Clause 70S}*.

Deductions allowed for expenditure incurred in obtaining superannuation premiums.

6.110 New section 116HAB provides that certain expenses incurred by a registered organisation in connection with obtaining superannuation premiums are allowable deductions to the organisation. The expenses to which the section applies are:

salaries, wages, bonuses, commissions, allowances and similar benefits paid or payable to a salesperson or a life insurance agent for the sale of superannuation policies. (The expenses covered by this provision include amounts incurred in obtaining future sales of

superannuation policies for the registered organisation.) Where any of these expenses are paid on the renewal of a policy (eg renewal commissions), or on continuation of a policy, a deduction is also allowable;

- expenditure incurred in recruiting and training people who are engaged in selling superannuation policies;
- salaries, wages, allowances and similar benefits paid or payable to employees of the registered organisation to the extent to which the salaries, wages, allowances and similar benefits relate to the provision of administrative, technical or similar assistance or support to salespeople or life insurance agents in their work;
- expenditure incurred in developing superannuation policies or expenditure on research in connection with superannuation policies;
- any other losses or outgoing incurred by the registered organisation in preparing, selling or issuing superannuation policies (eg product advertising expenses). Losses or outgoing incurred in collecting premiums are also deductible;
- expenses which are incurred in the general management of the registered organisation's business to the extent that those expenses are incurred in gaining or producing superannuation premiums.

[Clause 70S, new subsections 116HAB(1) and (2)]

6.111 Any of the expenses listed above which are expenses of a capital nature (for example, capital research and development costs, or capital payments in respect of restrictive covenants or restraint of trade agreements) are not allowable deductions under the new provisions of section 116HAB. ***[Clause 70S, new subsection 116HAB(4)]***

6.112 The amendments also provide that if:

- a deductions is allowed to a taxpayer in respect of a loss, outgoing or expenditure under a specific provision of the Act (other than sections 51, 116H, 116HAB or 116HAC); and
- that provision applies to registered organisations;

then in working out the deduction allowable to the registered organisation under that provision, references to assessable income include superannuation premiums to which new section 116HAB applies.

[Clause 70S, new subsection 116HAB(3)]

6.113 The effect of this provision is to continue to treat superannuation premiums as assessable income for the purpose of working out the deductions allowable under the *specific* deduction provisions of the Act. This ensures, for example, that deductions such as, depreciation under

sections 54 to 62AAV, repairs under section 53, rates under section 72, superannuation contributions for employees under section 82AAC, capital write-offs for the cost of certain buildings under Division 10B, etc. continue to be allowable to registered organisation. **[Clause 70S, new subsection 116HAB(3)]**

6.114 Subsection 116HAB(3) does not apply if another subsection of 116HAB applies. This means that where an expense is deductible under a specific provision of the Act (other than section 51, 116H, 116HAB or 116HAC) when read with subsection 116HAB(3), and a deduction is also allowable under another subsection of 116HAB, then that other subsection applies (and new subsection 116HAB(3) does not).

6.115 There is also a provision in new section 116HAB to ensure that if a deduction is not allowable for an expense under the existing law, then no deduction is allowable under new section 116HAB. This amendment is designed to ensure that restrictions which operate under the existing provisions of the Act, such as the restrictions on deductions for entertainment expenses and club fees, continue to apply after the introduction of the new provisions of section 116HAB. **[Clause 70S, new subsection 116HAB(5)]**

6.116 This is achieved by new subsection 116HAB(5) which operates in the following way. First it is assumed that -

- this Bill was not enacted; and
- a registered organisation's assessable income includes superannuation premiums received by the organisation.

Then, *on the basis of these assumptions*, if a deduction is not allowable to the registered organisation under the Act in respect of a loss outgoing or expenditure, no deduction is allowable under new section 116HAB. If only part of a deduction is allowable, section 116HAB allows a deduction for that part only. **[Clause 70S, new subsection 116HAB(5)]**

6.117 The amendments also ensure that a deduction which is based on, or calculated by reference to, all or a portion of a loss, outgoing or expenditure (for example, depreciation, deductions for capital expenditure on buildings, etc.) is treated as a deduction in respect of a loss, outgoing or expenditure for the purpose of section 116HAB. **[Clause 70S, new subsection 116HAB(6)]**

6.118 The new provisions will also ensure that references to superannuation premiums in new subsection 116HAB do not include superannuation premiums which are exempt from tax under section 23AH: that is, superannuation premiums derived by a resident organisation from carrying on business at or through a permanent establishment of that organisation in a foreign ('listed') country. (Broadly, listed countries are those that have comparable rates of tax to Australia's.) Essentially, this new provision (subsection 116HAB(7)) ensures that the

expenses covered by new section 116HAB are limited to expenses incurred in obtaining superannuation premiums which, apart from the general life insurance premium exempting provision (section 116G), would constitute assessable income of the registered organisation in Australia. *[Clause 70S, new subsection 116HAB(7)]*

6.119 These new provisions in relation to superannuation premiums apply to expenses incurred, or to deductions in respect of a loss, outgoing or expenditure incurred, on or after 1 January 1994. *[Clause 70S, new subsection 116HAB(8)]*

Deductions allowed for expenditure incurred in obtaining the investment component of certain life insurance premiums

6.120 New section 116HAC replaces section 116HAA from the intended date of commencement of that section, that is from 1 July 1994 onwards. The section allows deductions for expenditure incurred in connection with obtaining the investment component of "relevant life assurance premiums". "Relevant life assurance premiums" are premiums received in respect of life insurance policies other than:

- superannuation premiums (these premiums are covered by new section 116HAB);
- premiums received in respect of eligible policies. (Income derived from assets held in relation to eligible policies is not included in the assessable income of registered organisations.);
- specified roll-over amounts. (These premiums are defined by subsection 116E(1) to mean amounts paid to the organisation on or after 1 July 1988 that constitute a roll-over of untaxed elements of eligible termination payments. These amounts are included in the assessable income of a registered organisation and therefore are not addressed by section 116HAC.);
- premiums exempt from tax under section 23AH; that is, life insurance premiums derived by a resident organisation from carrying on business at or through a permanent establishment of that organisation in a foreign ('listed') country. (Broadly, listed countries are those that have comparable rates of tax to Australia's.).

Where the premiums received in respect of a life insurance policy qualify as "relevant life assurance premiums", the life insurance policy is a "relevant life assurance policy". *[Clause 70S, new subsection 116HAC(1)]*

6.121 In new section 116HAC "investment component" and "risk component" are the terms used to describe the components of a premium received under a life insurance policy (see the definitions in subsection 116E(1)). The risk component of a premium is calculated using the basis to be specified in the regulations and represents the cost of risk under the

policy. The investment component is defined as the premium remaining after deducting the risk component.

6.122 New section 116HAC provides that certain expenses incurred by a registered organisation in connection with obtaining the investment component of "relevant life assurance premiums" are allowable deductions to the organisation. The expenses to which the section applies are:

- salaries, wages, bonuses, commissions, allowances and similar benefits paid or payable to a salesperson or a life insurance agent for the sale of relevant life insurance policies. (The expenses covered by this provision include amounts incurred in obtaining future sales of life insurance policies for the registered organisation.) Where any of these expenses are paid on the renewal of a policy (eg renewal commissions), or on continuation of a policy, a deduction is also allowable;
- expenditure incurred in recruiting and training people who are engaged in selling relevant life insurance policies;
- salaries, wages, allowances and similar benefits paid or payable to employees of the registered organisation to the extent to which the salaries, wages, allowances and similar benefits relate to the provision of administrative, technical or similar assistance or support to salespeople or life insurance agents in their work;
- expenditure incurred in developing relevant life insurance policies or expenditure on research in connection with relevant life insurance policies;
- any other losses or outgoing incurred by the registered organisation in preparing, selling or issuing relevant life insurance policies (eg product advertising expenses). Losses or outgoing incurred in collecting premiums are also deductible;
- registered organisation's business to the extent that those expenses are incurred in gaining or producing "relevant life assurance premiums".

[Clause 70S, new subsections 116HAC(2) and (3)]

6.123 Any of the expenses listed above which are expenses of a capital nature (for example, capital research and development costs, or capital payments in respect of restrictive covenants or restraint of trade agreements) are not allowable deductions under the new provisions of section 116HAC. *[Clause 70S, new subsection 116HAC(5)]*

6.124 The amendments also provide that if:

- a deduction is allowed to a taxpayer in respect of a loss, outgoing or expenditure under a specific provision of the Act (other than sections 51, 116H, 116HAB or 116HAC); and
- that provision applies to registered organisations;

then in working out the deduction allowable to the registered organisation under that provision, references to assessable income include the investment component of "relevant life assurance premiums" to which new section 116HAC applies. **[Clause 70S, new subsection 116HAC(4)]**

6.125 The effect of this provision is to continue to treat the investment component of "relevant life assurance premiums" as assessable income for the purpose of working out the deduction allowable under the *specific* deduction provisions of the Act. This ensures, for example, that deductions such as, depreciation under sections 54 to 62AAV, repairs under section 53, rates under section 72, superannuation contributions for employees under section 82AAC, capital write-offs for the cost of certain buildings under Division 10B, etc, continue to be allowable to registered organisations. **[Clause 70S, new subsection 116HAC(4)]**

6.126 Subsection 116HAC(4) does not apply if another subsection of 116HAC applies. This means that where an expense is deductible under a specific provision of the Act (other than section 51, 116H, 116HAB or 116HAC) when read with subsection 116HAC(4), and a deduction is also allowable under another subsection of 116HAC, then that other subsection applies (and new subsection 116HAC(4) does not).

6.127 There is also a provision in new section 116HAC to ensure that if a deduction is not allowable for an expense under the existing law, then no deduction is allowable under new section 116HAC. This amendment is designed to ensure that restrictions which operate under the existing provisions of the Act, such as the restrictions on deductions for entertainment expenses and club fees, continue to apply after the introduction of the new provisions of section 116HAC. **[Clause 70S, new subsection 116HAC(6)]**

6.128 This is achieved by new subsection 116HAC(6) which operates in the following way. First it is assumed that -

- this Bill was not enacted; and
- a registered organisation's assessable income includes the investment component of "relevant life assurance premiums" received by the organisation.

Then, *on the basis of these assumptions*, if a deduction is not allowable to the registered organisation under the Act in respect of a loss outgoing or expenditure, no deduction is allowable under new section 116HAC. If

only part of a deduction is allowable, section 116HAC allows a deduction for that part only. **[Clause 70S, new subsection 116HAC(6)]**

6.129 Existing section 116HAA was not to apply unless a registered organisation obtained a certificate by an authorised actuary in relation to the operation of the section (subsection 116HAA(3)). The certificate was required to ensure that a sound and consistent basis was used for calculating the investment component of premiums for which deductions were allowable by section 116HAA. This requirement is to remain for new section 116HAC. A definition of 'authorised actuary' is contained in new subsection 116HAC(1). **[Clause 70S, new subsections 116HAC(1) and (7)]**

6.130 The amendments also ensure that a deduction which is based on, or calculated by reference to, all or a portion of a loss, outgoing or expenditure (for example, depreciation, deductions for capital expenditure on buildings, etc.) is treated as a deduction in respect of a loss, outgoing or expenditure for the purpose of section 116HAC. **[Clause 70S, new subsection 116HAC(8)]**

6.131 These new provisions in relation to "relevant life assurance premiums" apply to expenses, or to deductions in respect of a loss, outgoing or expenditure, incurred on or after 1 July 1994. **[Clause 70S, new subsection 116HAC(9)].**

Consequential amendments to Division 8A

6.132 The repeal of sections 116HA and 116HAA and the insertion of the replacement sections, sections 116HAB and 116HAC, will result in consequential amendments to section 116H. This is because existing sections 116HA and 116HAA deem superannuation and certain life insurance premiums to be assessable income for the purposes of determining the deductions allowable to a registered organisation; whereas new sections 116HAB and 116HAC will provide for specific expenses and categories of expenses to be deductible.

6.133 Section 116H provides that the deductions allowable to a registered organisation are limited to those mentioned in section 116H. Once sections 116HA and 116HAA are repealed the existing provisions of section 116H will not extend to deductions allowable under new sections 116HAB and 116HAC (because they are not generally incurred in deriving assessable income). Therefore a new paragraph, which specifically mentions the new sections, will be inserted in section 116H to allow deductions for expenses incurred by a registered organisation in obtaining superannuation premiums and the investment component of "relevant life assurance premiums". **[Clause 70P, new paragraph 116H(1)(aa)]**

6.134 As premiums are no longer deemed to be assessable income for the purposes of determining deductions, a further amendment is necessary to ensure that the proportion of deductions allowable to a registered organisation under existing paragraph 116H(b) generally remains

unaltered. (By these amendments, existing paragraph 116H(b) will become new paragraph 116H(1)(b)). Paragraph 116H(b) applies to deductions which do not relate exclusively to the assessable income of a organisation and which, apart from section 116H, would be allowable to a registered organisation. Deductions allowable under section 78 for gifts and under section 73 for subscriptions are examples of deductions which fall within this provision. The amendment will insert a definition of "assessable income" in subsection 116H(2) which will apply for the purpose of determining deductions allowable under new paragraph 116H(1)(b). This new definition of assessable income will include superannuation premiums to which section 116HAB applies and the investment component of "relevant life assurance premiums" to which section 116HAC applies. **[Clause 70P, new subsection 116H(2)]**

6.135 The insertion of new paragraph 116H(1)(aa) applies to deductions for losses, outgoings or expenditure incurred:

- in respect of deductions allowable under section 116HAB - on or after 1 January 1994; or
- in respect of deductions allowable under section 116HAC - on or after 1 July 1994.

The new definition of "assessable income" applies in respect of superannuation premiums received on or after 1 January 1994 and to the investment component of "relevant life assurance premiums" received on or after 1 July 1994. **[Cause 70P]**

No penalties

6.136 The Bill proposes to allow a period of 6 months during which life insurance companies and registered organisations can lodge an amended return excluding claims for deductions which are no longer allowable because of these amendments, without incurring any penalties. **[Clause 70T]**

6.137 The relevant provision applies where:

- a life insurance company or registered organisation lodged a return of income on or before the date of commencement of these amendments; and
- the return included a claim for a deduction under Division 8 or 8A of the Act; and
- when the return was made it was reasonably arguable that the deduction was allowable under Division 8 or 8A; and

that deduction is no longer allowable because of these amendments; and

within 6 months (or a further period allowed by the Commissioner) after this Bill receives Royal Assent, the taxpayer lodges an amended return that does not include a claim for the deduction.

Where these conditions are satisfied, no penalty is payable by the life insurance company or registered organisation because of the original claim for the deduction. However, interest is still payable on any underpayment of tax resulting from these amendments. **[Subclause 70T(1)]**

Determining whether it was reasonably arguable that a deduction was allowable

6.138 In determining whether it was reasonably arguable that the deduction was allowable under Division 8 or 8A prior to these amendments, section 222C of the Act will be treated as applying to this provision. **[Subclause 70T(2)]**

6.139 Section 222C was enacted by the *Taxation Laws Amendment (Self Assessment) Act 1992* (Act No 101 of 1992). It defines the circumstances in which a particular application of a tax law will be regarded as being reasonably arguable.

6.140 The basic test provided by section 222C for determining whether the application of the law is reasonably arguable is whether, having regard to the relevant authorities and the matter in question, it would be concluded that what is argued for is about as likely as not correct (subsection 222C(1)).

6.141 Provision is made in subsections 222C(2) and 222C(3) for the case where the application of a law assumed that the Commissioner would exercise a discretion in a particular way. The Commissioner exercises a discretion if the Commissioner:

- forms, or refuses or fails to form, an opinion;
- attains, or refuses or fails to attain, a state of mind;
- makes, or refuses or fails to make, a determination; or
- exercises, or refuses or fails to exercise, a power.

(subsection 222C(5))

6.142 In such a case, the taxpayer has a reasonably arguable position if the exercise by the Commissioner of the discretion in the particular way would be reasonably arguable in accordance with law (subsection 222C(2)). For this purpose, the exercise, or assumed exercise, of a discretion by the Commissioner is reasonably arguable in accordance with the law, if having regard to the relevant "authorities" and the particular

matter, it would be concluded that a court would be "about as likely as not" to hold that the exercise is or would be in accordance with law.

6.143 "Authority" is defined in subsection 222C(4) to include:

- an income tax law;
- material for the purposes of subsection 15AB(1) of the *Acts Interpretation Act 1901*;
- a decision of a court (whether or not Australian), the Administrative Appeals Tribunal or a Board of Review; or
- a public ruling within the meaning of Pt IVAAA of the *Taxation Administration Act 1953*.

6.144 This definition is an inclusive one. The explanatory memorandum to the *Taxation Laws Amendment (Self Assessment) Bill 1992* states that authorities relating to other areas of the law (for example, contract law) may provide support for a particular treatment of an item. The explanatory memorandum also states that taxation rulings issued by the Commissioner before the new arrangements for the making of public rulings may be considered.

6.145 A taxpayer may have a reasonably arguable position for the tax treatment of an item despite the absence of authorities other than the law itself. What is required in such cases is that the taxpayer has a well-reasoned construction of the applicable statutory provision which it could be concluded was about as likely as not the correct interpretation.

6.146 An opinion expressed by an accountant, lawyer or other adviser is not an authority. However, the authorities used to support or reach the view expressed by the adviser, including a well-reasoned construction of the relevant statutory provisions, may support the position taken by a taxpayer.

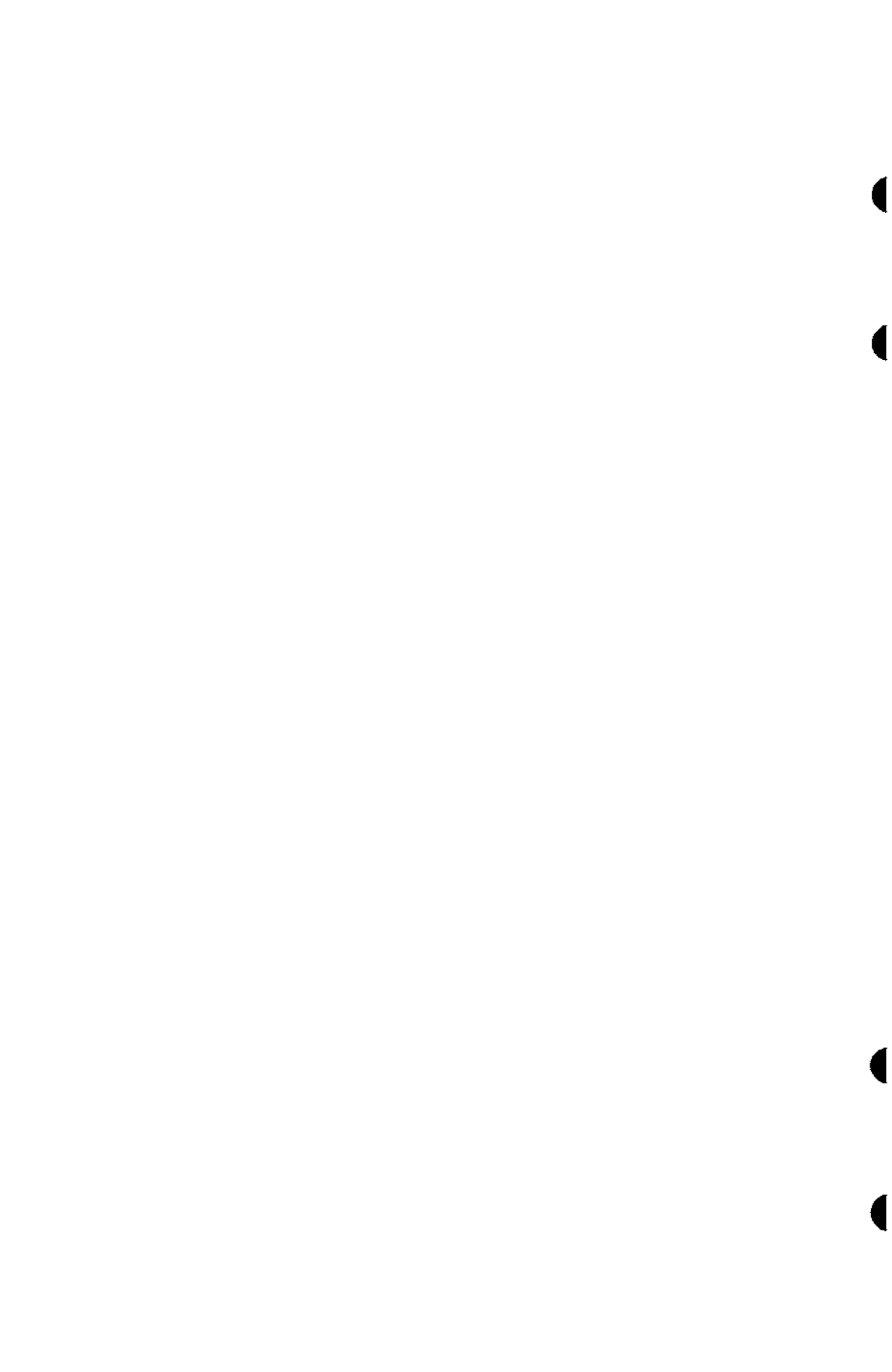
6.147 The relevance of any authority is a matter to be weighed against other authorities, including the applicable statutory provisions, and the facts of the case. An authority that has some facts in common with the tax treatment at issue is not particularly relevant if the authority is materially distinguishable on its facts, or is otherwise inapplicable to the tax treatment at issue. An authority that merely states a conclusion is ordinarily less persuasive than one that reaches its conclusion by cogently relating the applicable law to the pertinent facts. It will be relevant however, to consider the source of an authority. For example, a High Court decision on all fours with the tax treatment in question will be accorded more weight than a Federal Court decision, which in turn would be accorded more weight than a decision of the AAT.

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