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THE PARLIAMENT OF THE COMMONWEALTH

OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAXATION LAWS AMENDMENT BILL (NO. 5) 1989

EXPLANATORY MEMORANDUM

(Circulated by authority of the

Treasurer, the Hon. P.J. Keating, M.P.)

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GENERAL OUTLINE

This Bill will amend:

- the Income Tax Assessment Act 1936 -

  - .. to make the following changes to the way income tax is paid by companies, unit trusts taxed as companies, superannuation funds, approved deposit funds and pooled superannuation trusts for income of the 1989-90 and subsequent income years (proposal announced in the Budget on 15 August 1989)

Collection of tax

- a company or fund which has a notional tax liability of $20,000 or more (and does not estimate its liability to be less than $20,000) will be required to make two payments of tax - the first payment, being 85 per cent of notional tax or (if a lesser amount) the estimated total liability, will be due on 15 July in the year following the year of income and the final payment will be due on the following 15 March;

- a company or fund which has a notional tax of more than $1,000 but less than $20,000, or has a notional tax of $20,000 or more but estimates its tax to be in the range of $1,000 - $20,000, will have the option of paying in the same way as a company or fund referred to in the preceding note, or making a single final payment on 15 December;

- any other taxable company or fund will have to make a single final payment due on 15 March;

- a company or fund with a substituted accounting period will have to pay in the equivalent time frame, but no payment will fall due after 15 June in the year following the year of income;

Return of income

- a company or fund will be required to furnish a return of income specifying the tax payable on the taxable income or net income, as the case may be, by the date on which the company or fund is required to make the final payment of its tax liability;

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Return constitutes assessment

- the return of a company or fund will be deemed to be a notice of assessment, and the Commissioner of Taxation will be taken to have served the assessment on the date on which the final tax liability is payable or the return is furnished, whichever is the later;

Franking of dividends

- changes complementing the changes to company tax collections relevant for calculating franking credits and debits will be included within the imputation system for company dividends;

.. to adjust the statutory period for making debit and credit amendments for <u>all</u> taxpayers to 4 years and make a mechanism available for extending the period within which the Commissioner may amend an assessment in certain cases;

.. to require taxpayers' records to be kept for a period of five years instead of the current seven years consistent with the above change, subject to an appropriate extension where the period for amendment is extended, and to change the law to take into account records kept in electronic form;

.. to facilitate the self-determination by <u>all</u> taxpayers of entitlements to foreign tax credits and franking deficit tax offsets;

.. to allow a deduction for costs in ascertaining and meeting taxpayers' income tax obligations (proposal announced in the Budget on 15 August 1989);

.. to authorise deductions for expenditure incurred on or after 1 January 1990 by a life assurance company in gaining the investment component of certain life insurance premium income (proposal announced in the Budget on 15 August 1989);

.. to modify the imputation system by precluding all dividends paid under share-based financing arrangements from being frankable dividends (proposal announced in the Budget on 15 August 1989);

.. to extend from 1 July 1989 to 1 September 1989 the time allowed for restoration of deposits in certain approved deposit funds in order to qualify for tax exemption (proposal announced on 26 June 1989);

.. to correct a technical deficiency in provisions which deal with the exclusion of otherwise taxable contributions from the assessable income of a complying superannuation fund (proposal announced on 16 October 1989);

.. to modify the prescribed payments system so that only a householder who in fact assumes the responsibilities of a builder in relation to a construction project is treated as an owner-builder;

.. to allow income tax deductions for gifts to building funds for hostels that provide residential accommodation for school students from rural areas (proposal announced on 8 August 1989);

.. to reduce the rate of withholding from certain withdrawals from film accounts from 49 per cent to 47 per cent;

.. to make consequential changes following the renumbering of the Social Security Act.

. the Crimes (Taxation Offences) Act 1980 -

.. to modify the definition of "income tax" in that Act to account for changes made by this Bill to the Income Tax Assessment Act 1936 in respect of the new system for the collection of tax payable by companies and certain other entities.

. the Taxation Administration Act 1953 -

.. to account in that Act for changes made by this Bill to the Income Tax Assessment Act 1936 in respect of the new system for the collection of tax payable by companies and certain other entities.

FINANCIAL IMPACT

The changes to the system of collection of tax from companies, certain unit trusts taxed as companies, approved deposit funds, superannuation funds and pooled superannuation trusts are estimated to produce a revenue gain of $880 million in 1989-90 and $150 million in 1990-91.

The cost to revenue of the amendment allowing deductions for costs in ascertaining and meeting taxpayers' income tax obligations is estimated to be $40 million per annum commencing in 1990-91.

The estimated revenue cost of allowing a deduction to life assurance companies for expenditure incurred in gaining the investment component of certain life insurance premium income is nil in 1989-90 and 1990-91, $30m in 1991-92, $125m in 1992-93 and $140m in 1993-94.

The change to the imputation system to deal with share-based financing arrangements will prevent an unquantifiable loss of revenue.

The nature of the proposal to extend the time allowed for restoration of deposits in certain approved deposit funds does not permit a reliable estimate of the potential revenue effect.

The amendment which relates to taxable contributions of complying superannuation funds will ensure the protection of the revenue base of the tax on superannuation contributions.

The revenue cost of extending the income tax gift provisions to building funds for hostel accommodation for school students from rural areas is estimated to be less than $500,000 in a full financial year while the changes to the owner builder provisions of the prescribed payments system will have no effect on revenue.

The reduction in the rate of withholding from certain withdrawals from film accounts will have a negligible revenue effect.

MAIN FEATURES

The main features of this Bill are as follows:

Collection of tax on companies and trustees of certain funds (Clauses 33 to 36)

The Bill will amend the Income Tax Assessment Act 1936 (the "Assessment Act") to give effect to the 1989-90 Budget announcement of a new tax collection system for companies and trustees of certain funds to apply in respect of tax payable on income of the 1989-90 and subsequent income years. The Bill will also incorporate in the new system some further changes to the system as announced in the Budget following discussions with professional bodies.

At present, companies, and unit trusts taxed as companies, with a tax liability of $1,000 or more pay their tax in four instalments spread over the year following the income year. Others make just one payment.

All companies, unit trusts taxed as companies, superannuation funds and approved deposit funds (whether complying or non-complying) and pooled superannuation trusts will come within the scope of the new system.

Broadly, the Bill will provide for companies and funds with a tax liability of $20,000 or more to pay their tax in two instalments in the year following the relevant year of income. Companies and funds with a tax liability of less than $1,000 will make one payment, and all others will have the choice of those two systems.

The new arrangements are based on a self-assessment system.

Companies and funds will pay tax under one of three methods, each described in more detail below, depending on their level of tax liability:

- companies and funds which have a notional tax liability of $20,000 or more (and do not estimate their liability on income of the relevant year of income to be less than $20,000) will be required to make two payments of tax each year - the initial payment will be due on 15 July following the end of the income year, and will be an amount to equal 85 per cent of:

  (a) the notional tax (i.e., the tax payable at the current year rate on the taxable income of the preceding income year); <u>or</u>

  (b) the tax which the company or fund estimates is its total liability on income of the income year;

- the final payment will be due on 15 March, and will be the total actual tax liability for the year of income less the amount already paid;

- companies and funds which have a notional tax of more than $1,000 but less than $20,000, or have a notional tax of $20,000 or more but estimate their tax liability for the income year to be in the range $1,000 to $20,000, will be given the option of paying in the same way as entities referred to in the note above, or of making a single payment of the total actual tax liability for the income year on 15 December;

- all other taxable companies and funds will be required to make a single payment of their total actual tax liability for the income year on 15 March following the end of the income year, e.g., companies and funds:

(a) which have no notional tax (i.e., new companies and those previously non-taxable);

(b) the notional tax of which is less than $1,000; or

(c) the total actual liability of which, in respect of the year of income, is estimated to be less than $1,000.

The new arrangements will first affect payments made in the 1990-91 financial year (or substituted accounting period in the case of early balancing companies or funds) in respect of income of the 1989-90 income year. As described above, the possible payment dates are 15 July, 15 December and 15 March for companies and funds balancing on 30 June. For companies and funds with substituted accounting periods ending on or before 31 May in lieu of the following 30 June the possible payment dates are the 15th day of the first, sixth and ninth months after the end of the accounting period (subject to 15 January being the earliest required payment date). For late balancing companies the possible payment dates are within the same timeframe as for early balancing companies, except that there will be no payment due later than 15 June in the year following the year of income.

A company or fund that has made an initial payment of tax in respect of income of a year of income will be entitled to make a further estimate of its total tax liability for the year before it is required to make the final payment. If the initial payment was excessive on the basis of that further estimate the excess will be refunded. Consequently, a company or fund may make a further payment of tax at any time before the final payment where it considers that it has underestimated its initial payment liability.

Where a company or fund has made its initial payment of tax on the basis of its estimate of the income tax that will be payable, the Commissioner of Taxation will be authorised to adjust the estimate where he has reason to believe that the amount of income for the year will be greater or less. In addition, anti-avoidance provisions will operate to overcome any arrangement intended to relieve a company or fund from its liability to make an initial payment of tax.

Annual returns
(Clause 29)

The Bill will amend the provisions of the Assessment Act dealing with the requirements to furnish returns. Without changing their substance, the amendment will express those requirements more clearly and in language consistent with the Sex Discrimination Act 1984.

Determination of liability for tax
(Clause 30)

In an extension of the "self-assessment" system of determining tax liability that has applied since 1986, a company or fund will be required to furnish a return of income showing only limited details including its taxable income or net income, as the case requires, and the tax payable thereon. Certain information relevant for statistical or systems purposes will also be required. The taxpayer will be required to retain the papers supporting the calculation of taxable or net income.

A taxable company or fund will be required to furnish a return of income by the day on which the final payment of tax liability is due. The assessment will be deemed to have been made by the Commissioner of Taxation on that day, unless the return is lodged later, in which case the assessment will be deemed to have been made on the date of lodgment. The return will be deemed to be a notice of deemed assessment under the hand of the Commissioner served on the company or fund on the day, referred to above, when the assessment is deemed to have been made. This change applies to a return of income furnished by a company or fund for the 1989-90 and subsequent income years. The taxpayer's existing rights relating to an assessment will be retained.

Amendment of assessments
(Clause 31 and 32)

The Assessment Act will be amended to adjust the time period within which an assessment of tax may be amended to increase or decrease a liability.

Section 170 of the Assessment Act enables the Commissioner of Taxation to amend an assessment at any time, subject to certain limits specified in the section. In particular, subsection 170(2) deals with amendments increasing a taxpayer's liability where there has not been a full and true disclosure of all material facts necessary for an assessment, and there has been an avoidance of tax. In such cases the Commissioner may amend the assessment :

(a) within 6 years of the date on which the tax became due and payable; or

(b) at any time where the Commissioner is of the opinion that fraud or evasion has occurred.

Other provisions authorise a credit or debit amendment where there has been a full and true disclosure of all material facts necessary for an assessment. In these cases, however, the amendment can be made only within three years of the date on which the tax became due and payable. The Commissioner may also amend an assessment at any time to apply specifically nominated provisions of the income tax law, e.g., anti-profit shifting and other anti-avoidance measures.

The concept of full and true disclosure previously enabled the Commissioner to make an assessment of a taxpayer's tax liability based on the information disclosed in the taxpayer's return. In the context of self-assessment of a taxpayer's liability the concept has reduced relevance.

The Bill will amend the Assessment Act and remove the full and true disclosure concept from the amendment provisions. At the same time, the period for the general power of amendment increasing liability, presently 6 years in the absence of full and true disclosure, will be reduced to 4 years.

These amendments are applicable for <u>all</u> taxpayers.

In summary, the Commissioner will be authorised to amend an assessment to increase a liability within 4 years from the date upon which the assessment became due and payable. To account for the proposed new system of self-assessment for certain companies and funds the 4 year application period for them will be measured from the date on which their assessments are deemed to have been made.

The period within which a credit amendment may be made will be increased from 3 years to 4 years. The existing powers to amend at any time where fraud or evasion exists or where certain anti-avoidance provisions of the Assessment Act apply, will be retained.

An associated change will allow the Commissioner to apply to the Federal Court of Australia for an extension of the new statutory 4 year period to amend an assessment to increase liability. The onus will be on the Commissioner, prior to the end of the 4 year period, to show that an extension of time is warranted. The period of any extension will be determined by the Court. The Bill will also authorise the Commissioner and the taxpayer to agree on an extension of time to amend an assessment to increase the liability of the taxpayer.

These changes to the powers of amendment will apply to all taxpayers, in relation to assessments for the 1989-90 and later income years that are made on or after the day on which the Bill receives the Royal Assent.

<u>Keeping of records</u>
(Clauses 27, 40, 41 and 42)

Consistent with the changes to the time limit for amending assessments, the Assessment Act will be amended so that records will be required to be kept for a period of 5 years after the completion of the transactions or acts to which they relate. This period will be subject to any subsequent extension by the Federal Court of Australia of the period allowed for amendment beyond the proposed statutory limit of 4 years. Currently, records must be kept for a period of 7 years.

The Bill also contains a definition of "record" and takes into account records held otherwise than in written form, e.g., on electronic media.

The maximum penalty on conviction for failure to comply with the new record keeping requirements will be updated to a fine of $3,000, increased from $2,000.

Determination of credits
(Clauses 13 to 16)

Where a taxpayer makes a claim for a foreign tax credit in respect of foreign tax paid on foreign income included in the taxpayer's assessable income, the Commissioner of Taxation is required to make a determination as to whether a credit is allowable and if so, the amount of the credit. Having made the determination, the Commissioner is then required to advise the taxpayer.

The Assessment Act will be amended so that a taxpayer will be authorised to self-determine the credit. As a result the Commissioner will no longer be required to make a determination of credit, or advise the taxpayer of the amount of the credit unless the taxpayer requests that the Commissioner do so. The determination by the taxpayer will be deemed to be a determination by the Commissioner. The law will be amended also so that, consistent with the taxpayer making the calculation of credit, the taxpayer may be liable for interest where by an amendment the amount of credit is reduced.

The relevant changes will apply to determination of credits in respect of tax for the 1989-90 and subsequent years of income.

Franking of Dividends
(Clauses 17 and 18 to 25)

The Bill will amend Part IIIAA of the Assessment Act dealing with franking of company dividends to accommodate changes to the method of tax collection and assessment of companies and certain unit trusts that are taxed as companies.

The proposed amendments of the Assessment Act will set down the method for calculating franking credits or debits arising from payments and refunds made under the new collection system by or to particular entities. They will ensure also that where a company or unit trust that is liable for Franking Deficit Tax (FDT) decides to make an initial payment of tax under the new collection system based on actual (rather than notional) tax liability on 15 July, it will be relieved from payment of the amount of FDT liability to the extent of the initial payment.

Changes complementary to those being made to the self-determination of foreign tax credits are being made within Part IIIAA to authorise the self-determination of the FDT liability to be offset against the company tax liability.

<u>Deduction for costs in connection with ascertaining and meeting income tax obligations</u>
(Clauses 8, 28, 43, 46(2), 46(6), 46(10) and 47)

The Bill will give effect to the 1989-90 Budget proposal to allow deductions for expenditure incurred by taxpayers in connection with the management or administration of their income tax affairs.

There is no general deductibility for all taxpayers of expenditure they incur to meet their obligations under taxation laws. Losses and outgoings incurred by a taxpayer (including a business taxpayer) in ascertaining the taxpayer's income tax liability, disputing an assessment or determination of the Commissioner of Taxation or attending to matters arising from an Australian Taxation Office (ATO) audit of the taxpayer's affairs are not allowable deductions.

Under the existing income tax law a deduction is allowable for a payment to a registered tax agent (or a person exempt from registration) for the preparation of an income tax return. Amounts paid for other taxation advice or in connection with other tax matters are allowable deductions to the extent they are incurred in gaining or producing assessable income or are necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income, and to the extent they are not of capital or of a capital, private or domestic nature.

Examples of deductions allowable to business taxpayers for expenditure incurred in relation to taxation matters are costs associated with record-keeping, returns etc. for prescribed payments, PAYE tax, sales tax and fringe benefits tax. A taxpayer who is not conducting a business is entitled to tax-related deductions in very limited circumstances only, such as land tax for a rental property and other expenses related to the land tax assessment, e.g., costs of disputing the assessment.

The amendment proposed by clause 8 will, broadly, authorise a deduction for expenditure incurred by a taxpayer (irrespective of whether or not the taxpayer is carrying on a business) in respect of the management or administration of the income tax affairs of the taxpayer.

Allowable expenditure will include fees paid by a taxpayer to a registered tax agent (or a person exempt from registration) for professional advice in relation to the income tax affairs of the taxpayer, costs associated with disputing an assessment or determination made by the Commissioner, expenditure incurred in attending to an ATO audit and costs associated with tax planning.

A deduction will also be allowed for depreciation of property (such as a computer) to the extent the property is used by a taxpayer in ascertaining or meeting the taxpayer's income tax obligations.

No deduction will be available for costs associated with an offence against any law of the Commonwealth, a State or Territory or of a foreign country.

Clause 28 of the Bill will permit a taxpayer to include in the cost base, indexed cost base and reduced cost base for capital gains purposes fees paid to a registered tax agent (or a person exempt from registration) for professional advice concerning the impact of the income tax law on the acquisition or disposal of an asset. Fees paid for professional advice concerning the impact of taxes other than income tax (for example, stamp duty) on the acquisition or disposal of an asset will also be eligible to be included in each of the cost bases.

These amendments will apply to expenditure incurred on or after 1 July 1989.

<u>Life assurance companies - deduction for certain expenditure</u>
(Clauses 10 to 12, 46(4) and 48)

The Bill will give effect to the announcement in the 1989-90 Budget that expenditure incurred by a life assurance company (excluding friendly societies and other registered organisations) in gaining the investment component of life insurance premium income (other than premium income from exempt policies) is to be an allowable deduction. Generally, life insurance premium income is not assessable income of the life assurance company so that, under the existing law, expenditure incurred in relation to such income is not allowable as a deduction. The amendment to allow tax deductions for expenditure incurred in gaining the investment component of premiums will result in tax treatment similar to that of other financial institutions.

The investment component of life insurance premium income is to be determined by deducting the risk component of that income. The risk component represents the cost of risk in respect of the policy and varies between different types of policies. In an insurance only policy such as term insurance, the entire premium would consist of risk component.

Deductions will be conditioned on the life assurance company obtaining a certificate from an actuary in relation to the ascertainment of the investment component. In addition, the deduction will not be allowed in respect of exempt policies. For life assurance companies other than State and Territory government insurance offices exempt policies are those policies which provide certain immediate annuities. For State and Territory government insurance offices, exempt policies are policies referable to non-superannuation life assurance business. Deductions are not to be allowable in respect of exempt policies because, unlike other policies, income derived from assets included in the insurance funds of a life assurance company that is referable to exempt policies is exempt from tax.

The new deduction will apply in respect of expenditure incurred on or after 1 January 1990.

<u>Dividends paid under share-based financing arrangements</u>
(Clauses 17 and 46(5))

This Bill will give effect to the 1989-90 Budget announcement to modify the dividend imputation arrangements to preclude dividends paid under share-based financing arrangements from being frankable dividends. Under share-based financing arrangements the character of dividends paid is such that they may reasonably be regarded as equivalent to the payment of interest on a loan.

The imputation arrangements use a system of franking dividends to relieve those dividends paid by Australian resident companies from personal income tax in the hands of resident shareholders to the extent that income tax has been paid at the company level. By virtue of the intercorporate dividend rebate franked dividends are also free of tax in the hands of resident company shareholders.

A variety of methods have been used by companies to direct or transfer imputation credits to particular companies or shareholders so as to obtain disproportionable taxation benefits. To overcome these arrangements such dividends are to be excluded from the definition of frankable dividends in the imputation provisions. This measure will apply to dividends paid on shares issued on or after 16 August 1989 or dividends paid under a financial arrangement entered into on or after that date.

The amendment effectively extends the scope of section 46D of the Assessment Act to deny the intercorporate dividend rebate in respect of all dividends paid under share-based financing schemes.

Fixed interest complying ADFs - exemption of income attributable to certain 25 May 1988 deposits
(Clause 44)

Under the recent package of superannuation tax measures that received Royal Assent on 30 June 1989, a portion of the investment income of certain qualifying approved deposit funds (ADFs) is exempt from tax. In broad terms, qualifying ADFs are complying ADFs that receive at least 90 per cent of their income from interest. The amount of an ADF's income that is treated as exempt depends on the proportion of the total amount standing to the credit of all depositors with the ADF (called the "aggregate current balance") at a particular time which is attributable to amounts on deposit for certain "eligible depositors" at 25 May 1988 (called the "aggregate of current 25 May balances").

Under transitional arrangements, if an amount was withdrawn from an ADF after 25 May 1988, it could nevertheless be included in the "aggregate of current 25 May balances" provided it was returned to the same ADF before 1 July 1989. This Bill proposes to change the 1 July 1989 deadline to 1 September 1989 so extending the benefits of the transitional arrangements.

Taxable contributions of complying superannuation funds
(Clauses 43, 46(10), 46(11) and 49)

The Bill proposes an amendment to correct a technical deficiency in Division 2 of Part IX of the Assessment Act, which deals with the taxable contributions to be included in the assessable income of a superannuation fund or approved deposit fund.

Under the existing law, the trustee of a complying superannuation fund can, with the consent of a contributor to that fund, elect to have an amount of the contributions made to the fund not treated as taxable contributions. The amount of contributions so treated is limited to ensure that where a complying superannuation fund elects to have such contributions effectively exempted from tax, this will be offset by an increase in tax on end benefits. The limit is an amount equal to the sum of the following:

(i) the total of amounts covered by notices, given by the trustee of the complying superannuation fund to a recipient of an eligible termination payment (ETP), which provide that a portion of the post-June 83 component of the ETP is an untaxed element (that is, the ETP is taxed at a higher rate in the recipient's hands);

(ii) the portion of the pre-July 83 components of ETPs paid by the fund that corresponds to the proportion of the post-June 83 components of the ETPs represented by the notices in (i) above; and

(iii) the total of amounts covered by notices, given by the trustee of the complying superannuation fund to a recipient of a superannuation pension, which provide that the recipient is not entitled to a superannuation pension rebate for a portion of the pension.

The amendments proposed by this Bill will exclude the pre-July 83 components of ETPs paid by a fund from the determination of the limit on the amount of contributions that the trustee of a fund can elect not to treat as assessable income (i.e., paragraph (ii) above will not apply in determining the exemption). The purpose of the amendments is to ensure that the trustees of fully funded superannuation schemes cannot avoid tax on contributions by use of the exemption which is intended to cover cases where the employer does not fund benefits until retirement.

The amendments are to apply in relation to contributions made on or after 1 July 1988.

<u>Modification of owner-builder status</u>
(Clauses 38, 46(7) and 46(8))

Under the present law, when a building permit is issued in a home owner's name that person is taken to be an owner-builder for the purposes of the Prescribed Payment System and is subject to source deduction rules in the same way as a builder, rather than being liable only to report payments as a householder. The measures in the Bill will ensure that householders are not treated as owner-builders if they do not in fact assume the responsibilities of a builder in relation to a construction project.

This change will address a problem that has arisen because of the practice of some local councils to issue building permits in the name of a home owner regardless of who applies for the permit and carries out the construction work.

<u>Gifts, pensions etc.</u>
(Clauses 9 and 46(3))

The Bill will give effect to the proposal announced on 8 August 1989 to extend those provisions of the Assessment Act that authorise deductions for gifts of the value of $2 or more to specified organisations. The proposal applies to certain public funds established and maintained exclusively for providing money for the acquisition, construction or maintenance of a building that provides residential accommodation for school students from rural areas. Gifts made to such a fund on or after 7 April 1989 will qualify for deduction.

Withdrawal from film accounts
(Clauses 39 and 46(9))

Where a person withdraws an amount from an account opened in relation to a film in the Australian Film Industry Trust Fund, the law imposes a requirement on the person to make a deduction from that amount if it is not, upon withdrawal, to be dealt with in a prescribed manner. The amount withheld is to be remitted to the Commissioner of Taxation and is applied against tax due on an amended assessment withdrawing the deduction previously claimed for the excess contribution to the Trust Fund.

This amendment will adjust the rate of deduction to be applied in respect of investors, other than corporate investors to whom the refund is made. This rate is presently 49 per cent, the equivalent of the maximum rate in the personal tax scale.

The new rate of deduction will be 47 per cent, applicable for withdrawals from film accounts on or after 1 January 1990. The change is in accord with the reduction of the maximum rate in the personal tax scale to 47 per cent on and from that date.

AMENDMENT OF THE CRIMES (TAXATION OFFENCES) ACT 1980

A consequential amendment is to be made to the Crimes (Taxation Offences Act) 1980 to reflect changes being made to the Income Tax Assessment Act 1936 dealing with a new system of collection of tax on companies and certain funds (proposed new Division 1B of Part VI).

AMENDMENT OF THE TAXATION ADMINISTRATION ACT 1953

Two consequential amendments are to be made to the Taxation Administration Act 1953 on account of changes being made to the Income Tax Assessment Act 1936. The amendments relate to the definition of a statement made to a taxation officer and will take account of a change in procedure following the introduction of a system of full self-assessment for companies and certain other funds.

A more detailed explanation of the provisions of the Bill is contained in the following notes.

PART 1 - PRELIMINARY

Clause 1 : Short title

This clause provides for the amending Act to be cited as the Taxation Laws Amendment Act (No.5) 1989.

Clause 2 : Commencement

By this clause the amending Act is to commence on the day on which it receives the Royal Assent. But for this clause, by reason of subsection 5(1A) of the Acts Interpretation Act 1901, the Act would commence on the twenty-eighth day after the date of Assent.

PART 2 - AMENDMENT OF THE CRIMES (TAXATION OFFENCES) ACT 1980

The Crimes (Taxation Offences) Act 1980 came into operation on 4 December 1980 and provides criminal sanctions against persons who engage in stripping transactions designed to ensure that a company or trust is rendered incapable of paying income tax or sales tax. Such schemes became known as "bottom of the harbour" schemes. Since that time the Act has been amended to include fringe benefits tax and petroleum resource rent tax within the categories of taxes subject to the Crimes (Taxation Offences) legislation.

Clause 3 : Principal Act

This clause facilitates reference to the Crimes (Taxation Offences) Act 1980 which in this Part is referred to as "the Principal Act".

Clause 4 : Interpretation

Under subsection 3(1) of the Principal Act the term "income tax" is given a wider meaning than the basic income tax assessed under the Income Tax Assessment Act 1936 (the "Assessment Act"). It includes, for example, amounts of PAYE tax instalment deductions and additional tax payable for late payment of income tax.

This clause will deal with changes being made to the Assessment Act by Part 3 of this Bill. The changes will apply a new system for the collection of tax from companies and superannuation and certain other funds which are referred to in the new measures (to be inserted as Division 1B of Part VI of the Assessment Act) as "relevant entities".

Additional tax will become payable by a relevant entity under Division 1B of Part VI of the Assessment Act, where income or deductions have been transferred under an avoidance scheme (see notes on section 221AY in clause 36 of the Bill), or where an incorrect estimate has been made of the income tax payable for a year of income on which an instalment of tax (called an initial payment in the new measures) is based (see notes on section 221AZE in clause 36).

By paragraph (a) of this clause, any additional tax that does become payable for these reasons will be included in the definition of "income tax" for the purposes of the Principal Act. Accordingly, a reference to an initial payment of tax payable under new Division 1B of Part VI of the Assessment Act is being included in that definition by means of the insertion (by paragraph (b) of this clause) of new paragraph (ca).

PART 3 - AMENDMENT OF THE INCOME TAX ASSESSMENT ACT 1936

Clause 5 : Principal Act

This clause facilitates reference to the Income Tax Assessment Act 1936 which, in this Part, is referred to as "the Principal Act".

Clause 6 : Interpretation

Clause 6 of the Bill will amend the definition of "assessment" in subsection 6(1) of the Principal Act. Section 6 contains a number of definitions and provisions to assist in the interpretation of the Act.

The amendment of the definition of "assessment" by subclause 6(1) will make it clear that, as well as the ascertainment of taxable income and of the tax payable thereon, an assessment is to include the ascertainment of the net income of certain unit trusts and of trusts generally, and of the tax payable thereon, to the extent that a trustee is liable to be assessed and pay tax on that net income.

By subclause 6(2) the amendment made by subclause 6(1) is to apply and be taken to have applied in respect of all years of income.

Clause 7 : Exemption of certain pensions

Clause 7 will amend section 23AD of the Principal Act to change references to section 172 of the Social Security Act 1947 to section 237 of that Act. This change is due to the renumbering of certain sections of the Social Security Act by the Social Security (Review of Decisions) Act 1988 (Act No.85 of 1988).

Section 23AD of the Principal Act operates to determine which pensions, benefits and allowances paid under social security, repatriation and other welfare legislation are subject to, or exempt from, income tax.

Section 237 (formerly section 172) of the Social Security Act 1947, applies on the death of one of a pensioner couple so that the surviving pensioner receives an allowance termed a "Special Temporary Allowance". This allowance is exempt from tax by the operation of section 23AD.

Following renumbering effected by subsection 10(5) of the Social Security (Review of Decisions) Act 1988, references to section 172 of the Social Security Act in section 23AD of the Principal Act are to be construed as references to section 237 on and from 1 November 1988.

Clause 8 : Tax-related expenses

Clause 8 of the Bill proposes to repeal section 69 of the Principal Act and substitute a new section 69.

Under the existing section 69 a deduction is allowable for expenditure incurred for the preparation by a registered tax agent (or a person exempt from registration) of a return required under the Principal Act. Also, where a taxpayer dies during a year of income, expenditure incurred by a trustee for the preparation by a registered tax agent of the taxpayer's return to date of death is deemed to be expenditure incurred by the taxpayer during the lifetime of the taxpayer and as such is an allowable deduction in the return to date of death.

The new section will authorise a deduction for expenditure incurred by taxpayers (including taxpayers who are not carrying on a business) in connection with the management or administration of their income tax affairs.

Under new subsection 69(1) a deduction will be allowable for expenditure incurred by a taxpayer to the extent to which the expenditure is for a tax-related matter as defined in new subsection 69(2). A deduction under subsection (1) will be allowable for expenditure incurred on or after 1 July 1989 and will be allowable in the year of income in which the expenditure was incurred. Expenditure of a capital nature, such as the purchase of a computer, incurred in respect of a tax-related matter will not be an allowable deduction under subsection (1).

For the purposes of new section 69 a tax-related matter is defined, in new subsection 69(2), to mean:

(a) the management or administration of the income tax affairs of a taxpayer (paragraph (a)); or

(b) compliance with an obligation imposed on a taxpayer by a Commonwealth law, to the extent the obligation relates to another taxpayer's income tax affairs (paragraph (b)).

A tax-related matter does not include an offence-related matter, which is defined in new subsection 69(10) to be a matter relating to the commission, or possible commission, of an offence against a law of the Commonwealth, a State, a Territory or a foreign country.

By paragraph (a) of new subsection (2) expenditure for which a deduction will be allowable under subsection (1) will be expenditure incurred by a taxpayer in meeting obligations imposed on the taxpayer by Australian income tax laws. Allowable expenditure will include costs associated with the preparation of an income tax return, in disputing an assessment or determination of the Commissioner of Taxation (e.g., Administrative Appeals Tribunal filing fees), attending to an Tax Office audit and tax planning.

Another example of tax-related expenditure covered by paragraph (a) are costs incurred by a taxpayer, who is seeking an extension of time to pay an outstanding tax debt, for the preparation of financial statements that demonstrate that the taxpayer is unable to pay the debt on time.

For the purposes of new section 69 the income tax affairs of a taxpayer will include matters relating to the determination of the net income of a partnership or trust. Expenditure incurred by a partnership or a trustee for a tax-related matter in connection with determining the net income of the partnership or the trust will be an allowable deduction in the return of income for the partnership or trust.

Income tax affairs also include expenditure incurred in relation to amounts payable under the Principal Act that are ancillary to the collection of income tax, such as PAYE and provisional tax.

The term "income tax" is given an expanded definition in subsection 69(11) (refer to notes on that subsection) to mean tax (however described) imposed by any Commonwealth Act other than the Principal Act and payable under the Principal Act. For the purposes of subsection (2) this will mean that matters relating to amounts payable under the Principal Act that are not payments of income tax - such as withholding tax, interest on overpayments and franking deficit tax - will be part of the income tax affairs of the taxpayer for the purposes of the new section.

Examples of tax-related matters covered by paragraph (b) of new subsection 69(2) are costs incurred by a householder in relation to a prescribed payment made to a builder for work done on the householder's private residence, and costs incurred by a taxpayer in complying with a request by the Commissioner for information the taxpayer holds concerning the income tax affairs of another taxpayer.

New <u>subsection 69(3)</u> provides that, for the purposes of section 69, expenditure that is incurred by a taxpayer in relation to a tax-related matter will not be taken to be expenditure of a capital nature only because the income tax affairs to which the expenditure relates are of a capital nature.

Subsection 69(1) (refer to the earlier notes on that subsection) does not allow a deduction for tax-related expenditure that is of a capital nature. But for proposed subsection 69(3), a taxpayer would not be entitled to a deduction for fees for professional advice concerning the application of the capital gains tax provisions of the Principal Act in relation to an asset held by the taxpayer, or the cost of disputing whether expenditure associated with the establishment of a new business is an allowable deduction.

Existing section 69 allows a taxpayer a deduction for expenditure incurred for the preparation of an income tax return by a registered tax agent, a person exempt from registration as a tax agent or a barrister or solicitor. Any deduction that will be allowable under new section 69 for a fee or commission for professional advice concerning the operation of a law relating to taxation will be limited by the operation of new <u>subsection 69(4)</u> to fees and commissions paid for advice provided by a recognised professional tax adviser.

A "recognised professional tax adviser" is defined in new subsection 69(11) (refer to notes on that subsection) to be a registered tax agent, a person exempt from registration or a barrister or solicitor.

Subsection 69(4) will not operate to deny employers a deduction for payments to employees who provide professional advice to the employer about taxation laws but who are not recognised professional tax advisers.

Amounts paid for professional advice concerning taxation laws other than income tax will not be an allowable deduction under new section 69. However, amounts so incurred are allowable deductions under section 51 of the Principal Act to the extent they are incurred in gaining or producing assessable income or carrying on a business for the purpose of gaining or producing assessable income, and are not of capital or in the nature of capital, private or domestic expenditure. Any amount allowable under section 51 in relation to professional advice is not limited to advice provided by recognised professional tax advisers.

By new subsection 69(5) no deduction is to be allowable under proposed subsection 69(1) for any of the following expenditure:

(a) a payment of tax (as defined in subsection 69(11)) imposed under any Commonwealth Act and payable under the Principal Act. Examples of taxes payable under the Principal Act are income tax, an interest charge imposed by the Taxation (Interest on Underpayments) Act 1986 and payable under section 170AA of the Principal Act and an amount of franking deficit tax imposed by the Income Tax (Franking Deficit) Act 1987 and payable under section 160AQJ of the Principal Act (paragraph (a));

(b) an amount payable under Part VI of the Principal Act - broadly, instalments of tax payable by companies and individuals [illegible] tax (paragraph (b)); or

(c) a financing cost (as defined in new subsection 69(11) - refer to the notes on that subsection) such as interest payments and borrowing costs in respect of a payment of income tax or other amounts covered by paragraphs (a) or (b) of proposed subsection (5) (paragraph (c)).

Subsection 69(5) makes it clear that income tax payments and the cost of borrowing to make such payments are not allowable deductions under new subsection 69(1).

By subsection 69(6) any restriction that is expressly imposed by the Principal Act on the operation of section 51 is also to apply in the same way to new section 69.

Examples of restrictions that apply to section 51 and the way in which they will apply to new section 69 are:

- by subsection 51(3) of the Principal Act an amount payable as a penalty under a law of the Commonwealth, a State, a Territory or a foreign country and an amount payable on conviction for an offence against such a law are not allowable deductions under subsection 51(1). By the operation of proposed subsection 69(6) penalties such as those imposed under Part VII of the Principal Act will not be deductible under new section 69. The restriction on amounts payable on conviction for an offence will also apply to section 69. However, this will have little effect in practice as offence-related expenditure is specifically excluded from deduction under that section;

- the deductibility of entertainment expenses under section 51 is restricted by section 51AE. Subsection 69(6) will ensure that entertainment expenses that would otherwise be fully deductible under section 69, such as meals provided at a tax planning seminar or a business lunch held to discuss tax-related matters, are only deductible to the extent permitted by section 51AE.

New subsection 69(7) provides that where:

(a) a taxpayer dies during a year of income (paragraph (a)); and

(b) the trustee of the deceased taxpayer's estate incurs expenditure on or after 1 July 1989 that would have been an allowable deduction to the taxpayer under subsection 69(1) if incurred in his or her lifetime (paragraph (b)),

the expenditure incurred by the trustee for a tax-related matter in respect of the deceased taxpayer's income tax affairs will be an allowable deduction in the final return of income derived by the deceased taxpayer.

By clause 47 of the Bill (refer notes on that clause) a trustee of the estate of a deceased person who died before 1 July 1989 will be entitled to deduct from the assessable income in the deceased taxpayer's return of income derived up to the date of death, amounts paid after 1 July 1989 in relation to earlier income tax affairs of the deceased taxpayer as though the taxpayer would have been entitled to a deduction.

Subsection 69(8) will ensure that the assessable income of a taxpayer includes any amount allowed or allowable as a deduction under subsection 69(1) that is reimbursed to the taxpayer, paid for the taxpayer by another person or recouped by the taxpayer from another person. The amount will be required to be included in the taxpayer's assessable income for the income year in which it was reimbursed, paid or recouped.

Expenditure incurred by a taxpayer to acquire property for use in the management or administration of the taxpayer's income tax affairs will not be an allowable deduction under new section 69. However, by the operation of new subsection 69(9) any use made of property by a taxpayer on or after 1 July 1989 for a tax-related matter will, for the purpose of the Principal Act, be taken to be for the purpose of gaining or producing assessable income of the taxpayer.

This will have the effect that a taxpayer who uses an item of property (e.g., a computer) in the management or administration of the taxpayer's income tax affairs will be entitled to income tax deductions as if the property was used for the purpose of producing assessable income. Examples of deductions made allowable by this subsection are:

- depreciation of a computer to the extent that the computer is used for a tax-related matter, e.g., to prepare the taxpayer's income tax return;
- depreciation of a building used to accommodate employees of a company who are solely engaged in managing and administering the income tax affairs of the company; and
- borrowing costs associated with the acquisition of an item of property used for a tax-related matter.

Subsection 69(10) effectively restricts the operation of subsection 69(9) so that where, by the operation of subsection (9), income tax deductions are available in relation to property used for a tax-related matter, but another provision in the Principal Act expressly denies deductions in respect of items of property used for that purpose, deductions will not be allowable.

Subsection (11) defines the following terms for the purposes of new section 69:

"financing cost", a term used in subsection (5), means expenditure incurred by a taxpayer in obtaining finance. It would include interest and borrowing expenses. Proposed subsection (5) (refer to the earlier notes on that subsection) has the effect that a deduction is not to be allowable under new section 69 for payments of income tax and costs incurred to finance such payments.

"income tax" means tax, however described, imposed by any Commonwealth Act other than the Principal Act and payable under the Principal Act. This definition makes it clear that subsection (5) (refer earlier notes on that subsection) denies a deduction for any amounts of tax, penalty or other charges payable under the Principal Act. The definition also makes it clear that expenditure relating to these amounts (other than financing costs) is a tax-related matter for the purposes of new section 69 (refer notes on proposed subsection (2)).

"offence-related matter", a term used in subsection (2), means any matter that relates to the commission or possible commission of an offence against any law. A relevant example would be the cost of defending a prosecution for a tax related offence and matters relating to the investigation of such an offence.

"recognised professional tax adviser", a term used in subsection (4), means:

(a) a natural person, a partnership or a company registered as a tax agent under Part VIIA of the Principal Act;

(b) a person exempted from registration as a tax agent by the operation of subsection 251L(2) of the Principal Act; or

(c) a barrister, a solicitor or a barrister and solicitor of a federal court or a court of a State or Territory.

"tax-related matter" has the meaning given to it by subsection (2). This definition directs attention to that subsection (refer to the earlier notes on subsection 2).

Clause 9 : Gifts, pensions etc.

This clause will amend the provisions of the Principal Act that authorise income tax deductions for gifts of the value of $2 and upwards of money - or certain property other than money - made to the funds, authorities and institutions that are listed in the provisions.

The amendment will insert new subparagraph 78(1)(a)(xcv) in the Principal Act which, subject to certain requirements, will authorise deductions for gifts of $2 of more made to a public fund for hostels that provide residential accommodation for school students from rural areas. The term "rural areas" encompasses all areas outside the capital cities and other major population centres. It therefore includes large provincial centres, as well as smaller country towns and communities, and individual family properties.

Before gifts to a public fund will qualify for a deduction certain requirements will need to be met.

The fund must be a public fund established and maintained exclusively to provide money for the acquisition, construction or maintenance of a building. Secondly, the building must also be either already being used, or will be used, solely or principally as residential accommodation for students who usually reside in a rural area. It is also a requirement that the students are undertaking primary or secondary education courses or, if they are children with disabilities, special education programs, at a school or schools in the general vicinity of the residential accommodation (sub-subparagraph 78(1)(a)(xcv)(A)).

Another requirement is that the capital or ongoing costs of the school or schools must to some extent be funded by the Commonwealth, a State or a Territory (sub-subparagraph 78(1)(a)(xcv)(B)).

Finally, sub-subparagraph 78(1)(a)(xcv)(C) requires that the residential accommodation must be made available by the Commonwealth, a State or a Territory, by a public authority or, in certain circumstances, by a non-profit company. Such a company is one that is not carried on for the purposes of profit or gain to its individual members and is, by the terms of its constituent document, prohibited from making any distribution whether in money, property or otherwise, to its members.

A "company" and "constituent document" are both defined in subsection 6(1) of the Principal Act. A company is defined to include all bodies or associations corporate or unincorporated, but not including partnerships. In relation to a company, subsection 6(1) defines constituent document to mean the memorandum and articles of association of the company, or any rules or other document constituting the company or governing its activities. This means that eligible residential accommodation may also be provided by a non-profit unincorporated body or association.

By the operation of subclause 46(3), proposed subparagraph 78(1)(a)(xcv) will apply to gifts made on or after 7 April 1989.

Clauses 10 to 12 : Taxation of life assurance companies

Introductory note

Clauses 10 to 12 will amend Division 8 in Part III of the Principal Act which provides the legislative basis for the taxation of income derived by a life assurance company. The amendments will operate to allow a tax deduction to life assurance companies for expenditure incurred in gaining the investment component of certain life assurance premium income. However, the deduction will not be allowable in respect of premiums received under exempt policies. By subclause 46(4) the amendments made by these clauses apply in relation to expenditure incurred on or after 1 January 1990.

Further, clause 48 contains a transitional formula to calculate the allowable deduction under subsection 113(2) where, for the life assurance company, the year of income in which 1 January 1990 occurs commences prior to that date.

Clause 10 : Interpretation

Clause 10 will amend section 110 of the Principal Act which contains the definitions and other drafting measures adopted in Division 8 of Part III of the Principal Act. Clause 10 proposes to insert the following definitions in subsection 110(1):

"approved form" relates to the actuarial certificate that is required to be obtained under proposed new subsection 111AA(3). Without this certificate, a life assurance company will be ineligible to claim deductions for expenditure incurred in gaining the investment component of certain premiums.

"authorised actuary" is also defined for the purposes of the certificate required under subsection 111AA(3). For a life assurance company registered under the Life Insurance Act 1945 it means the appointed actuary of the company. An appointed actuary is described in subsection 47A(1) of that Act and means a person who has been a Fellow of the Institute of Actuaries of Australia for not less than 5 years, or is a person who the Insurance and Superannuation Commissioner is satisfied has actuarial qualifications and experience that will enable the person to perform the functions of an appointed actuary. For companies not so registered (broadly, State and Territory government insurance offices) an authorised actuary is a Fellow or an Accredited Member of the Institute of Actuaries of Australia.

"investment component" and "risk component" are the terms used to describe the components of a premium received under a life assurance policy. The risk component of a premium is to be calculated using a basis to be specified in regulations and represents the cost of risk under the policy. The proposed regulations will set out the method and basis to be used to determine the risk component. The investment component is defined as the premium remaining after deducting the risk component.

Clause 11 : Deductions to be allowable for expenditure incurred in gaining the investment component of certain premiums

Under the income tax law deductions for expenditure are generally allowable to the extent that the expenditure is incurred in the gaining or producing of assessable income and is not of a capital, private or domestic nature. Under section 111 of the Principal Act, premiums received by a life assurance company in respect of life assurance policies are generally exempt income and this therefore means that related deductions that would otherwise be available to a life assurance company are not allowable.

Proposed section 111AA will allow a life assurance company to treat the investment component of certain life assurance premiums as assessable income for the purposes of determining allowable deductions even though the premiums are in fact exempt income.

Paragraphs (a), (b) and (c) of subsection 111AA(1) clarify the scope of the section and provide that premiums other than superannuation premiums (paragraph (a)), premiums received under exempt policies (paragraph (b)) and specified roll-over amounts (paragraph (c)) will be covered. Superannuation premiums are separately dealt with under section 111A of the Principal Act. Under section 111A, superannuation premiums are treated as assessable income for purposes of determining allowable deductions even though the premiums may be exempt income.

Section 112A of the Principal Act exempts from tax that part of the income derived from assets included in the insurance funds of a life assurance company that is referable to exempt policies. Accordingly, premiums received in respect of exempt policies are excluded from the operation of section 111AA. Specified roll-over amounts (as defined in 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) are included in the assessable income of a life assurance company and therefore are not addressed by section 111AA.

Subsection 111AA(2) provides that in determining deductions allowable to a life assurance company, the investment component of the premiums to which the section applies is to be treated as assessable income.

However, section 111AA will not apply to premiums derived by a life assurance company unless the company obtains an actuarial certificate in the approved form (subsection 111AA(3)). The certificate needs to be obtained before the date of lodgment of the return of income of the life insurance company for the year in which the premiums are derived or within such further period as the Commissioner of Taxation allows. It is envisaged that the actuary will be required to certify the amount of the investment component of premiums to which proposed subsection 111AA(1) applies.

The life assurance company will be required to retain the certificate for 5 years or such other period as described in proposed new section 262A of the Principal Act which is explained further in the notes on clause 42.

Clause 12 : Deductions not allowable for expenditure incurred in gaining certain premium income

This clause will amend existing section 112 of the Principal Act. Currently section 112 denies a deduction for expenditure incurred by a life assurance company exclusively in gaining premiums (other than superannuation premiums) in respect of life assurance policies that are excluded from assessable income by section 111. The amendment proposed by clause 12 will enable a life assurance company to claim a deduction for expenditure incurred exclusively in deriving premiums to which section 111AA applies but not for expenditure incurred exclusively in deriving the risk component of those premiums.

The existing exclusion of superannuation premiums from the scope of the section is achieved through subsection 112(2). New section 112 will retain the exclusion in respect of superannuation premiums (subparagraph (a)(i)) and extend it so that the section will also not apply to expenditure exclusively incurred in gaining the premiums to which new section 111AA applies (subparagraph a(ii)).

New paragraph (b) of section 112 will ensure that a deduction is not allowable for expenditure exclusively incurred in gaining the risk component of premiums to which new section 111AA applies.

Paragraph (b) of the clause removes existing subsection 112(2) the provisions of which are being incorporated in subparagraph a(i) of the amended section 112.

Clause 13 : Self determination of credits by taxpayers

The amendments being made by clauses 13, 14, 15 and 16 of the Bill will insert three new sections - sections 160AIA, 160AIB and 160AJA - in Division 19 of Part III of the Principal Act and make other consequential amendments.

Division 19 contains machinery provisions which govern the procedures for determination by the Commissioner of Taxation of a credit claimed by a taxpayer where tax has been paid in a foreign country on foreign income included in the taxpayer's assessable income.

The existing law, by way of section 160AI of the Principal Act, requires the Commissioner to determine whether a credit claimed by a taxpayer is allowable and, if so, the amount of the credit. The determination of the credit does not form part of an assessment.

The amendment of Division 19, by the insertion of the three new sections, will authorise a taxpayer to self-determine the credit to be allowed. This change in procedure is necessary to facilitate the operation of new Division 1B of Part VI proposed to be inserted in the Principal Act by clause 36 of the Bill. That Division will require certain entities to calculate and pay the tax payable on their taxable income or net income, as the case may be, and will be the basis of a deemed assessment - the assessment will not be made formally by the Commissioner in the traditional manner. As a consequence of this new arrangement, the Commissioner will generally not be in the position to determine the credit allowable to a taxpayer before the tax is payable on income of a year of income. The changes proposed will allow the taxpayer to determine any credit so that it can be taken into account in calculating the tax payable. The changes, however, are not restricted to entities subject to the new Division 1B of Part VI and will apply for all taxpayers.

New <u>section 160AIA</u>, to be inserted by subclause 13(1) of the Bill, authorises a taxpayer, in making a claim for a credit in relation to a year of income, whether the claim is made in a return of income furnished in respect of that year or after the return is furnished, to determine:

(a) whether a credit is allowable (<u>paragraph (a)</u>); and

(b) the amount of the credit (<u>paragraph (b)</u>).

New <u>subsection 160AIB(1)</u> is designed to facilitate "self-determination" of a credit in Division 19 of Part III of the Principal Act by making it clear that the Commissioner may make a determination of credit for the purposes of the Division solely by relying on a claim made by a taxpayer. It will not be necessary for the Commissioner to actively determine the credit.

<u>Subsection 160AIB(2)</u> requires the Commissioner to consider any question raised by a taxpayer that is relevant to the determination of a credit. Where a taxpayer is unsure of the basis of calculation of credit, the taxpayer may bring the concern to the Commissioner's attention so that it receives his consideration.

<u>Subsection 160AIB(3)</u> will ensure that the correctness of a determination of a credit cannot be called into question merely because it was not made by the Commissioner. The effect of the subsection is to deem the making of any determination on the holding or forming of any opinion or judgment by the Commissioner at the time of

considering an objection against a determination to have been made, held or formed when the determination was made.

By subclause 13(2) new sections 160AIA and 160AIB to be inserted in the Principal Act by subclause 13(1) will apply to credits in respect of tax for the 1989-90 and subsequent years of income.

Clause 14 : Deemed determination of credit by Commissioner

Clause 14 of the Bill will insert a new section, section 160AJA, in Division 19 of Part III of the Principal Act.

The broad effect of new section 160AJA is that where a person makes a claim for a credit as a consequence of the payment of foreign tax, in a return of income or at a later time, and specifies the amount of the credit claimed, the Commissioner is to be deemed to have made a determination on that basis at the time the claim was made. The operation of Division 19 will therefore apply equally to a claim for a credit and to the amount of credit, whether determined by the Commissioner or by another person.

By paragraph 160AJA(a) the Commissioner will be deemed to have made, at the time the person claims a credit, a determination that a credit is allowable to the person (subparagraph (a)(i)) and that the amount of the credit is the amount specified in the claim (subparagraph (a)(ii)).

Paragraph 160AJA(b) treats the claim as a notice of the deemed determination and to have been made by the Commissioner. By paragraph 160AJA(c), the deemed notice is also to be taken to have been served on the person at the time when the claim was made.

By subclause 14(2) new section 160AJA to be inserted in the Principal Act by subclause 14(1) will apply to credits in respect of tax for the 1989-90 and subsequent years of income.

Clause 15 : Amendment of determinations

Section 160AK of the Principal Act sets out the power of the Commissioner of Taxation to amend a determination of credit made under Division 19 of Part III of that Act.

Subsection 160AK(1) permits a determination of credit to be amended by the Commissioner at any time, subject to subsections 160AK(2) and (3).

Where a person has made a full and true disclosure of all the facts material to the making of a determination, subsection 160AK(2) precludes the Commissioner from decreasing the amount of a credit after the elapse of three years from the time the determination was made, except for the purpose of correcting an error in calculation or a mistake of fact, or in consequence of a variation in, or a credit or refund of, Australian or foreign tax. If a taxpayer has made a full and true disclosure of all material facts, the Commissioner is not permitted to decrease the amount of a credit after three years has elapsed because of an error of law made in the original determination.

Under subsection 160AK(3) an amendment of a determination increasing the amount of a credit is permitted after three years from the making of a determination only if the amendment is for the purpose of correcting an error in calculation or a mistake of fact or in consequence of an alteration, credit or refund of Australian or foreign tax. The provision corresponds in principle with subsection 160AK(2) relating to amendments decreasing the amount of credits.

As part of the move to a system of full "self-assessment" for certain entities, including self-determination of credit (refer to the earlier notes on clauses 13 and 14), consequential changes are proposed to section 170 of the Principal Act to modify the time period in which the Commissioner may amend assessments (see later notes on clause 31). Broadly, corresponding changes are also proposed to subsections 160AK(2) and (3) of the Principal Act relating to amendment of credit determinations.

Subclause 15(1) of the Bill will omit subsections 160AK(2) and (3) of the Principal Act and substitute a new subsection 160AK(2). By this new subsection 160AK(2), an amendment of a determination made under Division 19 of Part III is not to be made after the end of four years from the original determination date (a term defined in existing subsection 160AK(6)), except to correct an error in calculation or a mistake of fact or in consequence of a variation in, or a credit or refund of, Australian or foreign tax.

The overall effect is to authorise the Commissioner, for any reason, to amend determinations to decrease or increase an amount of credit within four years of the date of the original determination.

Before the amendment the Commissioner had power to amend a determination to decrease an amount of credit at any time where there had not been a full and true disclosure of all the material facts necessary for the making of the determination. In the situation where a person is to be able to determine the credit allowable the concept of the person making a full and true disclosure is no longer relevant.

By subclause 15(2) the amendments made by subclause (1) apply to determinations of credits in respect of tax for the 1989-90 and subsequent years of income.

Clause 16 : Information for credit to be furnished within 4 years

Subclause 16(1) will amend section 160AM of the Principal Act as a consequence of the modification of the time period for amendment of a determination of credit proposed to be made to section 160AK of the Principal Act by clause 15 of the Bill (see above notes).

By this change, a person claiming a credit for foreign tax paid will now have four years, in lieu of three years, from the date when the Australian tax became due and payable to furnish the relevant information to the Commissioner. The existing provision which allows the Commissioner to grant an extension for up to three more years in special circumstances is retained.

By subclause 16(2) the amendment made by subclause (1) applies to determinations of credits in respect of tax for the 1989-90 and subsequent years of income.

Clause 17 : Interpretation

Introductory Note

Subclauses 17(1) and 18-26 make certain changes to Part IIIAA of the Principal Act relating to the operation of the imputation system for company dividends.

The imputation system operates to impute or allocate Australian income tax paid at the company level as a credit to resident individual shareholders who are assessed on the total amount of the dividend and the imputation credit, and are entitled to a rebate of tax equal to the imputation credit. A dividend with an imputation credit attached is known as a "franked" dividend and the extent to which it is "franked" as the "franked amount" of the dividends.

The extent to which dividends are franked is determined by the amount of company tax paid or payable by the company paying them, and the amount of dividends that company receives which are franked by the payment of company tax by another company.

Broadly, the rule is that a company is required to frank dividends it pays to the extent allowed by the surplus balance of its franking account at the time of payment. The franking account balance, which could be in surplus or deficit at any time, is calculated on an ongoing basis by deducting from the franking credits at any time, its franking debits at that time.

Because the franking account is maintained, in effect, by reference to the amount of "taxed income" available for distribution as franked dividends, entries in the account arising from the payment or refund of tax, offsets of franking deficit tax and foreign tax credits are made by correcting the relevant tax amounts to their "taxed income" equivalent. The rules for this purpose now make provision, amongst other things, for credits arising from the payment of company tax instalments and the receipt of a company tax assessment, and a debit from the offset of instalments on assessment.

Amendments are necessary to certain provisions in Part IIIAA dealing with franking credits and debits, as a consequence of the inclusion of new Division 1B in Part VI of the Principal Act, by clause 36 of this Bill. New Division 1B gives effect to a new tax collection system for companies and trustees of certain funds under which such entities will be required to make an initial payment of tax and/or a final payment of their liability .

The amendments explained below will adjust the imputation system to take account of the new method for making payments of tax by providing for :

(a) the calculation of the franking credit when an initial instalment of tax, or a further payment, is made;

(b) the calculation of the franking debit when a refund of the whole or part of an initial payment is made or the payment is applied against the liability for the year.

An amendment is also to be made to relieve a company from the whole or part of any franking deficit tax liability where it makes an initial payment of tax under new Division 1B on the basis of its own estimate of liability for the relevant year of income.

Subclause 17(1) will amend the definition of "frankable dividend" in section 160APA of the Principal Act. This term defines the dividends that are able to be franked with imputation credits. The definition effects a number of exclusions from the classes of dividends that may be franked and this clause proposes an addition to those exclusions.

Paragraphs (a) and (b) of subclause 17(1) will facilitate the addition of a new paragraph to the definition of frankable dividends by amending the format of the definition. Paragraph 17(1)(c) proposes the addition of paragraph (f) to the definition of frankable dividend.

Under proposed paragraph (f) a dividend that is a debt dividend for the purposes of section 46D of the Principal Act will be excluded from being a frankable dividend. Broadly, under section 46D a debt dividend is a dividend paid on shares used in any financial arrangements where the dividends may reasonably be regarded as equivalent to the payment of interest on a loan. A finance arrangement is any arrangement that has the purpose of enabling a company to obtain finance whether by the issue of shares or otherwise, or to obtain an extension of the period for which finance was obtained under an earlier arrangement.

The exclusion of debt dividends from the definition of frankable dividend will render them ineligible for franking under Part IIIAA of the Principal Act. As a result no franking credits or franking rebates will be attached to such dividends and they will be classed as unfranked dividends. Further, such dividends are subject to dividend withholding tax if paid to non-residents.

A further consequence is that by virtue of section 46D the intercorporate dividend rebate under section 46 will not be available on such dividends. Section 46D operates to deny the intercorporate dividend rebate in respect of the unfranked part of a debt dividend. The exclusion of debt dividends from frankable dividends will mean that all debt dividends will be unfranked.

By subclause 46(5) the amendments by subclause 17(1) will apply to dividends paid on shares issued on or after 16 August 1989 or dividends paid under a finance arrangement entered into on or after that date (see notes on that subclause).

The amendments proposed by subclause 17(2) and by clauses 18-25 to provisions in Part IIIAA of the Principal Act dealing with the imputation system of company tax are necessary as a consequence of the proposed introduction - by clause 36 of the Bill - of a new Division, Division 1B, into Part VI of the Principal Act. Division 1B will deal with new arrangements for the payment of tax by certain entities, including companies and unit trusts that are taxed as companies. These companies and unit trusts (called "relevant entities") will be required to make an instalment payment of tax - called an "initial payment of tax" - in respect of income of a year of income on 15 July (or an equivalent date for entities with a substituted accounting period) following the end of the year of income, with the final balance payable on 15 March. Others will be required to make a single payment of tax on 15 December or 15 March (or equivalent dated where a substituted accounting period operates). The entities will be allowed to make certain other additional payments and, in appropriate cases, to receive a refund of all or a part of an earlier excessive payment. Also, for these entities an assessment will be deemed to have been made at the time when the entity is required to make a final payment of tax (refer later notes on clause 27).

The changes to Part IIIAA will take account of the new basis of paying instalments and final payment of tax in respect of income of a year of income.

Subclause 17(2) proposes to amend paragraph (a) of the definition of the term "applicable general company tax rate" in section 160APA. The term is used in Part IIIAA in connection with the terms "adjusted amount" and "general company tax rate" to specify the company tax rate imposed for a financial year that is used to convert a basic amount of tax to an amount of franking credit or debit.

Subclause 17(2) will insert a new subparagraph - subparagraph (ia) - in paragraph (a) of the definition of "applicable general company tax rate". Subparagraph (ia) will deal with franking credits and debits arising as a result of the payment of an initial payment of tax by a company in respect of a year of income under new section 221AP that is part of proposed new Division 1B of Part VI of the Principal Act (refer to later notes on clause 36 of the Bill). In this context, the reference to a payment by a company may include a payment under Division 1B of Part VI by the trustee of a corporate unit trust or a public trading trust - refer to Division 7A of Part IIIAA of the Principal Act.

The franking credits or debits in relation to an initial payment of tax arise under proposed new sections 160APMA (clause 19) and 160APYA (clause 22) which are discussed in later notes on these clauses.

The applicable general company tax rate that is applied to convert the amount of an initial payment of tax to a franking credit or debit will be the general company tax rate for the year of tax to which the year of income of the entity relates.

New subparagraph (ib) to be inserted in paragraph (a) of the definition of "applicable general company tax rate" will deal with franking credits or debits arising on the making of a further payment of tax, following addition to an initial payment of tax, under proposed new Division 1B of Part VI of the Principal Act. The franking credits in relation to a further payment of tax arise under proposed new section 160APMB (clause 19) which is discussed later.

New subparagraph (ic) to be inserted in paragraph (a) of the definition of "applicable general company tax rate" will deal with franking debits arising on the payment of a refund to a company under proposed new Division 1B of Part VI of the Principal Act. The franking debit arises under section 160APYB (clause 22) which is discussed later.

Clause 18 : Residence requirement for credit to arise in relation to year of income

By section 160APK of the Principal Act, a franking credit of a company does not arise in relation to a payment of a company tax instalment, an assessment of tax, or a foreign tax credit allowable in respect of tax paid or payable, unless the company is "sufficiently resident" in the relevant year of income (as defined in section 160APG).

Clause 18 will amend section 160APK to insert a new paragraph (aa) to ensure that a franking credit will not arise from an initial payment of tax that a company is required to make under proposed section 221AP in respect of a year of income (refer clause 36 of the Bill), or a further payment by the company on account of tax, unless the company satisfies the residency requirement.

Clause 19 : Initial payment of tax

Clause 19 will insert two new sections - sections 160APMA and 160APMB - in Part IIIAA of the Principal Act. New section 160APMA, applicable for a payment under section 221AP in proposed Division 1B of Part VI of the Principal Act (see later notes on clause 36), will mirror existing section 160APM which gives a franking credit equal to the adjusted amount (as defined in existing section 160APA) in relation to a company tax instalment paid under Division 1A of Part VI.

By new section 160APMA, a franking credit will arise on the date on which the initial payment is made. The credit is equal to the adjusted amount (as defined in section 160APA) in relation to a payment in respect of an initial payment of tax that a company (including a trustee of a corporate unit trust or a public trading trust, as is appropriate) is required to make under section 221AP in respect of a year of income.

New section 160APMB deals with the situation where, under proposed new Division 1B of Part VI of the Principal Act, a company (or trustee of a relevant unit trust, as the case requires) makes a further payment on account of tax after it has made an initial payment as required under section 221AP, not being a payment under section 221AZD - the final payment of tax. A franking credit equal to the adjusted amount in relation to the further payment arises on the day the further payment is made.

These franking credits will be reversed on the day on which the assessment in which the payments of tax are credited is deemed to be served, in accordance with proposed new section 166A (refer notes on clauses 22 and 30).

Clause 20 : Notional receipt of company tax assessment

This clause inserts a new section - section 160APNA - in Part IIIAA of the Principal Act. The section will mirror existing section 160APN of the Principal Act which provides for a franking credit to arise on the day of service of an original company tax assessment for a year of income.

New section 160APNA will ensure that a franking credit equal to the adjusted amount (as defined in section 160APA) will arise on the day a company (or trustee of a corporate unit trust or public trading trust, as appropriate) is to be deemed to have been served, under proposed new section 166A (refer notes on clause 30), with a notice of a tax assessment. That is, the day on which the Commissioner of Taxation is deemed, by that section, to have made the assessment.

Clause 21 : Residence requirement for debit to arise in relation to year of income

Section 160APW of the Principal Act, like section 160APK (refer to earlier notes on clause 18) relating to franking credits, is to the effect that a franking debit does not arise in relation to the payment of a company tax instalment, an amended assessment of tax or a foreign tax credit allowable in respect of the tax paid or payable, unless the company is sufficiently resident in the relevant year of income (as defined in section 160APG).

Clause 21 proposes to insert a new paragraph in section 160APW - paragraph (aa) - so that a franking debit will not arise from an initial payment of tax that a company is required to make under section 221AP in respect of a year of income (see later notes on clause 36 of the Bill), or a further payment by the company on account of tax, unless the company is sufficiently resident in the relevant year of income.

Clause 22 : Crediting of initial payment of tax by a company

This clause will insert two new sections - sections 160APYA and 160APYB - in Part IIIAA of the Principal Act.

New section 160APYA will effect a reversal of the franking credits arising under section 160APMA (refer notes on clause 19) for an initial payment of company tax when the payment is applied or refunded on assessment. In this context the initial payment of tax will include further payments of tax made before the company makes the final payment of tax under proposed new section 221AZD. When a company (or a trustee of a corporate unit trust or public trading trust, as appropriate) has made an initial payment of tax in respect of its taxable income of a year of income and tax is payable in respect of that taxable income, section 221AZF (see later notes on clause 36) directs the Commissioner to credit the amount of the initial payment in payment successively of:

(a) any income tax payable in respect of the relevant taxable income;

(b) any franking deficit tax payable under section 160AQJ of the Principal Act; and

(c) any other liability to the Commonwealth arising under an Act administered by the Commissioner.

Section 160APYA establishes a franking debit equal to the adjusted amount (defined in section 160APA) in relation to an initial payment of tax in respect of a year of income on the day on which the payment is credited under section 221AZF in respect of income tax payable to the Commissioner. That is, the day on which the Commissioner is deemed, by section 166A (refer clause 30), to have made an assessment in respect of the year of income of the tax payable in respect of which the payment was made.

New section 160APYB establishes a franking debit equal to the adjusted amount (defined in section 160APA) in relation to any amount of an initial payment of tax that is refunded prior to the income tax being payable in respect of the relevant taxable income. The franking debit arises when the company receives the refund.

Clause 23 : Determination of estimated debit

Section 160AQD of the Principal Act provides the mechanism by which a company (including a unit trust taxed as a company - refer Division 7A of Part IIIA), having a franking surplus which it anticipates will be reduced at some future date other than by the payment of franked dividends, is able to seek a reduction in its franking surplus for the purpose of determining the required franking amount for dividends it proposes to pay.

Subsection 160AQD(1) specifies the circumstances in which a company may apply to the Commissioner for an estimated debit determination.

The amendments proposed by paragraphs 23(a) and (b) will allow a company to apply to the Commissioner for an estimated debit determination where it has paid an initial instalment of tax under section 221AP of the Principal Act. Section 221AP is to be inserted in the Principal Act by clause 36 of the Bill as part of new

Division 1B of Part VI dealing with a new system of collection of tax from companies and trustees of certain funds.

Clause 24 : Liability to franking deficit tax

Under section 160AQJ of the Principal Act a company is liable to pay franking deficit tax if, at the end of a franking year, it has a franking deficit - because it has paid franked dividends to its shareholders in excess of its available franking credits for the year. The franking deficit tax payable under section 160AQJ is available to offset later company tax payable by the company.

Clause 24 will amend section 160AQJ by the insertion of a new subsection 160AQJ(2) so that, where a company makes an initial payment of tax under the new system for paying company tax (as proposed by the measures in clause 36 of the Bill) on the basis of its own estimate of its income tax liability for a year of income, the company will be relieved from payment of all or part of its franking deficit tax liability. This reflects the basis of the present law under which a company that varies its instalments is able to offset its franking deficit tax liability.

To obtain the benefit of subsection 160AQJ(2), a company (including the trustee of a corporate unit trust or public trading trust, as appropriate) must have:

- given a written notice under paragraph 221AQ(1)(a) (refer later notes on clause 36) to make an initial payment of tax on the basis of its estimate of the income tax that will be payable for the relevant year of income, and not on the basis of notional tax for the year of income - (paragraph (a)); and

- made an initial payment of tax under section 221AP - refer also to notes on clause 36 (paragraph (b)).

Where these two conditions are satisfied, a company otherwise liable to pay franking deficit tax under subsection 160AQJ(1) of the Principal Act, in respect of the franking year in which the last day of the company's year of income occurs, is:

- not liable to pay the franking deficit tax if the amount of the tax does not exceed the amount of the initial payment of tax (paragraph (c)); or

- liable for the excess only, where the franking deficit tax exceeds the amount of the initial payment of tax (paragraph (d)).

<u>Clause 25 : Self-determination of offsets by taxpayers</u>

Clause 25 of the Bill will insert two new sections - sections 160AQKA and 160AQKB - in Part IIIAA of the Principal Act.

The two new sections - similar in operation to sections 160AIA and 160AIB, that are to be inserted in the Principal Act by clause 13 of the Bill, to deal with the determination of a foreign tax credit - will authorise a company (or the trustee of a corporate unit trust or public trading trust, as appropriate) to self-determine the franking deficit tax liability to be offset against any company tax liability.

Under the existing law, sections 160AQK to 160AQS provide the relevant offset mechanism and the amount of an offset entitlement is determined by the Commissioner and notified to the company in writing.

New <u>section 160AQKA</u> will authorise a company, in making a claim for franking deficit tax offset, to determine:

- whether an offset is allowable (<u>paragraph (a)</u>; and
- the amount of the offset (<u>paragraph (b)</u>).

New <u>subsection 160AQKB(1)</u>, will make it clear that the Commissioner may make a determination of an offset solely by relying on a claim made by a company.

<u>Subsection 160AQKB(2)</u> requires the Commissioner to consider any question raised by a company that is relevant to the determination of the offset. Where a company is unsure of the basis of determining an offset, it may bring the concern to the Commissioner's attention so that it receives his consideration.

<u>Subsection 160AQKB(3)</u> will ensure that the correctness of a determination of a claim for an offset cannot be called into question because it was not made by the Commissioner. The effect of the subsection is to deem the exercise of any determination, opinion or judgment by the Commissioner at the time of considering an objection against the determination of the offset to have been made, held or formed when the determination was made.

By subclause 25(2) of the Bill the new sections 160AQKA and 160AQKB will apply to an offset determination company tax for the franking year ending 30 June 1990 and in respect of all subsequent franking years.

Clause 26 : Residence requirement for credit or debit to arise

Existing subsection 160ARDD(2) of the Principal Act stipulates that a franking credit or debit of a corporate trust estate (as defined in section 160APA) does not arise in respect of certain payments or occurrences unless the trust estate is a current corporate trust (also defined in section 160APA) in relation to the relevant year of income.

By clause 26, paragraph 160ARDD(2)(a) will be amended to include a reference to an initial payment of tax made under section 221AP of the Principal Act. Section 221AP is to be inserted in the Principal Act by clause 36 of this Bill as part of Division 1B of Part VI dealing with a new system of collection of tax from companies and trustees of certain funds - see later notes on that clause.

Clause 27 : Company to keep records

The amendment of paragraph 160ASC(d) of the Principal Act to be made by this clause is of a drafting nature consequential on the amendment of section 262A of that Act proposed by clause 42 of this Bill - see the notes on that clause.

Clause 28: Cost base etc.

Costs incidental to the acquisition or disposal of an asset may be eligible to be included in the cost base, reduced cost base or indexed cost of the asset base for the purposes of determining a taxpayer's capital gain or loss in relation to the asset under Part IIIA of the Principal Act.

The incidental acquisition and disposal costs that may be included in the relevant cost base of the asset are set out in subsections 160ZH(5) and (7) of the Principal Act. Fees, commission or remuneration for professional services incurred in connection with the acquisition or disposal of an asset are eligible to be included in each of the bases except fees, commissions or remuneration paid for professional advice concerning the operation of the Principal Act or any other law relating to taxation.

Clause 28 will amend subsections 160ZH(5) and (7) of the Principal Act so that the only fees and commissions for professional advice that are to be specifically excluded from the cost base, reduced cost base or indexed cost base of an asset will be those paid for professional advice concerning the operation of the Principal Act given by a person who is not a recognised professional tax adviser within the meaning of proposed section 69 (refer to the earlier notes on clause 8).

This amendment will ensure that amounts paid to a recognised professional tax adviser for advice concerning the operation of the Principal Act, that are incidental to the acquisition or disposal of an asset and are not deductible under proposed new section 69 will be eligible to be included in the relevant cost base of the asset.

Amounts paid for professional advice concerning the impact of tax laws other than income tax on the acquisition or disposal of an asset will also be eligible to be included in the cost bases under this amendment. Professional advice about taxes other than income tax will not be restricted to advice given by a recognised professional tax adviser.

This will bring the treatment of professional advice in calculating capital gains and losses into line with the treatment of professional advice in calculating deductions allowable under section 51 and proposed section 69 of the Principal Act.

Subsections 160ZH(6) and (8) of the Principal Act will continue to prevent costs that have been allowed or that are allowable as a deduction to the taxpayer in any year of income from being included in the cost base, reduced cost base or the indexed cost base of an asset. Deductions allowable for taxation advice in relation to a capital gains tax matter under subsection 69(1) will be excluded from the relevant cost base.

Clause 29 : Annual returns

Clause 29 will amend section 161 of the Principal Act by omitting subsection (1) and inserting a new subsection which, while not changing the substance of the existing provision will express its requirements more clearly.

By new subsection 161(1) every person, if required to do so by the Commissioner, must furnish a return of income within the time specified by the Commissioner or within such further time as the Commissioner allows. The return must be furnished in the required form, and in the manner prescribed in the regulations. Also, the return must be signed by the person and contain the information required in relation to the income and profits or gains of a capital nature derived during the relevant year of income, and any deductions or losses of a capital nature.

New subsection 161(1A) effectively re-enacts the existing rule whereby the Commissioner may exempt from furnishing a return of income, classes of persons, who are not liable to pay income tax.

The new subsections 161(1) and (1A) will apply in respect of the 1989-90 and all subsequent income years.

Clause 30 : Deemed assessment

Introductory Note

The present system

The basic operation of the present income tax law requires the Commissioner of Taxation, from returns lodged and from any other information in the Commissioner's possession, to make an assessment of the amount of the taxable income of any taxpayer, and of the tax payable thereon. When this process is complete a notice of assessment is served on the taxpayer.

This fundamental approach was retained under the self-assessment system that commenced in relation to 1986 returns of income. Under this system, returns are not generally subject to technical scrutiny before an assessment is made - the main emphasis is on post-assessment checking. To this end, section 169A of the Principal Act authorises the Commissioner to accept, either in whole or in part, a statement in the return of the assessable income derived by the taxpayer and of any deductions or rebates claimed, and any other statement in the return relevant to the assessment.

Many provisions of the Principal Act give the Commissioner a discretion whether to apply a particular provision or not. Section 169A specifies that, in determining whether an assessment is correct, any determination, opinion or judgment of the Commissioner made or formed in connection with the consideration of an objection against the assessment is deemed to have been made or formed when the assessment was made. This provision preserves the Commissioner's right to exercise his discretionary powers.

The new system

The full self-assessment arrangements announced in the 1989-90 Budget will not alter this fundamental approach of accepting a taxpayer's calculations for the purpose of issuing an assessment and having the main emphasis on post-assessment checking. What will change, however, is that the Commissioner will not issue any formal notice of assessment to companies and funds (defined as relevant entities in new Subdivision 1B of Part VI - refer clause 36) after lodgment of the return of income which will be due on nominated dates. Instead the company or fund will be required to furnish a return showing its taxable income and the tax payable thereon but generally fewer details will be required than in the past. In consequence of this, the entity will be required to retain the papers supporting the calculations.

The assessment arrangements for companies and funds will be similar to those applying now for fringe benefits tax and franking deficits tax. That is, an assessment will be deemed to have been made on the date on which the final payment of tax liability is due (generally 15 December or 15 March) unless the return is lodged late, in which case the assessment will be deemed to have been made on the date of lodgment. Where a return is lodged late, the company or fund will be liable, as is now the case, for additional tax for failure to furnish a return.

The Bill therefore proposes only limited changes to the present law to give effect to the move to full self-assessment for companies and funds. All existing rights of a taxpayer relating to an assessment will continue to apply. This includes the right of a company or fund to object against its own calculation where it wishes to challenge a view of the Commissioner which it has neverthless adopted for prudence in self-assessing its own tax.

As it can under the existing law, a company or fund will be able to seek an opinion from the Commissioner on a matter bearing on its liability.

Clause 36 of the Bill will introduce into Part VI of the Principal Act a new Division - Division 1B - dealing with the collection of tax on companies and trustees of certain funds - refer to later notes on that clause. Affected companies or funds (called "relevant entities") will be required to self-assess their income tax liability. That will require such bodies to make their own calculation of the taxable income or net income, as the case may be, and of the tax payable, and to remit the tax payable with the return of income to the Commissioner. The lodgment of the relevant return will result in the Commissioner having deemed to have assessed the entity's income tax liability. This will be achieved by clause 30 of the Bill which will insert a new section - section 166A - in Part IV of the Principal Act.

By <u>section 166A</u>, where a taxpayer that is a relevant entity within the meaning of proposed Division 1B of Part VI furnishes a return in respect of income of a year of income to which the new Division applies:

- the Commissioner will be deemed to have made an assessment of the taxable income or net income, as the case may be, and of the tax payable thereon - both amounts being as specified on the return. The assessment will be deemed to have been made on the date by which the entity is required to make the final payment of tax under section 221AZD (i.e., 15 December or 15 March - or the equivalent dates for entities with a substituted accounting period) where the return of income is lodged on or before that date (<u>subparagraph (a)(i)</u>). If the return is furnished after the final payment date, the assessment will be deemed to have been made on the date the return is furnished (subparagraph (a)(ii));

- the return will be deemed to be a notice of the deemed assessment, under the hand of the Commissioner, on and after the day on which the Commissioner is deemed to have made the assessment (paragraph (b)); and

- the notice of the deemed assessment is to be taken to have been served on the day on which the Commissioner is deemed to have made the assessment (paragraph (c)).

Clause 31 : Amendment of assessments

Section 170 of the Principal Act sets out limitations on the power of the Commissioner of Taxation to amend an assessment. Where a taxpayer has not made a full and true disclosure of all material facts necessary for a correct assessment and there is an avoidance of tax, subsection 170(2) provides that an amended assessment to increase the liability of the taxpayer may be made at any time in a case of fraud or evasion and, in any other case, within 6 years from when tax became due and payable under the assessment.

In the situation where a full and true disclosure of all material facts has been made, the Commissioner is authorised - by existing subsection 170(3) - to amend an assessment increasing the liability within 3 years from when tax became due and payable under the assessment. The same 3 year time period applies for amendments reducing liability.

In tandem with the new system of collecting tax for companies, unit trusts assessed as companies, approved deposit funds, superannuation funds and pooled superannuation trusts under proposed Division 1B of Part VI (refer notes on clause 36), it is also intended that those entities will move to a system of full "self-assessment" under which an assessment will be deemed to be made, broadly, when a return of income is lodged. The entities will not be required in practice to disclose the details of their assessable income and allowable deductions in the return - they will be required to disclose much less information than in the past. However, taxpayers affected will still be required to retain all information relevant to the determination of their taxable income and furnish this information to the Commissioner if called on to do so (see later notes on clause 42 relating to amendments proposed to be made to section 262A of the Principal Act).

Reflecting these changes, and the fact that under the existing system of self-assessment taxpayers' returns are not generally subject to technical scrutiny on lodgment, it is no longer appropriate to retain in section 170 the concept of a taxpayer making a full and true disclosure in a return.

Clause 31 will therefore amend section 170, in relation to all taxpayers so that, apart from cases of fraud and evasion and other specific provisions (where the Commissioner will continue to be empowered to amend an assessment at any time), the time period for the Commissioner to amend an assessment where there has been an avoidance of tax will be reduced from 6 years to 4 years. However, the Commissioner will be authorised to apply to the Federal Court of Australia to have this 4 year period referred to in paragraph (a) extended, or to seek the agreement of the relevant taxpayer to an extension in certain circumstances.

Paragraph (a) of subclause 31(1) omits subsections 170(2), (3) and (4) of the Principal Act and substitutes new subsections.

New <u>subsection 170(2)</u> allows the Commissioner to amend an assessment where there has been an avoidance of tax.

By <u>paragraph 170(2)(a)</u> the Commissioner is authorised to amend an assessment at any time where the avoidance of tax is, in the opinion of the Commissioner, due to fraud or evasion. This does not change the existing law with respect to fraud or evasion.

<u>Paragraph 170(2)(b)</u> applies to any case where paragraph (a) does not apply; that is, where the Commissioner is not of the opinion that there has been fraud or evasion.

<u>Subparagraph 170(2)(b)(i)</u> applies specifically to taxpayers who fall within the definition of 'relevant entity' as defined in Division 1B of Part VI of the Principal Act - refer to the later notes on new section 221AK to be inserted in the Principal Act by clause 36. Where an assessment of a relevant entity is deemed by section 166A of the Principal Act to have been made, the Commissioner may amend the assessment within 4 years from the date upon which the assessment is deemed to have been made. Section 166A is being inserted in the Principal Act by clause 30 of the Bill.

<u>Subparagraph 170(2)(b)(ii)</u> applies to all taxpayers other than relevant entities and authorises the Commissioner to amend an assessment within 4 years from the date upon which the tax became due and payable under the assessment.

Subsection 170(3) extends from 3 years to 4 years the period within which an amendment effecting a reduction in the liability of a taxpayer under an assessment can be made.

By paragraph 170(3)(a), where the taxpayer is a 'relevant entity' as defined in Division 1B of Part VI of the Principal Act (refer clause 36), the 4 year amendment period for credit amendments commences on the date upon which an assessment is deemed by section 166A of the Principal Act (refer clause 30) to have been made.

By paragraph 170(3)(b), for any other case, the 4 year amendment period for credit amendments commences on the date upon which tax became due and payable under the assessment.

By subsection 170(4), the Commissioner may apply to the Federal Court of Australia for an order extending the period within which the Commissioner may amend an assessment under proposed new paragraph 170(2)(b), or may request the taxpayer to consent to the extension of the amendment period. The Commissioner's application to the Federal Court or request to the taxpayer, as the case may be, must be made before the end of the original 4 year amendment period, or where the amendment period has previously been extended under proposed new subsections (4A) or (4B), before the end of that extended period.

An extension of the period under paragraph 170(2)(b) for amending an assessment may be sought under subsection (4) where:

- the Commissioner has begun an examination of the affairs of a taxpayer (paragraph (a)); and
- the examination has not been completed within the 4 year period available under paragraph 170(2)(b) within which the Commissioner may amend an assessment to which the examination relates or, alternately, if the amendment period has already been extended by a previous order of the Federal Court (refer subsection (4A)) or by the previous consent of the taxpayer (refer subsection (4B)), within that further extended period (paragraph (b)).

The Federal Court must be satisfied that the reasons for the Commissioner not having completed an examination of the taxpayer's affairs in the period within which the Commissioner may amend the assessment (i.e., 4 years or some previously extended period), warrant an extension or further extension (as the case may be) to the amendment period. Subsection 170(4A) sets out the factors which the Federal Court is to be satisfied exist when considering whether to grant the Commissioner's application.

These factors are that it was not reasonably practicable, or it was inappropriate, for the Commissioner to complete the examination within the period referred to in paragraph (4)(b) because of any action taken by the taxpayer or any failure of the taxpayer to take action that it would have been reasonable for the taxpayer to take. Where the Court is so satisfied, it may make an order extending the period within which the Commissioner may amend the assessment. The extension is for such period as the Court considers appropriate.

Where the Commissioner has asked a taxpayer to consent to an extension of the amendment period, as also allowed for by subsection (4), subsection 170(4B) authorises the taxpayer to consent to such an extension. The consent by the taxpayer is to be in writing and must stipulate the period of the extension.

By paragraph (4C)(a), a reference in subsection (4A) to action taken by a taxpayer includes a reference to the instigation by a taxpayer of a proceeding before a court or tribunal (subparagraph (i)): or to the taxpayer hindering or preventing the Commissioner or an officer authorised by the Commissioner exercising any power under section 263 of the Principal Act (subparagraph (ii)).

By paragraph (4C)(b), a reference in subsection (4A) to a failure by a taxpayer to take action includes a reference to the failure by a taxpayer to provide facilities and assistance under subsection 263(3) of the Principal Act, or to comply with a request by the Commissioner for the taxpayer to provide information, produce documents or attend and give evidence under section 264 of that Act.

Paragraph (b) of subclause 31(1) will amend subsections 170(5), (6), (9) and (9A) of the Principal Act by omitting the number "3" and substituting "4". This will reflect the general change in the amendment period from 3 years to 4 years, and is consequential on the changes made to the former subsections 170(2), (3) and (4) discussed above.

By subclause 31(2), the amendments made by subclause (1) apply to assessments for the 1989-90 and later income years that are made on or after the day on which this Bill receives the Royal Assent.

Clause 32 : Payment of interest by taxpayer where assessment or determination is amended

Clause 32 will amend section 170AA of the Principal Act to insert a new subsection (1A) and make other amendments of a consequential nature.

Section 170AA provides for the payment of interest at a prescribed rate by a taxpayer where there is an increase in tax payable in an amended assessment and the increase does not attract additional penalty tax under the provisions of Part VII of the Principal Act.

By subsection 170AA(1A), a taxpayer will, subject to the remaining provisions of the section, be liable to pay interest on an adjustment under an amended determination reducing a credit, e.g., a foreign tax credit, or a franking deficit tax offset, previously allowed to a taxpayer. The amount (referred to as the "principal amount") in respect of which interest is payable is the amount by which the credit or offset allowable to the taxpayer under the amended determination is less than the amount of the credit or offset allowed to the taxpayer under the determination that was amended.

Paragraphs (b)-(f) of subclause (1) will make a number of consequential drafting changes to section 170AA following the insertion of the new subsection (1A).

By subclause (2) amendments made to the Principal Act by subclause (1) are to apply in respect of amendments of determinations where those amendments are made on or after the date on which the Bill receives Royal Assent.

Clause 33 : Commissioner may collect tax from person owing money to taxpayer

This clause expands the definition of the term "tax" in section 218 of the Principal Act so as to include a reference to amounts due in accordance with new Division 1B of Part VI of the Principal Act to be inserted by clause 36 of the Bill - see later notes on that clause. Division 1B is to apply in respect of tax payable on income of the 1989-90 and subsequent income years.

Under section 218 the Commissioner of Taxation is authorised to collect tax that is owing by a taxpayer from a person who owes money to the taxpayer, or has authority to pay money to the taxpayer.

Clause 34 : Heading to Division 1A of Part VI

By this clause, the heading of Division 1A of Part VI of the Principal Act will be amended to reflect the restriction of the operation of the Division to the collection of tax from companies for the years of income ending before the 1989-90 year.

This change is consequential on the proposed insertion of a new Division 1B dealing with the collection of tax on companies and certain other funds for the 1989-90 and subsequent income years (refer to the following notes on clauses 35 and 36).

Clause 35 : Application

This clause will insert a new section in the Principal Act - section 221AA - which will terminate the application of Division 1A of Part VI - the existing provisions for the collection by instalments of tax on companies in respect of income of the year of income ending on 30 June 1990 and all later years.

Clause 36 : Division 1B - Collection of Tax on Companies and Trustees of certain Funds

Clause 36 will insert a new Division - Division 1B - in Part VI of the Principal Act to replace the present tax collection arrangements for companies. The new system will also operate for collection of tax from superannuation funds and other retirement benefit funds.

The new arrangements are broadly described under the main features section of this memorandum. A brief outline of the structure of new Division 1B is given below in order to assist understanding of the subsequent explanation of each proposed section:-

section 221AK	:	defines terms used in the Division - the companies and funds to which it applies being called "relevant entities" - and contains other drafting aids.
section 221AL	:	sets out rules under which net capital gains are disregarded when making an estimate for the purpose of calculating the base for an initial payment of tax.
section 221AM	:	specifies when income tax becomes due and payable.
section 221AN	:	modifies the dates on which certain payments of tax are due for relevant entities with substituted accounting periods.
section 221AO	:	establishes the liability of a relevant entity to make payments under the new Division.
section 221AP	:	specifies the date by which an initial payment of tax must be made.
section 221AQ	:	establishes two alternative methods of calculating an initial payment of tax.
section 221AR	:	authorises a relevant entity to revise an estimate of actual tax liability.

section 221AS	:	allows the Commissioner to seek details of the basis of an estimate of actual tax liability.
section 221AT	:	sets out the circumstances in which an initial payment of tax is not required - the $1,000 threshold.
section 221AU	:	provides for certain relevant entities to elect to make a single payment instead of an initial and final payment of tax - the $20,000 threshold.
section 221AV	:	authorises the Commissioner to waive or reduce the amount of an initial payment of tax.
section 221AW	:	empowers the Commissioner to vary an estimate of income tax.
section 221AX	:	deals with arrangements to avoid making an initial payment of tax.
section 221AY	:	provides for additional tax where avoidance arrangements are entered into.
section 221AZ	:	ensures the initial payment of tax is appropriately increased where further payments of tax are made.
section 221AZA	:	makes downward adjustments of the initial payment of tax where refunds occur.
section 221AZB	:	sets out the rules to determine the amount of "notional tax" - a term used in the calculation of an initial payment of tax.
section 221AZC	:	modifies the rules for determining notional tax for certain funds with substituted early accounting periods - but only for the year of income ending on 30 June 1990.
section 221AZD	:	specifies the requirements that relevant entities must comply with when paying their final tax liability.
section 221AZE	:	provides for additional tax where an estimate of actual tax liability is incorrect.
section 221AZF	:	specifies the order under which payments made in accordance with the Division are to be credited or applied.

Notes on the proposed provisions of the new Division being inserted by clause 36 follow.

Section 221AK : General interpretative provisions

Section 221AK contains a number of definitions and interpretative provisions to facilitate drafting of the operative clauses of the new Division.

Subsection 221AK(1) defines the following terms, each of which is to have the given meaning unless the contrary intention appears.

"AD/RLA component" obtains its meaning from Division 8 of Part III of the Principal Act. In effect, it is that part of the taxable income of a life assurance company which relates to accident, disability and residual life assurance business. Any net capital gains which relate to this component of taxable income are excluded from the base for calculating the initial payment of tax - see later notes on sections 221AL and 221AZB.

"amount" includes a nil amount when the term is used in relation to an estimate of the income tax that will be payable in respect of taxable income for a year of income by a relevant entity (also a defined term).

"company" is given an extended meaning to include a trustee of a corporate unit trust (a defined term) or of a public trading trust (also a defined term) but does not otherwise include a company in the capacity of trustee. This wider meaning of the term ensures that the new collection system applies to these types of trusts.

"corporate unit trust" has the same meaning as in Division 6B of Part III of the Principal Act. These types of trusts, which are generally formed as part of a company reorganization, are treated as though they are companies for tax purposes.

"CS/RA component" obtains its meaning from Divisions 8 and 8A of Part III of the Principal Act. In effect, it is that part of the taxable income of a life assurance company or a registered organization (also a defined term) which relates to complying superannuation and approved deposit fund policies. Any net capital gains which relate to this component of taxable income are included in the base for calculating the initial payment of tax - see later notes on sections 221AL and 221AZB.

"<u>EIB component</u>" is to have its meaning for the purposes of Division 8A of Part III of the Principal Act. It is that part of the taxable income of a registered organization which relates to accident, disability and life assurance policies. Any net capital gains which relate to this component of taxable income are excluded from the base for calculating the initial payment of tax - see also later notes on sections 221AL and 221AZB.

"<u>initial payment of tax</u>" is to be read in conjunction with sections 221AP and 221AQ. Companies and funds liable to make an initial payment of tax must do so no later than the 15th day of the first month after the end of their year of income equal to 85 per cent of either their notional tax, or their own estimate of actual tax liability for the year of income.

"<u>month</u>" means one of the twelve calendar months of the year.

"<u>NCS component</u>" takes its meaning from Divisions 8 and 8A of Part III of the Principal Act. It is that part of the taxable income of a life assurance company or a registered organization that relates to non-complying superannuation or approved deposit fund policies. Any net capital gains which relate to this component of taxable income are excluded from the base for calculating the initial payment of tax - see later notes on sections 221AL and 221AZB.

"<u>non-fund component</u>" also takes its meaning from Division 8 of Part III of the Principal Act. In effect it is that part of the taxable income of a non-mutual life assurance company that does not relate to assurance business. Any net capital gains which relate to this component of taxable income are excluded from the base for calculating the initial payment of tax - see later notes on sections 221AL and 221AZB.

"<u>public trading trust</u>" has the same meaning as in Division 6C of Part III of the Principal Act. These types of trusts are treated as though they were companies for tax purposes.

"<u>relevant entity</u>" is defined to mean:

- a company (which, as noted earlier, is given an extended meaning in this Division); or

- any person acting in the capacity of a trustee of -

- a complying or non-complying approved deposit fund (ADF) in relation to the year of income;
- a complying or non-complying superannuation fund in relation to the year of income; or
- a pooled superannuation trust in relation to the year of income, being terms that are defined in section 267 of the Principal Act (for the purposes of taxing superannuation business) and that, by virtue of subsection (2) (discussed below) are given the same meaning in this Division.

"registered organization" which takes its meaning from Division 8A of Part III of the Principal Act is -

- an association registered as a trade union under any State Act or law of a Territory;
- a friendly society; and
- an association of employees that is an organization within the meaning of the Industrial Relations Act 1988,

being an association or society the income of which would, but for Division 8A be exempt from tax by virtue of paragraph 23(f) or subparagraph 23(g)(i) of the Principal Act, whether or not that income would be exempt from tax by virtue of any other provision of the Act.

"taxable income" is defined to ensure that references in Division 1B to the taxable income of a relevant entity, being a person in the capacity of a trustee of specified trusts and funds, are read as references to the net income or taxable income, as the use may be, and as defined in the Principal Act in relation to the trusts and funds specified.

"year of income to which this Division applies" is a drafting mechanism to specify the application of the new Division, i.e., the year of income ending on 30 June 1990 and later years.

Subsection 221AK(2) extends the application of definitions of terms in section 267 of the Principal Act to this Division subject to subsection 221AK(1). As noted earlier this is a drafting aid which allows terms used in Part IX - "Taxation of Superannuation Business and Related Business" - to be used in this Division.

By subsection 221AK(3) specified sections of the Principal Act that use the terms 'income tax' and 'tax' are to be modified to include tax payable in accordance with new Division 1B. The specified sections are general provisions relating to the collection and recovery of income tax, including provisions authorising the Commissioner to sue for recovery, to collect unpaid amounts from agents, to remit additional tax incurred by reason of late payment, and to grant extensions of time for payment. The general effect of subsection (3) is to give these provisions the same force in relation to initial payments of tax as they have in relation to income tax itself while preserving, for other purposes of the Principal Act, a distinction between initial payments of tax and income tax payable with the assessment.

Subsection 221AK(4) is similar in effect to subsection (3), except that it is concerned not with the collection and recovery of payments, but with the collection and recovery of additional tax payable under proposed section 221AY or section 221AZE, where a relevant entity has obtained a reduction of an initial payment by entering into an avoidance scheme, or on the basis of an estimate of tax which proves to be less than the actual tax payable for the year. The provisions of the law governing extensions of time for payment and penalties for late payment - sections 206 and 207 - would not be applicable in relation to additional tax payable in these circumstances and accordingly are not referred to in subsection (4).

Subsection 221AK(5) makes it clear that the ascertainment of an amount of notional tax (the base figure for calculating the initial payment of tax), or the initial payment itself, is not to be taken to be an assessment. This will ensure that the rights of objection and appeal against assessments will not extend to the liability for the initial payment of tax. After the return form is lodged and an assessment has been deemed to have been made, the liability can be challenged by objection and appeal.

By subsection 221AK(6), the amount of the initial payment of tax is to be rounded to the nearest dollar.

Section 221AL : Net capital gains to be disregarded in making certain calculations

A relevant entity is required to make an initial payment of tax in respect of income of a year of income - generally by 15 July following the end of the year of income. The initial payment is to be an amount equal to 85% of the amount of the entity's notional tax (see later notes on section 221AZB) or, at the option of the entity, 85% of its own estimate of the income tax payable on its taxable income for the income year to which the initial payment relates.

The purpose of new section 221AL is to set down rules for making an estimate where a company's assessable income for the year of income includes a net capital gain within the meaning of Part IIIA of the Principal Act.

By virtue of paragraph (a), a net capital gain is to be excluded from the base for estimating the initial payment of tax for all companies other than life assurance companies or registered organizations. Net capital gains are to be included in the base for calculating the initial payment by complying superannuation funds, complying approved deposit funds and pooled superannuation trusts. Paragraphs (b) and (c) ensure that the superannuation business of life offices and registered organizations are treated in a similar fashion.

In the case of a life assurance company (paragraph (b)), net capital gains are to be included in the base for calculating the initial payment of tax in respect of that component of taxable income that relates to complying superannuation and roll-over business (the CS/RA component) (subparagraph (b)(i)).

Subparagraph (b)(ii) specifically excludes net capital gains from all other possible components of a life office's taxable income for the purpose of establishing the base for calculating the initial payment of tax. Those components are non-complying superannuation business (the NCS component), non-fund business (the non-fund component) and accident/disability and residual life assurance (the AD/RLA component).

Paragraph (c) contains similar provisions for registered organizations such as friendly societies.

Section 221AM : When income tax becomes due and payable

Section 221AM specifies, for the purposes of the Principal Act, when income tax in respect of a relevant entity's taxable income of a year of income becomes due and payable.

By virtue of paragraph 221AM(a), income tax becomes payable on the day by which the entity is required to make a payment under section 221AZD (see later notes on that section) - generally 15 March - provided a return is furnished on or before that date. Where an entity has elected to make a single payment of tax in accordance with section 221AU (see notes on that section) the relevant date will be 15 December. These dates vary for entities using a substituted accounting period - refer to the notes on section 221AN.

Paragraph (b) stipulates that if the entity furnishes a return after the relevant date (15 March or 15 December, or such other date as allowed by section 221AN), income tax becomes due and payable on the date the return is furnished - i.e., the date of the deemed assessment under new section 166A (see earlier notes on clause 30). This has the effect of precluding the operation of section 207 (additional tax for late payment) as the tax is not due and payable until the return is furnished. However, the entity will be liable for additional tax under section 222 for failure to furnish a return.

Section 221AN : Modified application of Division for certain entities with substituted accounting periods

Section 18 of the Principal Act permits a taxpayer, with the leave of the Commissioner, to adopt an accounting period being the 12 months ending on some date other than 30 June in lieu of that date. Section 221AN modifies the application of the new Division 1B in relation to a relevant entity that adopts or has adopted a substituted accounting period in lieu of the year of income ended 30 June.

An entity that has adopted a substituted accounting period can be either an early balancer or a late balancer. An early balancer is an entity whose year of income ends a month or more before the end of the normal year of income. A late balancer is an entity that balances after 30 June in lieu of that date. In practice, entities that balance on and after 1 December, and before 1 June do so in lieu of the following 30 June (early balancers), and those that balance after 30 June and up to 30 November do so in lieu of that preceding 30 June (late balancers).

Early balancers are to be required to pay their initial payment of tax by the 15th day of the first month after the end of the substituted accounting period, and to calculate their own final liability and pay the balance of tax owing by the 15th day of the ninth month following the end of that substituted accounting period. For this purpose, entities that balance on or before 30 December in lieu of the following 30th June are to be treated as if they balanced on 31 December.

Late balancers are also to be required to pay their initial payment of tax by the 15th day of the first month after the end of the substituted accounting period and to calculate their own final liability and pay the balance of tax owing by the 15th day of the ninth month following the end of that period. However, those entities that balance later than 30 September will be required to make their final payment of tax by the following 15 June.

<u>Section 221AN(1)</u> is the operative provision which modifies the application of Division 1B for relevant entities with substituted accounting periods. It also facilitates references to an accounting period ending on a date (in this section called the "substituted date"), having a date other than 30 June (in this section called the "relevant 30 June").

<u>Subsection 221AN(2)</u> has the effect of treating entities with a balance date between 1 June and 29 June as if they balanced on 30 June.

<u>Subsection 221AN(3)</u> sets out the rules relating to relevant entities with substituted accounting periods other than those covered in subsection (2).

By <u>paragraph (a)</u>, relevant entities that balance on or before 30 December next preceding the relevant 30 June will be required to make their initial payment of tax in accordance with section 221AP (see later notes on that section) by 15 January next in lieu of 15 July. Their final payment of tax will be due by 15 September next in lieu of 15 March (see later notes on section 221AZD). If such an entity has elected to make a single payment of tax in accordance with subsection 221AU(1) which is discussed later, the payment will be due on 15 June next in lieu of 15 September.

<u>Paragraph (b)</u> is to the effect that relevant entities that balance early at any time between 31 December and 31 May next preceding the relevant 30 June, will be required to make their initial payment of tax in accordance with section 221AP by the 15th day of the month next following the month after the balance date. Their final payment of tax will be due by the 15th day of the ninth month after the balance date. If an entity in this category has elected to make a single payment of tax in accordance with subsection 221AU(1) the payment will be due by the 15th day of the sixth month after the balance date.

<u>Paragraph (c)</u> deals with late balancers. Entities that balance later than the relevant 30 June will be required to make their initial payment of tax by the 15th of the month next following the month after the balance date. Their final payment of tax will be due by the 15th day of the ninth month after the balance date or the 15th day of June next following that date, whichever is the earlier.

If an entity has elected to make a single payment of tax in accordance with subsection 221AU(1) the payment will be due by the 15th day of the sixth month after the balance date or the 15th day of June next following the relevant 30 June whichever is the earlier date.

Section 221AO : Liability to make payments under this Division

Section 221AO sets out the object of the Division. Put simply, it is to ensure that relevant entities pay their income tax in a timely and expeditious manner in accordance with the Division. The payment arrangements are set out earlier in this memorandum.

Section 221AP : When initial payment is to be made

Section 221AP specifies the date by which a relevant entity must make its initial payment of tax in respect of its taxable income for a year of income. That date is 15 July next following that year of income unless:

- the entity has a substituted accounting period (see earlier notes on section 221AN);
- the entity is not required to make a single payment because that payment would have been based on a tax liability of $1000 or less (see later notes on section 221AT);
- the entity has elected to make a single payment of tax (see later notes on section 221AU); or
- the Commissioner of Taxation has waived the initial payment of tax (see later notes on section 221AV).

Section 221AQ : Amount of initial payment

This section is the operative provision that specifies how the amount of an initial payment of tax will be determined.

By subsection 221AQ(1), the initial payment of tax is to be 85% of a relevant entity's notional tax (defined in section 221AZB which is discussed later) in respect of that year of income, unless the entity has, in a written notice to the Commissioner, specified the estimate of its actual tax liability in respect of its taxable income of the year of income. In that case, the initial payment will be 85% of the amount estimated by the entity to be the income tax that will be payable.

Subsection 221AQ(2) stipulates that the notice given for the above purpose must specify the amount estimated by the entity as its actual tax liability for the year of income in question. If the entity estimates that no income tax will be payable, the notice must state that fact (because "amount" includes a nil amount - see earlier notes on section 221AK). The notice is irrevocable.

A relevant entity that has made an initial payment of tax based on its notional tax will be permitted to later make an estimate of the income tax that will be payable in respect of its taxable income of that year of income. In these circumstances, subsection 221AQ(3) requires the Commissioner to refund to the entity, as soon as practicable, the difference between the amount already paid and 85% of the estimated tax.

Section 221AR : Power of relevant entity to revise estimate in certain circumstances

Section 221AR permits a relevant entity that make an initial payment based on its own estimate, rather than its notional tax, to make a further estimate and receive a refund. The section applies only to a relevant entity which gave a notice to the Commissioner under subsection 221AQ(1) estimating its actual tax liability, at the time of the initial payment. An entity which made its initial payment based on its notional tax, and then gave a notice under subsection 221AQ(1), is precluded from making a revised estimate under this section but may achieve the same result by making an estimate in accordance with subsection 221AQ(3) which is discussed above.

Subsection 221AR(1) allows the entity to give to the Commissioner, before the date by which it is required to make a final payment, a written notice of its revised estimate of the amount of income tax that will be payable in respect of its taxable income of that year of income.

By subsection 221AR(2) an entity is allowed to make only one revised estimate in respect of each year of income.

The Commissioner has the power to vary estimates of income tax that are inaccurate or involve arrangements to avoid the initial payment - see later notes on sections 221AW and 221AX. Subsections 221AR(3) and (4) ensure that where the Commissioner has varied an estimate in accordance with section 221AW or section 221AX, an entity is not entitled to make a revised estimate of its income tax that would be less than the amount determined by the Commissioner.

Subsection 221AR(5) requires an entity to pay to the Commissioner, at the time of giving notice of a higher revised estimate, an amount equal to 85% of the difference between the revised and original estimates. Conversely, subsection 221AR(6) requires the Commissioner to refund, as soon as practicable, an amount equal to 85% of the difference where an entity has made a revised estimate that is less than the original estimate.

A relevant entity that has underestimated its actual tax payable will have the opportunity to make a further payment or payments of tax and to have such payments taken into account in any calculation of additional tax for an incorrect estimate (see later notes on section 221AZE). Subsection 221AR(7) makes it clear that nothing in this section prevents an entity that has made an initial payment of tax, from making further payments on account of its tax provided they are made before the day on which the entity is required to make its final payment of tax in accordance with section 221AZD - generally 15 March (see the notes on that section).

Section 221AS : Statement as to basis of estimate

A relevant entity that opts to make its initial payment on the basis of its own estimate of tax payable, will generally not be required to explain how it arrived at that estimate. However, as an anti-avoidance measure, the Commissioner is to be given the power to require an entity to validate the estimate if the Commissioner specifically requests the entity to do so.

To this end, section 221AS authorises the Commissioner to serve a written notice on an entity that has made an estimate or revised estimate of the income tax that will be payable in respect of its taxable income of a year of income. The notice will require the entity, within the period specified in the notice, to give to the Commissioner a written statement showing the basis on which the estimate or revised estimate was calculated. It shall contain such information and explanations that relate to the collection of tax under this Division as are specified without limiting the information and explanations that may be required. The matters referred to in sub-subparagraphs 221AX(4)(b)(ii) (A) to (H) inclusive for the purpose of determining whether there is an arrangement to obtain an initial payment benefit (see later notes on that sub-subparagraph) may be specified.

A penalty of up to $3,000 will apply for contravention of this provision.

Section 221AT : Circumstances in which initial payment not required

By virtue of section 221AT certain relevant entities will not be required to make an initial payment of tax in respect of their total tax liability. Full payment will instead be due at the time the final payment would otherwise be due - generally 15 March.

Entities that will not be required to make an initial payment of tax are those:-

- that have no notional tax (i.e., new entities and those previously non-taxable);
- with a notional tax of less than $1,000; and
- which specify, in a written notice to the Commissioner under subsection 221AQ, that the estimated actual liability for the income year is less than $1,000.

Subsection 221AT(1) contains a formula for determining whether an entity having a tax liability is eligible to make only one final payment of its total tax. The formula is expressed as:

$$\frac{100 \times \text{otherwise required initial payment}}{85}$$

Where an amount ascertained in accordance with this formula is less than $1,000, an initial payment of tax is not required - unless the Commissioner determines otherwise in relation to the entity or a specified class of entities in which the entity is included.

The formula term "otherwise required initial payment" is defined by subsection (3) - refer to the notes below.

Subsection 221AT(2) permits the Commissioner, by notice published in the Gazette, to determine a threshold amount other than $1,000 to be the minimum amount.

Subsection 221AT(3) defines the term "otherwise required initial payment" to mean the amount that would otherwise have been the initial payment of tax (refer section 221AQ) of the entity in respect of its taxable income of the year, but for the operation of this section. In practice, this amount is 85% of the notional tax on the entity's estimate of its actual tax.

Section 221AU : Election to make single payment

Section 221AU allows a relevant entity whose notional tax, or whose estimate of actual liability for the year, is $1,000 or more and less than $20,000, to elect to pay the total liability on the 15th day of the sixth month after the end of the year of income - generally 15 December. As explained earlier, the relevant date for entities using a substituted accounting period is determined by section 221AN.

Subsection 221AU(1) contains a formula for determining whether an entity is able to elect to pay its total liability in a single payment by 15 December. The formula is expressed as:

$$\frac{100 \times \text{otherwise required initial payment}}{85}$$

Where an amount ascertained in accordance with this formula is not less than $1,000 (or such other minimum amount determined by the Commissioner - see notes on section 221AT) but is less than $20,000, the entity may by notice in writing to the Commissioner elect that this section is to apply in respect of that year of income (unless the Commissioner determines otherwise in relation to the entity or a specified class of entities in which the entity is included).

The term "otherwise required initial payment" is defined by subsection (5) - refer notes below.

Under subsection 221AU(2) an entity that makes an election under subsection (1):

- is not required to make an initial payment of tax in respect of its taxable income of a year of income (paragraph (a)); but

- it must comply with the requirements of section 221AZD by 15 December instead of the following 15 March (subject to the operation of section 221AN for entities with substituted accounting periods) to lodge a return specifying the amount of taxable income and to pay the amount of tax due (paragraph (b)).

By subsection 221AU(3) an election made under subsection (1) is irrevocable.

Subsection 221AU(4) covers the situation where a relevant entity has made an initial payment of tax, and then makes an election under subsection (1) to make only a single final payment of total tax. In this case the Commissioner will, as soon as practicable, refund to the entity the amount of the initial payment made.

Subsection 221AU(5) defines the term "otherwise required initial payment" to mean the amount that would otherwise have been the initial payment of tax (refer section 221AQ) of the entity in respect of its taxable income of the year, but for the operation of this section. In practice, the amount is 85% of the notional tax or the entity's estimate of actual tax.

Section 221AV : Power of Commissioner to reduce amount of initial payment or waive initial payment

The purpose of section 221AV is to authorise the Commissioner of Taxation to reduce or waive an initial payment of tax where it would be appropriate to do so.

Subsection 221AV(1) will allow the Commissioner to determine, having regard to the purpose for which Division 1B is enacted (as expressed in section 221AO), and to the existence of particular circumstances in relation to a relevant entity, that an initial payment of tax otherwise payable by an entity should be reduced, or that the initial payment should not be payable by the entity.

Apart from the circumstances specifically mentioned in subsection (2), the voluntary prepayment of an amount in excess of the amount that an entity would be liable to make as an initial payment of tax, or the cessation of an entity's business before the commencement of the year of income in respect of which an initial payment is due for payment, could be reasons for the exercise of the Commissioner's powers under this section.

Subsection 221AV(2) specifies particular circumstances to which regard may be had for the purpose of applying subsection (1). These include the operation of specified provisions of the Principal Act relating to:

- subsection 98A(2) (deductions from tax assessed against a non-resident beneficiary on account of tax assessed to a trustee);

- Division 18 of Part III and the Income Tax (International Agreements) Act 1953 (entitlements to foreign tax credits);

- section 160AQK (entitlement to offsets for franking deficit tax); or

- Division 3A of Part VI (credits for prescribed payment deductions).

Subsection 221AV(3) stipulates that where the Commissioner makes a determination under subsection (1), the Commissioner must have served on the relevant entity a written notice setting out the amount of the reduction, or where the determination is to the effect that an initial payment of tax is not required, that fact.

Subsection 221AV(4) will ensure that the Commissioner refunds to the entity, as soon as practicable, the excess or the amount of the payment, as appropriate, where the entity has made an initial payment of tax in respect of its taxable income of a year of income and a determination has been made under subsection (1).

Section 221AW : Power of Commissioner to vary estimate of income tax

This section authorises the Commissioner to vary a relevant entity's estimate of the amount of income tax that will be payable by the entity for a year of income (refer to the earlier notes on section 221AQ) where the Commissioner believes that the estimate is not accurate. It should be noted that once the Commissioner has determined an amount under this section, the entity is precluded from making a revised estimate in terms of section 221AR that would be less than the amount determined by the Commissioner (see previous notes on subsection 221AR(3)).

Subsection 221AW(1) gives the Commissioner the power to substitute his own estimate - in place of an entity's estimate or revised estimate - of the income tax that will become payable by the entity in respect of its taxable income of that year of income. The entity must have given a notice under paragraph 221AQ(1)(a) in respect of the year of income and the Commissioner must have reason to believe that the tax that will become payable will be greater or less than the amount of the estimate or revised estimate.

By the operation of subsection 221AW(2), a determination under subsection (1) which increases an entity's initial payment of tax is of no effect if it exceeds 85% of the entity's notional tax in respect of the year of income. This provision means that a relevant entity cannot be required to pay more than 85% of its notional tax as an initial payment of tax, although it may choose to do so.

Subsection 221AW(3) specifies that a written notice must be served on a relevant entity where the Commissioner makes a determination under subsection (1). The notice must specify:

- the amount that is to be substituted for the amount of the entity's estimate or revised estimate of the income tax that will be payable in respect of the taxable income of the year of income, and the basis on which the determination was made (paragraph (a)); and

- the date on which the determination takes effect - which must not be less than 30 days after the date of service of the notice (paragraph (b)).

By subsection 221AW(4), any additional amount payable by reason of the determination which increases the initial payment of tax is payable not later than the date on which the determination takes effect - generally 30 days after service of the notice.

Subsection 221AW(5) deals with the situation where a relevant entity has made an initial payment of tax, a determination has been made under subsection (1), and either the amount of the payment exceeds the amount the entity was required to pay, or the entity is not required to make a payment. In these circumstances the Commissioner is to refund to the entity the excess or the amount of the payment, as applicable, as soon as practicable.

Section 221AX : Initial payment avoidance arrangements

Section 221AX is designed to overcome arrangements to avoid or reduce the payment of an initial payment of tax under Division 1B. The arrangements would rely on the shifting of income or deductions between a company or fund and another entity and the availability to the company or fund of the right to reduce the initial payment of tax otherwise applicable by estimating its actual tax liability in respect of income of a year of income.

The section will safeguard against an arrangement where, on an objective view of the arrangement and related matters, it would be concluded that it was entered into for the sole or dominant purpose of obtaining a reduction of the initial payment of tax (refer section 221AP) otherwise payable.

Where the Commissioner forms an opinion that an entity has obtained, or would otherwise have obtained, a reduction of its initial payment of tax liability as a consequence of an arrangement (called an "initial payment tax benefit"), the Commissioner will be authorised to determine the amount of the initial payment of tax.

A reference to the obtaining of an initial payment tax benefit in connection with an arrangement in relation to a year of income is, broadly, a reference to the entity's assessable income of the year of income being less than it would otherwise have been because of an amount not being included in that income, or to a deduction being allowed that would not have been allowable, but for the arrangement.

The Commissioner will be required to give the entity a notice in writing stating that the Commissioner has formed that opinion, and indicating the amount of the initial payment tax benefit. The entity will have the usual right of objection and of review or appeal against the Commissioner's decision on the objection. Section 221AY is the corollary to section 221AX and operates to impose additional tax on an entity party to an arrangement referred to in section 221AX, being an entity to which income has been channelled or by which a deduction has been foregone by virtue of the arrangement.

By subsection 221AX(1), the term "arrangement" used in the section is to mean -

- any agreement, arrangement, understanding, promise or undertaking whether the agreement, arrangement, etc. is express or implied and whether or not enforceable by legal proceeding, irrespective of whether it was intended to be so enforceable (paragraph (a)); and

- any scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise (paragraph (b)).

Subsection 221AX(2) recognises that an arrangement may involve a number of parties. Accordingly, a reference to the carrying out of an arrangement by a person is to be taken as including a reference to the carrying out of an arrangement by a person together with others.

Subsection 221AX(3) is relevant to the operation of this section which refers to an arrangement being for the "purpose" of enabling a person to obtain an "initial payment tax benefit" - refer subsection 221AX(10). Where an arrangement is for more than one purpose, it is to be taken to be entered into or carried out for the purpose of enabling a person to obtain an initial payment tax benefit if this is the dominant purpose for which it was entered into or carried out.

By subsection 221AX(4) three conditions must be satisfied before the section can apply. If all are satisfied the amount of initial payment of tax is to be determined by the Commissioner in accordance with subsection (5). The conditions are:

- the entity must have estimated its actual tax liability in accordance with paragraph 221AQ(1)(a) (paragraph (a));

- the Commissioner is of the opinion that the entity has obtained an "initial payment tax benefit" in connection with an arrangement entered into before or after the commencement of this section (subparagraph (b)(i)); and

- having regard to the range of matters specified in the subparagraph, the Commissioner is of the opinion it would be concluded that the person, or one of the persons, who entered into the arrangement did so for the sole or dominant purpose (refer subsection 221AX(3)) of enabling the entity to obtain an "initial payment tax benefit" in connection with the arrangement (subparagraph (b)(ii)).

The range of matters to which the Commissioner is to have regard under sub-subparagraphs (b)(ii) (A) to (H) are:

- the manner in which the arrangement was entered into or carried out;
- its form and substance;
- the time at which the arrangement was entered into and the period during which it was carried out;
- the result that would be achieved under Division 1B of Part VI by the arrangement, but for section 221AX;
- any change in the financial position of the entity resulting from the arrangement;
- any change in the financial position of any person connected with the entity;
- any other consequence for the entity or any connected person resulting from the arrangement;
- the nature of any connection between the entity and any such connected person whose financial position changes as a result of the arrangement.

Where the conditions of subsection (4) are satisfied, subsection 221AX(5) allows the Commissioner to determine either of two matters to apply as a consequence of the arrangement:

- that the amount of the initial payment of tax to be made by the entity in respect of its taxable income in respect of the relevant year of income is to be 85 per cent of the entity's notional tax (paragraph (a)); or
- that the amount of the estimate or revised estimate, as the case requires, made by the entity of the tax payable in respect of its taxable income is taken for the purposes of Division 1B to be increased by the amount of the initial payment tax benefit - refer to later notes on subsection 221AX(11) (paragraph (b)).

By subsection 221AX(6), the Commissioner is required, if a determination is made under subsection (5), to serve a written notice on the entity -

- stating that the Commissioner is of the opinion that the entity has obtained an initial payment tax benefit (paragraph (a));

- specifying the nature and amount of tax benefit (paragraph (b));
- setting out the terms of the determination (paragraph (c)); and
- specifying the date of effect of the determination, which is not to be less than seven days after the date of service of the notice (paragraph (d)).

A determination under subsection (5) is by subsection 221AX(7) to have effect despite the operation of any other provision of Division 1B of Part V1.

Under subsection 221AX(8) any additional amount payable in respect of the initial payment of tax by an entity as a consequence of a determination made by the Commissioner under subsection (5) is due not later than the date the determination takes effect.

By subsection 221AX(9), once a determination under subsection (5) comes into effect, an entity is not entitled to make a revised estimate under section 221AR of its income tax liability in respect of the year of income if:

(a) in the case of a determination under paragraph (5)(a), the revised estimate will result in the initial payment of tax being less than 85% of the entity's notional tax in respect of the year of income (paragraph (a)); or

(b) where, in the case of a determination under paragraph (5)(b) in respect of an estimate under paragraph 221AQ(1)(a), the revised estimate will be less than the entity's estimate under paragraph 221AQ(1)(a), as increased by the determination (paragraph (b)).

Subsection 221AX(10) spells out what is meant by a reference in this section to the obtaining of an initial payment tax benefit in connection with an arrangement. In effect, it is the estimate or revised estimate, under section 221AQ or 221AR, of the income tax that would be payable by an entity in respect of its taxable income of a year of income being less than it would otherwise be because of the matters listed in paragraphs (10)(a) or (b).

Paragraph (a) requires either of two matters to be found to apply as a consequence of the relevant arrangement in respect of an entity that is a company:

- an amount not being included in the company's assessable income of the year of income that, but for the arrangement, would have been included, or might reasonably be expected to be included (subparagraph (i)); or

- a deduction being allowable to the company in relation to that year of income that, but for the arrangement, would not be allowable, or might reasonably be expected not to be allowable (subparagraph (ii)).

Paragraph (b) applies the same tests to an entity that is a trustee of a fund or unit trust (refer paragraph (b) of the definition of 'relevant entity' in subsection 221AK(1)).

Subsection 221AX(11) operates to determine the amount of the initial payment tax benefit obtained by an entity for the purposes of this section. If, apart from section 221AX:

- the entity would be required to make an initial payment of tax - the benefit is to be the amount by which that payment would have been greater (paragraph (a)); or

- the entity would not be required to make an initial payment of tax - the benefit is to be the amount of the initial payment of tax the entity would have been required to make (paragraph (b)),

had the entity not obtained the initial payment tax benefit in relation to the year.

By subsection 221AX(12), subsections (5) to (11) relating to the determination of an initial payment tax benefit in respect of an entity are not to apply, and are to be taken never to have applied, if the Commissioner is satisfied that, as a result of an arrangement referred to in subsection (4):

- the initial payment of tax made by another entity, or entities, has increased (paragraph (a)); and

- the amount of the increase, or sum of the increases, is not less than the amount of the initial payment tax benefit obtained by the first-mentioned entity (paragraph (b)).

As a result, where there has been an arrangement, but a party to that arrangement makes an increased initial payment of tax (for example, by lodgment of a notice under section 221AQ or section 221AR increasing the amount of the estimated taxable income of the entity) offsetting the reduction available to the other party, the section does not have application. In these cases, subsection 221AX(13) requires the Commissioner to withdraw a notice served under subsection (6) (specifying the terms of a determination under subsection (5) in respect of an initial payment tax benefit).

Subsection 221AX(14) operates in conjunction with subsection (13) to ensure that any additional amount paid by an entity in accordance with the section is refunded where the Commissioner becomes satisfied that the requirements of subsection (12) described above are met.

Section 221AY : Additional tax if income or deduction transferred under avoidance scheme

The operation of this section is associated with the operation of section 221AX which is designed to overcome arrangements to avoid or reduce the payment of an amount of an initial payment of tax under Division 1B. Section 221AY is, in effect, the second limb of the anti-avoidance measures, and is directed at the entity which, as a party to an arrangement referred to in subsection 221AX(1) (i.e., one where the Commissioner is of the opinion that another entity has received an initial payment tax benefit):

(a) has had an amount included in its assessable income which but for the arrangement, would not, or might reasonably be expected not, to have been so included (paragraph (a)(i)); or

(b) has not had a deduction allowed which, but for the arrangement would or might reasonably be expected to have been allowable (paragraph (a)(ii)).

It is a further requirement for the section to apply that the entity did not give a notice under paragraph 221AQ(1)(a) (paragraph (b)), and that tax has become due and payable in respect of its taxable income of the relevant year of income (paragraph (c)).

Where the section applies, and for the period specified, additional tax by way of penalty is due and payable on the bases of calculations provided for in subsection 221AY(2), (3) or (4) at the rate of 20 per cent per annum.

By subsection 221AY(5), the Commissioner is authorised to remit the whole or part of any additional tax.

Subsection 221AY(6) ensures that the amount of income tax on which the penalty is calculated is the net amount after specified credits and offsets to which the entity is entitled.

Section 221AZ : Additional payments to form part of initial payment

A relevant entity is required to make an initial payment of tax under section 221AP in respect of its taxable income of the year of income. The purpose of section 221AZ is to make it clear that any additional payments made under certain other specified subsections of the new Division are treated as part of the initial payment. This will ensure that estimates of tax liability (and any penalties for underestimates) are considered on a proper footing.

To this end, section 221AZ specifies that a reference in this Division to an initial payment is, unless the context otherwise requires, to be taken to include additional payments arising from:

- a revised estimate by the entity under subsection 221AR(5);
- a variation of an estimate by the Commissioner in accordance with subsection 221AW(4);
- a variation by the Commissioner of an estimate in accordance with subsection 221AX(8) as a result of initial payment avoidance arrangements; or
- further payments by the entity under subsection 221AR(7) at any time before the final payment of tax is due.

<u>Section 221AZA : Refund to reduce initial payment of tax</u>

As the converse to section 221AZ outlined above, <u>section 221AZA</u> ensures that the amount of an initial payment of an entity is reduced to take account of:

- an estimate by the entity after it has made an initial payment based on 85% of its notional tax (subsection 221AQ(3));
- a revised estimate of the income tax made by the entity (subsection 221AR(6));
- an election by a relevant entity to make a single final payment of tax after it has earlier made an initial payment of tax (subsection 221AU(4));
- a variation by the Commissioner to reduce or waive an initial payment (subsection 221AV(4));
- a variation of an estimate of income tax payable made by the Commissioner (subsection 221AW(5)); or
- a notice by the Commissioner that a variation of an estimate of income tax payable as a result of an initial payment avoidance arrangement has been withdrawn (subsection 221AX(14)).

Section 221AZB : Notional tax

"Notional tax" is a term used to identify the amount by reference to which the amount of an initial payment of tax payable by a relevant entity is determined. Section 221AZB contains the machinery by which the amount of notional tax of a relevant entity is to be determined.

By subsection 221AZB(1), the section has effect, subject to section 221AZC which is a transitional measure that will modify the notional tax for certain entities with substituted early accounting periods in relation to a year of income ending on 30 June 1990 - see later notes on that section.

Subsection 221AZB(2) fixes the amount of notional tax of a relevant entity for a year of income as an amount equal to the income tax assessed in respect of the entity's taxable income of the next preceding year.

Subsection 221AZB(3) modifies the calculation of notional tax for certain entities whose assessable income of the year of income to which the calculation relates included a net capital gain within the meaning of Part IIIA of the Principal Act.

By virtue of paragraph (a), a net capital gain is to be excluded from the base for determining notional tax for all companies other than life assurance companies or registered organisations. Net capital gains are to be included in the base for determining notional tax of complying superannuation funds, complying approved deposit funds and pooled superannuation trusts. Paragraphs (b) and (c) ensure that net capital gains attributable to the superannuation business of life offices and registered organisations are treated in a similar fashion. In the case of a life assurance company, net capital gains are to be included in the base for determining notional tax in respect of that component of taxable income that relates to complying superannuation and roll-over business (the CS/RA component) (subparagraph (b)(i)).

Subparagraph (b)(ii) specifically excludes net capital gains from all other possible components of a life office's taxable income for the purpose of determining notional tax. Those components are non-complying superannuation business (the NCS component), non-fund business (the non-fund component) and accident/disability and residual life assurance (the AD/RLA component).

Paragraph (c) contains provisions to the same effect for registered organizations such as friendly societies.

Subsection 221AZB(4) will apply where the rates of income tax payable by a class of relevant entities for a financial year change and the Income Tax Regulations, in recognition of such a change, make provision for a variation in the amount of notional tax of relevant entities. In such a case, the notional tax will be the amount ascertained in accordance with subsections (2) and (3), as varied in accordance with the Regulations.

Section 221AZC : Modification of notional tax for certain entities with substituted early accounting periods

The purpose of section 221AZC is to "increase" the notional tax for 1990-91 of certain relevant entities that have early balancing substituted accounting periods in respect of their superannuation business. This reflects the fact that the 1990-91 notional tax for these entities would otherwise include an amount in respect of complying superannuation business. This is calculated by reference only to such part of the income of the 1988-89 income year that was derived after 30 June 1988 when the new arrangements for taxing superannuation funds commenced - i.e., the substituted period covers less than a full year's income of that kind.

Subsection 221AZC(1) gives effect to the modification of notional tax in relation to the year of income ending 30 June 1990 in respect of:

- a complying ADF (paragraph (a));
- a complying superannuation fund (paragraph (b)); and
- a pooled superannuation trust (paragraph (c)),

as defined in section 267 of the Principal Act.

Where one of these entities has adopted, or adopts, in lieu of the 1989-90 year of income, an accounting period ending before 1 June 1990, the notional tax ascertained in accordance with subsections 221AZB(2) and (3) is to be modified in accordance with a formula expressed as:

$$\frac{\text{Ascertained amount} \times 12}{12 - \text{Complete months}}$$

where -

"Ascertained amount" is the amount determined in accordance with subsections 221AZB(2) and (3) in relation to the entity in respect of that year of income - generally the notional tax; and

"Complete months" is the number of complete months occurring after the end of the accounting period and before 1 July 1990.

Thus, if a complying superannuation fund balanced on 30 April 1990 and the amount ascertained as the notional tax in accordance with subsections 221AZB(2) and (3) was $50,000, application of the above formula would be as follows -

$$\frac{50{,}000 \times 12}{12 - 2}$$
$$= 60{,}000$$

The modified notional tax is therefore $60,000.

Subsection 221AZC(2) contains a similar formula for modifying the notional tax of life offices and registered organisations which have adopted, or adopt, in lieu of the year of income ending 30 June 1990 an accounting period ending before 1 June 1990. The formula is expressed as:

$$(\text{Ascertained amount} - \text{CS/RA tax}) + \frac{\text{CS/RA tax} \times 12}{12 - \text{Complete months}}$$

where -

"Ascertained amount" has the same meaning as in subsection (1) - i.e., the amount ascertained in accordance with subsection 221AZB(2) and (3);

"CS/RA tax" means so much of the "Ascertained amount" as relates to the complying superannuation and roll-over component (the CS/RA component) of the entity's taxable income of the year of income ending 30 June 1990;

"Complete months" has the same meaning as in subsection (1).

Thus, if a life assurance company balanced on 30 April 1990 and the amount ascertained as the notional tax in accordance with subsections 221AZB(2) and (3) was $50,000, $10,000 of which related to complying superannuation and roll-over business, application of that formula would be as follows:

$$50{,}000 - 10{,}000 + \frac{10{,}000 \times 12}{12 - 2}$$

$$= 52{,}000$$

The modified notional tax is therefore $52,000.

Section 221AZD : Final tax liability

By this section a relevant entity is required to make a final payment of tax, i.e., of the amount by which the tax payable in respect of the taxable income of a year of income exceeds any initial payment of tax (refer sections 221AQ, 221AZ and 221AZA) that has been made.

For this purpose, section 221AZD requires a relevant entity, in relation to a year of income to which Division 1B of Part VI applies:

- to specify its taxable income and the amount of tax payable in respect of that taxable income for the year of income in a return of income furnished for that income year (paragraph (a)); and

- unless no tax is payable or the amount in paragraph (a) does not exceed the initial payment of tax made in respect of that year of income (refer sections 221AP and section 221AZ), to make a final payment of tax by 15 March next following the relevant income year of an amount equal to the excess of the tax payable as specified in paragraph (a) over the initial payment, or if no initial payment was made, the amount of the tax payable (paragraph (b)).

In this section, the payment date of 15 March is varied where either section 221AN or section 221AU apply.

Section 221AN modifies the application of Division 1B for entities with substituted accounting periods, to the effect that the 15 March date, becomes the 15th day of the ninth month after the end of the year of income. However, for entities balancing later than the relevant 30 June the date is not to be later than 15 June following the relevant 30 June - for more details refer to the earlier discussion on section 221AN.

In specified circumstances section 221AU allows an entity to choose not to pay an initial payment of tax. Where this happens the 15 March date in section 221AZD is to be taken as a reference to 15 December. Again, this later date is subject to change for entities with substituted accounting periods by the operation of section 221AN - in effect it is replaced by the 15th day of the sixth month after the end of the accounting period.

Section 221AZE : Additional tax if estimate incorrect

New section 221AZE will establish the basis for charging additional tax, by way of penalty, where a relevant entity (as defined in section 221AK) underestimates its taxable income for a year of income in a notice it has given under paragraph 221AQ(1)(a) or subsection 221AR(1). A notice under paragraph 221AQ(1)(a) is required where an entity decides to make an initial payment of tax other than by paying 85 per cent of its notional tax. A notice under subsection 221AR(1) is required where an entity revises the estimate given under paragraph 221AQ(1)(a).

The additional tax, at the rate of 20 per cent per annum, is payable where a relevant entity liable to pay tax in respect of income of a year of income, has given a notice under paragraph 221AQ (1)(a) in respect of that year and, in accordance with subsection 221AZE(1):

(a) the lesser of the amounts described in subparagraphs (b)(i),(ii) and (iii) applicable to the entity - broadly, the income tax payable, the tax payable exclusive of any capital gain (as calculated in accordance with subsection 221AZE(2)), or the notional tax;

exceeds by more than 10 per cent of the amount,

(b) either of the amounts described in subparagraphs (b)(iv) and (v) - the estimate or revised estimate of tax payable under paragraph 221AQ(1)(a) or subsection 221AR(1).

Where additional tax is payable because of the test in subsection (1), it is due and payable by an entity at the rate of 20 per cent per annum on the amount by which 85 per cent of the relevant amount (the lesser of the amounts in subparagraphs (b)(i)-(iii)) applicable to the entity) exceeds the amount or total of the amounts paid by the entity on or before the day applicable in respect of the initial payment of tax (subsection 221AZE(3)). In this context the initial payment of tax will include any further payments of tax - refer to the notes on section 221AZ.

Additional tax is to be charged in respect of each day in the period that:

(a) commenced on the day that is the later of either:

  (i) the day by which the entity was required to make an initial payment of tax for the year of income; or

  (ii) the day on which the entity made an estimate or revised estimate that resulted in the excess in paragraph (1)(b) (paragraph (a)); and

(b) ended on the day on which the entity made the payment that is required by section 221AZD - i.e. the final payment (paragraph (b)).

The charging of additional tax in respect of each day will allow the calculation to have regard to variations at any particular time of the amount on which the tax is to be payable.

Subsection 221AZE(4) modifies the application of subsection (3) where a relevant entity receives a refund of an amount paid as an initial payment of tax.

By paragraph (a) the initial payment of tax is to be taken to have been reduced by the amount of the refund for the purpose of the ascertainment under subsection (3) of the amount on which the additional tax is payable.

By paragraph (b), where the entity receives a refund by the action of the Commissioner under section 221AV or 221AW (see earlier notes on those sections) paragraph (4)(a) does not apply, and subsection (3) has effect as if the entity had not received the refund.

Subsection 221AZE(5) gives the Commissioner authority to remit the whole or part of any additional tax payable in accordance with this section.

Subsection 221AZE(6) reduces by specified credits and offsets the amount that would otherwise be taken to be the income tax payable by an entity for the purpose of calculating additional tax in accordance with this section.

Section 221AZF : Crediting of payments

Subsection 221AZF(1) stipulates the manner in which a payment made by a taxpayer under Division 1B of Part VI - i.e., an initial payment of tax under section 221AP or a final payment of tax under section 221AZD - is to be credited by the Commissioner.

A payment under Division 1B in respect of a taxpayer's taxable income of a year of income is to be credited in payment successively of:

- income tax payable in respect of that taxable income (paragraph (a));

- a liability for franking deficit tax under section 160AQJ of the Principal Act (paragraph (b)); and

- any other liability of the taxpayer due under an Act which is administered by the Commissioner (paragraph (c)).

Any excess is to be refunded to the taxpayer.

By subsection 221AZF(2), the application of a payment against income tax payable for the relevant year of income will occur when the Commissioner is deemed to have made an assessment in accordance with section 166A (see earlier notes on clause 30).

Clause 37 : Liability to provisional tax

Subsection 221YB(1) of the Principal Act excludes a company, not being a company in the capacity of a trustee, from liability to pay provisional tax.

This clause will omit subsection 221YB(1) and insert a new subsection (1). The new subsection will ensure that provisional tax is not payable by a "relevant entity" within the meaning of subsection 221AK(1) that is proposed to be included in the Principal Act by clause 36 of the Bill. The term "relevant entity" will include a company (other than a company in the capacity of a trustee), a trustee of a corporate unit trust or public trading trust taxed as a company and certain other complying or non-complying approved deposit funds or superannuation funds.

This amendment, by subclause 37(2), applies in respect of the 1989-90 income year and all subsequent years.

Clause 38: Interpretation

Clause 38 of the Bill will amend subsection 221YHA(3B) contained in Division 3A of Part VI of the Principal Act to modify the definition of "owner-builder" for the purposes of the prescribed payments system (PPS).

The PPS is a system for collecting tax at source for certain payments for work in specified industries. Under this system, tax is deducted from payments at the time they are made, and is remitted to the Taxation Office by the person making the payment. One of the industries covered by PPS is the building construction industry.

Householders undertaking building and construction projects are generally required only to report prescribed payments without collecting tax at source. However, householders who undertake domestic construction projects costing over $10,000 by arrangements under which the householder effectively assumes the role of the builder, are treated as owner-builders and are subject to the full operation of the PPS, i.e., they must make deductions from prescribed payments, and remit these amounts to the Taxation Office.

To this end, subparagraph 221YHA(3B)(b)(i) of the Principal Act specifies that where a building permit or similar approval is issued by the relevant issuing authority (e.g., a municipal council) in the name of a householder, that person is to be treated as an owner-builder. However, it was never intended to subject householders to owner-builder obligations unless they effectively assume the role of builder. In its present form the law can have this effect in a limited number of cases where permits are issued in the name of a householder even though a builder will be responsible for the project.

To address this situation, a new paragraph - paragraph 221YHA(3B)(ba) -is being inserted in the Principal Act to modify the test in existing subparagraph 221 YHA(3B)(b)(i) so that it will apply only to a householder in whose name a permit is issued if, in fact, that person is the "actual builder" - a term used in the new paragraph for this purpose. Specifically, a householder will not be treated as an owner-builder where the work carried out in relation to the construction project by the actual builder, or contracts entered into by the actual builder, constitute a major part of the project. On the other hand, if the actual builder is carrying out only a minor part of the construction, or contracts with others but only in relation to a minor part of the construction, subparagraph YHA(3B)(b)(i) will continue to treat the householder as an owner-builder.

These amendments apply to relevant payments made on or after the date of commencement of this Bill, but the Bill also provides for affected householders under pre-existing contracts to avoid owner-builder status after that date. The application rules are explained in the later notes on clause 46 of the Bill.

Clause 39 : Deductions from certain withdrawals from film accounts

Section 221ZN of the Principal Act is part of a system of withholding tax that applies in relation to the arrangements that govern deductions for investments in Australian films made under contracts entered into after 12 January 1983. It imposes on a person who withdraws an amount from an account opened in relation to a film in the Australian Film Industry Trust Fund a requirement to make a deduction from that amount if it is not, upon withdrawal, dealt with in the prescribed manner. Generally an amount will be taken to be dealt with in the prescribed manner if it is expended directly in producing the film (subsection 124ZAA(7)). The amount deducted is then remitted to the Commissioner. Amounts withheld under these arrangements are applied against tax due on the amended assessment withdrawing the deduction previously claimed in respect of the excess contribution.

Paragraphs 221ZN(1)(a) and (b) specify the rate at which such deductions are to be made. Where the amount of a withdrawal is paid to a person, other than a company, the rate of deduction, currently set at 49 per cent, is equivalent to the maximum rate in the personal tax scale.

In line with the reduction in the maximum rate in the personal tax scale to apply from 1 January 1990, clause 39 will reduce the rate of deduction under subparagraph 221ZN(1)(a)(ii) and paragraph (1)(b) from 49 per cent to 47 per cent for withdrawals on or after that date. The personal rates of tax are declared by the Income Tax Rates Act 1986.

Clause 40 : Penalty for failure to keep or furnish documents or information

This clause will amend section 222 of the Principal Act by inserting new subsection 222(1A).

The effect of section 222 is that a taxpayer who refuses or fails to duly furnish a return or any information relating to a year of income, where that return or information relates to the taxpayer or to his or her affairs, is liable to additional tax by way of penalty. The amount of the additional tax is double the amount of tax payable by the taxpayer in respect of the year of income, or $20 if the amount of the additional tax otherwise payable would be less.

Under the new arrangements proposed by this Bill for the payment of tax by companies and certain other entities (referred to as "relevant entities"), relevant entities will remain liable to lodge a return of income. However, consistent with changes for a system of full self-assessment only a limited amount of information will need to be in the return form. Other information such as accounts, documents, certificates or notices that were previously required to be lodged on or before the last date for furnishing a return of income will generally now be required to be retained by relevant entities.

The amendment of section 222 proposed by this clause will extend the scope of the section to records used by the relevant entity in calculating its taxable income and which the relevant entity will retain in its possession.

New subsection (1A) makes a relevant entity within the meaning of new Division 1B of part VI liable to pay, by way of penalty, additional tax equal to double the amount of tax payable by the taxpayer in respect of that year of income if:

- the entity fails to keep a record containing particulars of the basis of the calculation of its taxable income and the tax payable thereon that were specified in a return in accordance with new section 221AZD (paragraph (a)); or

- refuses or fails to produce to the Commissioner, when required to do so, a document containing particulars of the basis of the calculation of its taxable income and the tax payable thereon that were specified in accordance with new section 221AZD (paragraph (b)).

Clause 41 : Penalty for false or misleading statements

This clause will amend section 223 of the Principal Act.

Section 223 imposes a penalty, by way of additional tax, where a statement is made which is false or misleading in a material particular, or there is an omission which renders the statement misleading in a material particular and less tax would be payable if an assessment were made on the basis that the statement was not false or misleading.

Two amendments of section 223 are proposed by this clause. The first amendment relates to claims for foreign tax credits and offsets of franking deficit tax.

At present, for section 223 to operate the tax properly payable by the taxpayer must exceed the tax that would have been payable if it were assessed on the basis that the statement were not false or misleading. With the proposed change to self-determination of foreign tax credits and offsets of franking deficit taxes (see notes on clauses 13 and 25 in relation to new sections 160AIA and 160AQKA), taxpayers will determine their own credits and offsets by simply making the claim. That claim may be subject to audit or other review at a later date. The first amendment of section 223 will enable penalties to be imposed in respect of false or misleading claims for credits and offsets.

The second amendment of section 223 will correspond to the amendment to section 222 of the Principal Act proposed by clause 40. Under the new self-assessment arrangements for relevant entities, accounts and other documents used by an entity to calculate its taxable income and tax payable will be retained by the entity for at least 5 years (see notes on clause 42 which will amend section 262A). This proposed amendment will extend the scope of the section to false or misleading statements in those documents.

Paragraph (1)(a) will insert new subsection 223(1A) by which a taxpayer will be liable to pay, by way of penalty, additional tax equal to double the amount of the difference where the taxpayer:

- makes a statement to a taxation officer (or another person such as a tax agent) that is false or misleading in a material particular (subparagraph (a)(i)); or

- omits from a statement made to a taxation officer (or another person) any matter or thing without which the statement is misleading in a material particular (subparagraph (a)(ii)),

and as a result a credit or an offset within the meaning of Division 1 of Part IIIAA (franking deficit tax) allowed is more than the credit or offset that is correctly allowable.

Paragraph (1)(b) of clause 41 will amend paragraphs 223(8)(a) and 223(9)(a) to ensure that documents that are prepared for the extended self-assessment arrangements are within the scope of the section whether or not they are sent to the Commissioner.

Paragraph (1)(c) of clause 41 will further amend subsection 223(8) by making it clear that the section applies to documents produced pursuant to paragraph 264(1)(b) of the Principal Act if those documents contain particulars of the basis of the calculation of taxable income and the tax payable that were specified in a return in accordance with new section 221AZD (see further notes on that section).

By subclause (2), the amendments made by subclause (1) apply in respect of statements that are made, or omissions that occur, after the commencement of this section.

Clause 42 : Keeping of records

Clause 42 will repeal section 262A of the Principal Act and substitute a new section 262A.

Existing section 262A requires every person carrying on a business to keep records in the English language of the person's income and expenditure sufficient to enable the assessable income and allowable deductions to be readily ascertained. The section also requires the records to be retained for a period of at least 7 years after the completion of the transactions, acts or operations to which they relate. The records need not be kept where the Commissioner has notified the person that their preservation is no longer required or, in the case of a company which has gone into liquidation, it has been dissolved.

These requirements are to be retained subject to the modifications outlined in the following notes.

By subsection 262A(1), a taxpayer carrying on a business must, subject to the section, keep records that record and explain all transactions and other acts engaged in by the taxpayer that are relevant for any purpose of the Principal Act.

Subsection 262A(2) explains the type of records which are required to be kept. These include documents relating to a person's income and expenditure (paragraph (a)) and other relevant documents required for any purpose of the Principal Act (paragraph (b)). For example, a document or certificate obtained, such as an actuarial certificate, or a statement prepared in relation to an election or determination made, is a record for the purpose of the Principal Act. The purpose of subsection 262A(2) is to make it clear that all records of a type previously included in a return form but no longer required to be included under self-assessment are to be retained by the taxpayer for the purposes of examination by the Commissioner if and when requested by the Commissioner for the purposes of the Act.

Subsection 262A(3) obliges a person who is required by the section to keep records, to keep those records:

- by paragraph (a) - in the English language or, if not in written form (e.g., in an electronic medium such as a magnetic tape or computer disc), in a form which is readily accessible and convertible into writing in English; and
- by paragraph (b) - so as to enable the person's assessable income and allowable deductions, and any credits to which the person is entitled, to be readily ascertainable.

Where records are required to be kept or obtained under or for purposes of the Act, subsection 262A(4) requires any person who has possession of those records to retain them. By paragraph (a) the period for which those records are required to be retained is, in most cases, 5 years. The 5 year period runs from the day on which the records were prepared or obtained or from when the transactions or acts to which those records relate were completed, whichever is later. This is a reduction of 2 years in the present law requirement, and is associated with the reduction from 6 to 4 years in the general limitation period for the amendment of an assessment of all taxpayers.

By paragraph (b), the period of retention will extend beyond 5 years where the period within which the Commissioner may amend an assessment of the relevant taxpayer has been extended beyond 5 years, by virtue of new subsections 170(4A) or 170(4B) (see notes on clause 31). Where the amendment period is extended beyond the 5 year period referred to at paragraph (a), the records must be retained to the end of the extended amendment period.

By subsection 262A(5) a person need not retain records where:

- the Commissioner has notified the person that retention of the records is not required (paragraph (a)); or
- in the case of a company, the company has gone into liquidation and been finally dissolved (paragraph (b)).

The maximum penalty on conviction for failure to comply with section 262A is a fine of $3,000.

Clause 43 : Taxable contributions

Where contributions are made to a superannuation fund by a taxpayer in respect of a person who performs work for the taxpayer and the taxpayer is entitled to a deduction under section 51 of the Principal Act for the contributions, the amount contributed by the taxpayer is included, by subparagraph 274(1)(a)(ii) of the Principal Act, in the assessable income of the trustee of the fund.

Paragraph (a) of clause 43 will amend the subparagraph by inserting a reference to new section 69 (refer to the earlier notes on clause 28A that explain the intended operation of this section). This will ensure that a contribution made to a superannuation fund by a taxpayer, in respect of which the taxpayer is entitled to a deduction under new section 69, will be included in the assessable income of the trustee of the fund.

An example of circumstances in which this amendment will have effect is where a taxpayer makes contributions to a superannuation fund for the benefit of a self-employed professional who is engaged by the taxpayer to provide professional advice in relation to taxation matters. A deduction for the contributions would not be allowable to the taxpayer under section 51 of the Principal Act because the provision of income tax advice is generally of a private or capital nature. The contributions would, however, be deductible under new subsection 69(1) if the person giving the advice is a recognised professional tax advisor as defined in new section 69 and the advice is a tax-related matter for the purposes of the new section.

<u>Paragraphs (b) and (c) of clause 43</u> will correct a technical deficiency in subsection 274(8) of the Principal Act which sets a limit on contributions covered by notices under subsection 274(7). That subsection specifies that certain contributions to a complying superannuation fund may not be treated as assessable income where the trustee of the fund, with the consent of the contributor, gives to the Commissioner of Taxation a notice to that effect.

The limit on contributions specified under subsection 274(8) is the aggregate of:

- the total amount of the post-June 83 components of ETPs specified in notices under subsection 27AB(4) (paragraph 274(8)(a)) - that is, a notice, given by the trustee of a complying superannuation fund to the recipient of an eligible termination payment (ETP), which provides that a portion of the post-June 83 component of the ETP is an untaxed element;
- the portion of the pre-July 83 components of ETPs that corresponds to the proportion of post-June 83 components of the ETPs represented by subsection 27AB(4) notices (paragraph 274(8)(b)); and
- the total amount of pensions paid in a year which do not qualify for a superannuation rebate as specified in section 159SS notices given by the trustee (paragraph 274(8)(c)) - that is, a notice similar to the subsection 27AB(4) notice, but given to the recipient of a superannuation pension.

The amendment made by paragraphs (b) and (c) will omit paragraph 274(8)(b) of the Principal Act so that no part of the pre-July 83 components of ETPs will be included in calculating the limit on contributions covered by subsection 274(7) notices.

By <u>subclause (11)</u> of clause 46 the amendment is to apply to contributions made to a fund on or after 1 July 1988. Clause 49 contains transitional provisions for subsection 274(7) notices given to the Commissioner before the amending Act receives Royal Assent (see notes on that clause).

<u>Clause 44 : Fixed interest complying ADFs - exemption of income attributable to certain 25 May 1988 deposits</u>

Clause 44 of the Bill will amend the definition of "current 25 May balance" in subsection 290A(4) by replacing the date 1 July 1989 with 1 September 1989. The term "current 25 May balance" is used for the purpose of determining the proportion of the income of a continuously complying fixed interest ADF that is exempt from tax under section 290A. The "current 25 May balance" for an eligible depositor at a particular time is, in broad terms, the amount remaining of the amount that was on deposit (the "original 25 May balance") with the relevant ADF as at the end of 25 May 1988.

The amount of income exempt under section 290A is a simple proportion of a qualifying ADF's normal assessable income. The exempt proportion is calculated under subsection 290A(2) by dividing the current 25 May balances for all eligible depositors on a particular day (called the "reckoning time") by the total amount on deposit with the ADF on the same day for all depositors. It is open to an ADF to choose the reckoning time in the relevant year of income that gives the maximum proportion of exempt income.

The effect of the existing definition of "current 25 May balance" is that any part of the "original 25 May balance" for an eligible depositor that has been withdrawn and returned to the ADF by the depositor before 1 July 1989, and before the time at which subsection 290A(2) is being applied, will count towards the ADF's exemption. Extension of the deadline from 1 July 1989 to 1 September 1989 will enable more people to take advantage of the concession.

Clause 45 : Rebates

This clause will amend section 300 of the Principal Act. It is consequential on the amendment of subsection 221YB(1) of the Principal Act by Clause 37.

The amendment of that section will have the effect of ensuring that non-complying superannuation funds, non-complying approved deposit funds and pooled superannuation trusts will pay tax in accordance with the provisions of new Division 1B of Part VI and not be liable to pay provisional tax under Division 3 of Part VI.

Clause 46 : Application of amendments

This clause, which will not amend the Principal Act, contains application provisions relating to the operation of certain measures contained in the Bill. For reference purposes the Principal Act, as amended by this Bill, is called the "amended Act" (subclause (1)).

By Subclause (2) the repeal of section 69 (refer to earlier notes on clause 8) applies to tax related expenditure incurred on or after 1 July 1989.

By the operation of subclause (3) of clause 46, proposed subparagraph 78(1)(a)(xcv) will apply to gifts made on or after 7 April 1989. Subparagraph 78(1)(a)(xcv) proposes to allow income tax deductions for gifts to building funds for hostels that provide residential accommodation for school students from rural areas.

Subclause (4) applies the amendments made by clauses 10 to 12 to expenditure incurred on or after 1 January 1990 by a life assurance company in gaining the investment component of certain premiums.

By subclause (5) the amendments to the definition of frankable dividend proposed by clause 17 will apply to any dividend that is paid in either of the following circumstance :

- the dividend is paid in respect of a share issued on or after 16 August 1989. (paragraph (a)). The word issued is to have its usual meaning in relation to share transactions which implies action, as distinct from the act of allotment, whereby the allottee's title to the share actually becomes complete, e.g., by the allottee being included on the register of shareholders or by receipt of a share certificate (per Dixon J., Central Piggery Co. Ltd. v McNicoll and Hurst (1949) 78 CLR 594 at pp. 599, 600); or

- the dividend is paid under a finance arrangement (as that term is defined in section 46D of the Principal Act) entered into on or after 16 August 1989 (paragraph (b)). This will ensure that the operation of the new measure cannot be avoided by using shares that were issued before the 16 August 1989 to obtain finance under a finance arrangement entered into on or after that date, or to renew or extend an existing finance arrangement.

Subclause (6) proposes that the amendments made by clause 28 to subsections 160ZH(5) and (7) of the Principal Act (refer to notes on clause 28) (capital gains and losses) will apply to expenditure incurred on or after 1 July 1989.

By subclause (7) the amendment to the operation of the prescribed payments system in relation to householders under clause 38 will apply in relation to any prescribed payment made on or after the date of Royal Assent to the Bill under a contract entered into -

- on or after that date (subparagraph (a)(i)); or

- before that date if, also before that date, the householder notifies the Commissioner that he or she wishes to change their status to a householder (subparagraph (a)(ii)).

As indicated in the earlier notes on clause 38, the prescribed payment system (PPS) provisions are to be amended to exempt persons from owner-builder obligations where they have contracted with an actual builder who will undertake the major part of the construction project.

The amendment will also apply to pre-existing contracts where the above notification procedure is carried out after the date of Royal Assent. In these cases, however, the amendment will apply only to payments made on or after the date of such notification (paragraph (b).

Subclause (8) will ensure that a person who changes from owner-builder to householder status will not be subject to any penalties that might otherwise apply for failure to comply with the strict terms of the various notification requirements of the prescribed payments system.

By subclause (9) the reduced rate of deduction of tax (refer clause 39) on certain withdrawals from film accounts applies to amounts withdrawn on or after 1 January 1990.

Subclause (10) will amend paragraph (a) of clause 43 to apply to contributions made to a superannuation fund on or after 1 July 1989.

Subclause (11) ensures that the amendments made by paragraphs (b) and (c) of clause 43 to correct a technical deficiency in subsection 274(8) in relation to contributions to superannuation funds, apply in relation to contributions made on or after 1 July 1988.

Clause 47: Transitional - section 69 of the amended Act

By subclause (1) a reference in this section to the "amended Act" is a reference to the Income Tax Assessment Act 1936 as proposed to be amended by this Bill.

Subclause (2) is a transitional provision that applies to expenditure incurred on or after 1 July 1989 by the trustee of a deceased estate for matters relating to the income tax affairs of the deceased in respect of a period occurring before 1 July 1989. This provision will ensure that the trustee is entitled to claim deductions for costs incurred after 1 July 1989 in relation to the return to date of death of the deceased taxpayer as if new section 69 (being inserted by clause 8) would have applied to allow a deduction to the deceased taxpayer before 1 July 1989.

Subclause (3) makes it clear that proposed subsection 69(9) (refer to notes on clause 8) will not authorise a deduction in respect of a period before 1 July 1989 in relation to a property used for a tax-related matter.

Clause 48 : Transitional - subsection 113(2) of the amended Act

Section 113 of the Principal Act provides for the determination of the deductible portion of the general management expenses of a life assurance company. General management expenses of a life assurance company do not include expenses of a capital nature, expenses incurred exclusively in gaining or producing assessable income or expenses incurred exclusively in gaining or producing non-assessable income. General management expenses would however include expenditure incurred in gaining premiums under policies described in new section 111AA where those premiums contain an investment component. The deductible portion of general management expenses can be determined either on a factual basis or on a formula basis. It is this formula basis, specified in subsection 113(2), which is subject to the transitional arrangements covered by clause 48.

This is relevant for the purposes of determining deductions, proposed by amendments in clauses 10 to 12, to life assurance companies for expenditure incurred in gaining the investment component of certain life assurance premium income. By subclause 46(4) the amendments made by these clauses apply in relation to expenditure incurred on or after 1 January 1990. Clause 48 contains a transitional formula to calculate the allowable deduction under subsection 113(2) where, for the life assurance company, the year of income in which 1 January 1990 occurs commences before that date.

Subclause 48(1) explains the meanings of two terms used in the clause. The "amended Act" is the Principal Act as amended by this Bill and the "1 January 1990 year" is the income year in which 1 January 1990 falls.

Subclause 48(2) will operate in lieu of subsection 113(2) where the year of income in which 1 January 1990 occurs commences before that date. Accordingly, the transitional provision will not apply in respect of life assurance companies with a substituted accounting period commencing on 1 January.

The transitional provision contains a formula to replace the existing formula in subsection 113(2) for ascertaining the proportion of expenses of general management that is to be allowable as a deduction. The provision does not replace or affect any other provisions of the Principal Act. For example, subsection 113(3) and (4) will still operate to limit the availability of deductions.

The formula in subclause 48(2) effectively divides into two the year of income in which 1 January 1990 occurs. The first component of the formula gives the same result, in respect of expenditure incurred before 1 January 1990, as that which would be obtained under the Principal Act by disregarding the amendments proposed by clauses 10 to 12.

The second component of the formula applies in respect of expenditure incurred on or after 1 January 1990 in the general management of the business of the company and has regard to the amendments proposed by clauses 10 to 12. In particular, the investment component of premiums derived in the year of income and to which proposed section 111AA applies, is treated as assessable income. This covers premiums derived in the year of income including premiums derived before 1 January 1990.

The overall effect of the formula is that a higher factor is applied to expenditure incurred on or after 1 January 1990 than that applied to expenditure incurred before that date. In addition, because the investment component of certain premiums is to be treated as assessable income for the purposes of allowing deductions, expenditure that would not have been taken to have been incurred in the general management of the business of the company prior to the amendments proposed by clauses 10 to 12 may be included in the second component of the formula.

Clause 49 : Transitional - section 274 of the amended Act

This clause provides transitional provisions for the amendments being made by clause 43 of this Bill. By clause 49, if a complying superannuation fund has given notices under subsection 274(7) to the Commissioner of Taxation before the commencement of clause 49 and the amount covered by those notices exceeds the sum of amounts referred to in paragraphs 274(8)(a) and (c), then those notices will be taken never to have been given (see the notes on clause 43 for an explanation of paragraphs 274(8)(a) and (c)). If a trustee of a fund has already lodged notices with the Commissioner that are now deemed never to have been lodged, the trustee may apply to the Commissioner under existing subsection 274(9) for an extension of time to lodge the notice.

Clause 50 : Amendment of assessments

Clause 50 of the Bill authorises the Commissioner of Taxation to re-open an income tax assessment made before the Bill becomes law should this be necessary for the purposes of giving effect to the amendments proposed by Part 3 of the Bill.

PART 4 - AMENDMENT OF THE TAXATION ADMINISTRATION ACT 1953

Introductory note

Part III of the Taxation Administration Act 1953 contains offence and prosecution provisions which create a number of offences which are of general application to the various Commonwealth tax laws and makes provision for their prosecution.

Clause 51 : Principal Act

This clause facilitates reference to the Taxation Administration Act 1953 which, in this part is referred to as "the Principal Act".

Clause 52 : Interpretation

Clause 52 will amend section 8J of the Principal Act containing definitions and other interpretative provisions relevant to the application of Subdivision B of Part III of the Act.

Paragraph 52(a) will amend paragraph 8J(2)(a) of the Principal Act so that a reference in Subdivision B of Division 2 of Part III to a statement made to a taxation officer will include a reference to a statement made in certain nominated documents prepared under or pursuant to a taxation law. An amendment of a similar nature is being made to section 223 of the Income Tax Assessment Act 1936 (the "Assessment Act") - see earlier notes on clause 41.

The change is necessary because of a move to full self-assessment under the Assessment Act for certain companies and funds - to be defined as "relevant entities" in proposed section 221AK of the Assessment Act - refer to the notes on clause 36 of the Bill.

The relevant entities will prepare documents in calculating the taxable income (or net income) and the amount of income tax payable to be specified on a return of income, but will not ordinarily be required to include them in the return when it is furnished to the Commissioner of Taxation. Under section 262A of the Assessment Act they are required to retain the documents for a specified period.

Paragraph 52(b) will amend paragraph 8J(2)(k) of the Principal Act so that the reference in Subdivision B of Division 2 of Part III of that Act to a statement made to a taxation officer will include a statement made in a document containing particulars of the calculation of taxable income (or net income) and of the tax payable thereon that are specified in a return of income of the entities defined in section 221AK of the Assessment Act (refer above). As explained earlier, this change will take into account the basis of operation of the new system of full self-assessment to apply to the relevant entities.

Clause 53 : Penalty taxes to be alternative to prosecution for certain offences

This clause will amend subsection 8ZE(1)(b) and 8ZE(2)(c) so that additional tax is not payable where a prosecution is instituted against a person for failing to keep records as required by section 262A of the Assessment Act.