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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAXATION LAWS AMENDMENT BILL (NO. 6) 1992

MEDICARE LEVY AMENDMENT BILL (NO. 2) 1992

EXPLANATORY MEMORANDUM

(Circulated by the authority of the Treasurer,
the Hon. John Dawkins, M.P.)

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General Outline and Financial Impact

The Taxation Laws Amendment Bill (No. 6) 1992 will amend various Acts (unless otherwise indicated all amendments refer to the *Income Tax Assessment Act 1936*) by making the following changes:

Expenditure on non-compulsory uniform or wardrobe

- Denies a tax deduction for expenses incurred by employees in relation to a non-compulsory uniform or wardrobe.

Date of effect: 1 January 1993

Proposal announced: 1992-93 Budget.

Financial impact: The savings are expected to be $2 million per annum.

Gift Provisions - Royal College Of Pathologists Of Australasia

- Reflects a change of name for the College of Pathologists of Australia which is listed in the income tax gift provisions.

Date of effect: On or after 16 January 1980.

Proposal announced: Not previously announced.

Financial impact: This change will have no impact on revenue.

Dividend Streaming Arrangements Amendment

Enables resident companies to take into account dividends that will be paid under international dividend streaming arrangements when determining the required franking amount for a related dividend.

Date of effect: The amendment will apply to dividends paid by resident companies on or after the date the Bill receives Royal Assent.

Proposal announced: 1992-93 Budget.

Financial impact: Insignificant.

Taxation of limited partnerships as companies

- Subjects limited partnerships to taxation as companies, and treats them as companies for the purposes of the income tax law, with corresponding treatment of partners in such partnerships.

Date of effect: The amendments will apply to all limited partnerships formed on or after 19 August 1992. All limited partnerships formed prior to 19 August 1992 will be subject to the new arrangements in the 1995-96 year of income and subsequent years. If a limited partnership formed before 19 August 1992 is unable to satisfy a continuity of business test or a continuity of majority ownership test, the partnership will be taxed as a company for the year of income in which it ceases to satisfy the test, and all later years.

Proposal announced: 1992-93 Budget.

Financial impact: The amendment is likely to have some revenue benefit. However, a reliable estimate cannot be made.

Exemption from Income Tax: Family Payment Advance

Exempts from income tax the Family Payment Advance made under Part 2.17 of the Social Security Act 1991.

Date of effect: On or after 1 January 1993.

Proposal announced: Not announced.

Financial impact: Nil.

Prescribed Payments System (PPS) Simplification

- Simplifies the administration of the PPS by:
  - replacing the current monthly reporting arrangements for payers of prescribed payments with annual reporting; and
  - modifying the current arrangements for deduction variation certificates, deduction exemption certificates, and approvals to quote reporting exemption numbers.

Date of effect: The amendments will apply on or after 1 January 1993 with the exception of those relating to deduction variation certificates which will apply on or after 1 July 1992.

Proposal announced: Treasurer's Press Release No.111 of 1 July 1992

Financial impact: The direct revenue impact from these measures is not significant. However, implementation of these measures will enable current Taxation Office resources to be directed from administration to enforcement activities.

Medicare Levy Rate Increase and Technical Amendment of the Act

Increase in Rate of Levy

- The Medicare Levy Amendment Bill (No.2) 1992 will amend the Medicare Levy Act 1986 to raise the rate of Medicare levy from 1.25 per cent to 1.4 per cent.

Date of effect: 1 July 1993

Proposal announced: 1992-93 Budget

Financial Impact: The benefit to revenue in 1993-94 is estimated to be $300million.

Technical amendment

- Makes a minor technical amendment to the Medicare Levy Act consequential on amendment of the Social Security Act 1986.

Date of effect: 1 January 1993.

Proposal announced: Not previously announced.

Financial Impact: Nil.

Clauses involved in the proposed amendments

Clause 1: stipulates the short title of the Act as being *Taxation Laws Amendment Act (No.6) 1992.*

Clause 2: stipulates the commencement date of the provisions of the Bill.

Clause 3: defines "Principal Act" as meaning the *Income Tax Assessment Act 1936.*

Expenditure on non-compulsory uniform or wardrobe

[See pages 13-19 for further detail]

Clause 4: proposes to insert new section 51AL to deny a deduction to an employee for expenditure incurred on or after 1 January 1993 in relation to a non-compulsory uniform or wardrobe.

Gift Provisions - Royal College Of Pathologists Of Australasia

[See page 21 for further detail]

Clause 5: proposes to omit from subparagraph 78(1)(a)(xxxvi) "College of Pathologists of Australia" and substitute "Royal College Of Pathologists of Australasia".

Clause 6: states the date of effect of the amendment.

Dividend Streaming Arrangements Amendment

[See pages 23-27 for further detail]

Clause 7: Proposes to insert two new components - **LD** (proposed linked dividends) and **SD** (eligible substituted dividends) - into the formula in subsection 160AQE(2) that calculates the provisional required franking amount and will insert definitions for those two components.

Taxation of limited partnerships as companies

[See pages 29-42 for further detail]

Clause 8: Inserts Division 5A of Part III of the Act which will tax limited partnerships in the same way as companies. They are treated as companies for the purposes of the income tax law, and there is corresponding treatment of partners in limited partnerships.

Clause 9: Ensures that the amendments made by Divison 5A do not result in a person being guilty of an offence because of any act or omission which occurred before Royal Assent to the amendments.

Exemption from Income Tax: Family Payment Advance

[See pages 43-44 for further detail]

Clause 10: Proposes to insert a new entry, "family payment advance", in the Table in Section 24AB of the Income Tax Assessment Act 1936 which is an index of payments made under the Social Security Act 1991 which are generally exempt from income tax.

Clause 11: Proposes to insert new section 24 ABX to exempt "family payment advance" from income tax.

Clause 12: Proposes that the amendments in Division 16 of the Bill will apply to payments of "family payment advance" made on or after 1 January 1993.

Prescribed Payments System (PPS) Simplification

[See pages 45-60 for further detail]

Clauses 13 & 14: amend sections 202A and 202BD of the Act to introduce the term "eligible paying authority" into the Tax File Number provisions for the purposes of the proposed payee declaration.

Clause 15. Partitions the current PPS provisions contained in Division 3A of Part VI of the Act into two subdivisions. Subdivision A will contain two sections: an objects section ***[new section 221YHAAF]*** and a section containing a simplified outline of the operative provisions ***[new section 221YHAAG].*** Subdivision B will contain the current operative provisions as amended by this Bill.

Clause 16: amends section 221YHA of the Act by:

- omitting from subsection 221YHA(1) the definitions of 'deduction form', 'first instalment payment', 'householder notification form', 'instalment series', 'invoice', 'month', 'non-instalment payment', 'non-reportable payment', 'obligation transfer form', 'prescribed certificate', 'reconciliation form', 'reporting exemption declaration' and 'subsequent instalment payment'; and

- inserting in subsection 221YHA(1) the definitions of 'deduction variation certificate percentage', 'eligible paying authority', 'higher deduction percentage election', 'higher deduction percentage election form', 'householder payment summary form', 'non-declaration percentage', 'ordinary percentage', 'owner builder', 'payee declaration', 'payee declaration form', 'payment summary form', 'reconciliation statement form', 'remittance advice form', and 'tax file number'.

Clause 17: repeals sections 221YHAA to 221YHD (inclusive) which cover the furnishing of deduction forms; provision of information to the Commissioner; duties of payees and duties of eligible paying authorities. Continuing requirements from those sections and new requirements are contained in **new sections 221YHB to 221YHDE**.

Clause 18: proposes to amend section 221YHF of the Act to ensure that, under the new administrative arrangements, credit is given in a payee's assessment for the amount of tax deducted from prescribed payments. Under current arrangements, the credit is equal to the amount shown on deduction forms.

Clause 19· proposes to amend section 221YHJ which concerns failure, on the part of the payer, to remit amounts deducted within the time required to the Commissioner. The amendment replaces the current references to the existing requirements to remit the deductions made with the new references.

Clause 20: repeals section 221YHK which provides penalties for failure to furnish deduction forms to the Commissioner within the required time. Those forms will not be required under the proposals.

Clause 21: proposes to amend section 221YHL of the Act to eliminate the reference to remission of penalties imposed under section 221YHK for failure to furnish deduction forms to the Commissioner within the required time.

Clause 22: amends section 221YHM of the Act to include the new references to deductions made in respect of prescribed payments under the new arrangements.

Clause 23: repeals section 221YHP covering existing deduction variation certificates and substitutes ***new section 221YHP*** to allow the deduction variation certificates issued under the new arrangements to remain in force until a lesser rate than that shown on the certificate is required or the Commissioner revokes the certificate under section 221YHS.

Clause 24: amends section 221YHQ covering deduction exemption certificates so that the section will cover both deduction exemption certificates and reporting exemptions (existing section 221YHR). Deduction exemption certificates issued on or after 1 January 1993 will remain in force indefinitely until revoked under section 221YHS as amended.

Subject to the new revocation arrangements ***[clause 90: new section 221YHSA]*** for approvals to quote a reporting exemption number, the new arrangements to quote will remain in force (not exceeding 3 years) until the date specified in the approval.

Clause 25 Repeals section 221YHR which covers reporting exemptions and inserts new 221YHR which will enable a payee at any time before receiving a prescribed payment to elect a higher rate of tax to be deducted from a prescribed payment.

Clause 26: proposes to amend section 221YHS which covers the revocation of deduction variation and exemption certificates (currently defined as a prescribed certificate) to change the way in which the revocation notice is provided. The change is necessary because information concerning the certificates will now be in the payee declaration and not in the deduction form which is no longer required.

Clause 27: inserts new section 221YHSA to allow the Commissioner to revoke an approval given under ***new paragraph 221YHQ(1A)(b)*** to quote a reporting exemption number to an eligible paying authority.

Clause 28: amends section 221YHT which covers notification and review of decisions to remove references to existing section 221YHR (reporting exemptions) as reporting and deduction exemptions will be both under 221YHQ. Further, a decision made by the Commissioner under new subsection 221YHB(8) covering tax file numbers will also be reviewable under section 221YHT.

Clause 29: amends section 221YHU which covers offences so that it specifies a number of offences relating to attempts to fraudulently obtain a credit for deductions of tax under the new regime for prescribed payments. The offence descriptions will refer to new forms as the existing references to deduction forms are not relevant.

Clause 30: provides that the amendments made in relation to prescribed payments under the Bill will apply to prescribed payments made on or after 1 January 1993.

Clause 31: inserts transitional provisions necessary to:

provide that payees who were entitled to receive payments before 1 January 1993 may make a payee declaration in respect of those payments where they are received on or after that date***[subclause (2)].***

- ensure that householders whose projects are not completed on 1 January 1993 will be required to provide the householder payment summary form on completion of the project ***[subclause (4)]***;
- preserve certain aspects of the current arrangements including notification of paying authorities and existing deduction and reporting exemptions until they expire where expiration is after 31 December 1992 ***[subclauses (3), (5), (7), (8) and (9)]***; and
- ensure certificates issued as deduction variation certificates on or after 1 July 1992 and before 1 January 1993 will remain in force as if they were issued under new section 221YHP ***[subclause (6)].***

Clause 32: Amendment of assessments.

Medicare Levy Rate Increase and Technical Amendment of the Act

[See pages 61-64 for further detail]

(Medicare Levy Amendment Act 1986)

Subclause 1 (1): cites the amending Act as the Medicare Levy Amendment Act (No. 2) 1992.

Subclause 1 (2): facilitates references to the *Medicare Levy Act 1986* which it refers to as the "Principal Act".

Clause 2: provides for the amending Act to commence on the day on which it receives Royal Assent.

Clause 3 amends section 6 of the Principal Act by omitting "1.25%" from subsections (1), (2) and (3) and substituting "1.4%" in each instance.

Subclause 4 (1)· amends subsection 8(2) of the Principal Act by:

- omitting "0.1875" and substituting "0.186"; and
- omitting "1.25%" and substituting "1.4%".

Subclause 4 (2): amends subsection 8(6) of the Principal Act by omitting "family allowance" and substituting "family payment".

Subclause 5(1): provides that amendments to section 6 and subsection 8(2) of the Principal Act will apply for the financial years commencing on or after 1 July 1993.

Subclause 5(2): provides that amendments to subsection 8(6) of the Principal Act will apply to payments made on or after 1 January 1993.

Chapter 1

Expenditure on non-compulsory uniform or wardrobe

Expenditure on non-compulsory uniforms or wardrobes

Summary of proposed amendments

Purpose of amendment: This Bill will amend the *Income Tax Assessment Act 1936* to give effect to the 1992 Budget announcement to deny deductions for expenses incurred by employees in relation to non-compulsory uniforms or wardrobes.

Date of Effect: The amendment will apply from 1 January 1993.

Background to the legislation

Expenditure on clothing and its maintenance incurred by an employee is generally not allowable as a deduction under subsection 51(1) of the *Income Tax Assessment Act 1936* (the Act) for two reasons. First, it is not incurred in gaining assessable income and, second, it is private expenditure. However, deductions under subsection 51(1) of the Act have been allowed for certain types of clothing in particular circumstances, as evidenced by various Court and Tribunal decisions. These have formed the basis of various rulings by the Commissioner of Taxation.

The cost of employees' clothing has been deductible where it was considered to be 'necessary and peculiar' to the taxpayer's occupation, or where the taxpayer was required to incur 'abnormal expenditure' in relation to otherwise conventional attire because of his or her occupation. Both the 'necessary and peculiar' test and the 'abnormal expenditure' test were developed by the Boards of Review and the AAT, but have not received universal acceptance, even by those Tribunals.

In 1991 the Commissioner of Taxation issued Taxation Ruling IT2641 concerning the deductibility of the costs of purchase and maintenance of 'corporate' wardrobes and 'corporate' uniforms. The Ruling stated that a taxpayer would be able to claim a deduction for the cost of the initial purchase, repair, replacement and cleaning of items accepted as forming part of a 'corporate' wardrobe or uniform, even where wearing it was not a compulsory condition of employment.

The Ruling also noted that where an employer provides the items of a 'corporate' uniform or wardrobe, or financial support to purchase such items, this may constitute a fringe benefit under the *Fringe Benefits Tax Assessment Act 1986 (FBTAA).* However, the "otherwise deductible" provisions (either section 24 or 44 of the FBTAA) would operate to reduce the taxable value of any such fringe benefit, by the amount of any tax deduction that would otherwise have been available to the employee.

Budget Announcement

The Government announced in the 1992 Budget its decision to restrict the circumstances in which expenditure incurred by an employee in relation to a non-compulsory uniform or wardrobe would be deductible. It decided to deny any deduction for relevant expenditure unless the wearing of the uniform is a compulsory condition of employment.

This restriction, however, is not to operate to deny a deduction for clothing worn to protect employees from injury or their normal clothing from damage.

The measure is intended to ensure that the tax laws do not confer an unfair advantage on some employees by permitting tax deductions for clothing which may not be essentially different from that worn to work by other employees for which no deductions are allowed.

Explanation of proposed amendments

What is the effect of the amendments?

While the general requirements set down in subsection 51(1) would still need to be satisfied before a taxpayer can obtain a deduction, **new subsection 51AL(1)** will have the effect of denying employees a deduction for expenditure incurred in relation to a non-compulsory uniform or wardrobe. The requirement or compulsion to wear the uniform or wardrobe must be an **express policy** of the employer - although it is not necessary that it be set out in any written document. In addition the employer must consistently enforce this policy ***[Clause 4, new subsection 51AL(3)].***

What is a non-compulsory uniform/wardrobe expense?

Ordinarily, a non-compulsory uniform or wardrobe expense will include expenditure incurred in acquiring, repairing, cleaning, maintaining, upgrading or improving an item of clothing that is included in a non-compulsory uniform or wardrobe ***[Clause 4, new subsection 51AL(2)].***

What is a non-compulsory uniform/wardrobe?

A non-compulsory uniform or wardrobe is a set of one or more items of clothing where the following conditions or circumstances apply:

i. the clothing is not protective clothing ***[Clause 4, new subsection 51AL(3)]***;

ii. the set of clothing distinctively identifies the employee as a person associated with the employer or group comprising the employer and employer associates and ***[Clause 4, new paragraph 51AL(3)(a)]***;

iii. either,

   a) the employer does not have an express policy that prohibits employees from substituting items of ordinary clothing for an item of clothing included in the set while performing their duties ***[Clause 4, new subsubparagraph 51AL(3)(b)(i)(A)]***;

and

b) this policy applies to all other employees in the employ of the employer that are in the same class of employee as the particular employee ***[Clause 4, new subsubparagraph 51AL(3)(b)(i)(B)];***

or

c) the employer has put such a policy in place but does not enforce it ***[Clause 4, new subparagraph 51AL(3)(b)(ii)].***

Why include associates of the employer?

The **associates** referred to in subparagraph 51AL(3)(a)(ii) are those which fall within the meaning of section 26AAB of the Act. Examples of associates covered by section 26AAB include partners of a taxpayer, and a company that is effectively controlled (either individually or collectively) by the taxpayer. The reason for including associates of employers is to ensure that the amendment applies to those employees whose employers require them to wear a uniform or wardrobe which does not immediately associate them with their employer but rather as belonging, for example, to a multi company group.

For example, it may be that a uniform or wardrobe immediately identifies an employee as belonging to a financial organisation rather than a particular subsidiary of the holding company. For example, a bank may have a number of subsidiary companies such as those dealing with financial and investment services as well as the main company which provides banking services; however, all employees irrespective of which company they belong to may wear the same uniform.

Uniforms/Wardrobes and Distinctive Identification

A uniform or wardrobe is a collection of inter-related items of clothing and accessories which distinctively identify a particular employer organisation. The clothing must be unique, distinctive and peculiar to the organisation (or a group consisting of the particular employer and their associates - see new paragraph 51AL(3)(a)).

The uniform/wardrobe must distinctively identify the wearer as a person associated directly or indirectly with his or her employer. Associations of an indirect nature may occur where a wardrobe or uniform identifies a product sold by an organisation rather than the actual employer. For example, cosmetic salespersons in a department store maybe required to wear "product identification" uniforms rather than one identifying the particular employer organisation. Another example may involve fastfood salespeople who are required to wear a "product identification" uniform rather than one pertaining to the actual individual employer organisation.

Impact on temporary or relief staff

The amendment recognises that there may be occasions where it is necessary for an employer to engage temporary or relief staff for a **short time** to cover unplanned staff absences or other urgent needs ***[Clause 4, new subsubparagraph 51AL(3)(b)(i)(B)].***

In these situations it would be unfair to require the emergency staff to acquire a corporate uniform or wardrobe. On the other hand, unless an exception was made for these staff, other employees in the relevant class of employees would not be entitled to a deduction for expenses relating to the corporate wardrobe. This is because the wearing of a uniform or wardrobe would not be a requirement which is applicable to **all** employees in the relevant class. For this reason an exception has been made for relief or temporary staff.

Uniform/Wardrobe must be worn in its entirety

Employees, in order to obtain a deduction, are required to wear a uniform/wardrobe in its entirety ***[Clause 4, new subsubparagraph 51AL(3)(b)(i)(A)].*** That is , employees will not be able to interchange wardrobe items with items from their private collection, or only wear a select few items from the uniform/wardrobe (such as a 'corporate' tie and not the 'corporate' suit; or a 'corporate' blouse or scarf and not the rest of the ensemble).

The amendment does however recognise that there maybe 'special circumstances' where an employee would not be required to wear his or her uniform/wardrobe in its entirety for a period of time ***[Clause 4, new subparagraph 51AL(3)(b)(i)].*** This would be the case, for example, where a bank teller, as part of his or her work, has to appear as a witness in court and wears a suit instead of his or her corporate wardrobe.

Definitions

Employee

The amendment will apply to employees who wish to claim a deduction for expenditure incurred in relation to a uniform or wardrobe. The term employee has the same meaning as that used in section 221A of the Act except that it also includes those persons who are in receipt of a prescribed payment ***[Clause 4, new subsections 51AL(4) and 51AL(5)].***

Class of employee

In addition to satisfying the requirements of subsection 51(1) to qualify for a deduction the employee, and all other employees of his or her class, must be compelled to wear the uniform/wardrobe.

The phrase class of employee relates to the level or category of work conducted by a distinct or discrete body of employees of the employer. It does not relate to the security of tenure (i.e. whether an employee is permanent or casual). For example, there may be a different 'corporate' collection for executive staff and service staff. Alternatively, for example, service staff may have a compulsory uniform or wardrobe but executive staff do not. Each of these bodies of staff constitute a class of employee ***[Clause 4, new subsection 51AL(5)].***

Protective Clothing

Protective clothing is specifically excluded from the operation of this amendment ***[see new subsection 51AL(3)]***. Whether a deduction is allowable for the purchase or maintenance of protective clothing will depend upon the operation of subsection 51(1) to the particular facts of each case.

Protective clothing is clothing which is worn to protect employees from death, injury or disease; or to protect their normal clothing (or artificial limbs, etc) from damage ***[Clause 4, new subsection 51AL(5)]***. Clothing such as overalls, aprons, goggles, shields and safety boots are examples of protective clothing provided they are worn or used to protect the employee and not as a fashion garment.

Clothing which is worn to protect persons other than the wearer of the clothing, for example, certain apparel which persons employed in the food and catering industries are required to wear to prevent contamination of foodstuffs, would also be regarded as being 'protective'.

Chapter 2

Gift Provisions - Royal College of Pathologists of Australasia

Gift Provisions - Royal College of Pathologists of Australasia

Summary of proposed amendments

Purpose of amendment: Reflects a change in the name of the College of Pathologists of Australia which is listed in the income tax gift provisions.

Date of Effect: 16 January 1980

Background to the legislation

On the 16 January 1980, the College Of Pathologists of Australia, which is listed under subparagraph 78(1)(a)(xxxvi) of the *Income Tax Assessment Act 1936* changed its name to the Royal College of Pathologists of Australasia.

Explanation of proposed amendments

The Bill amends paragraph 78(1)(a) of the Act to omit from subparagraph 78(1)(a)(xxxvi) "College of Pathologists of Australia" and substitute it with "Royal College of Pathologists of Australasia" *[Clause 5]*. This subparagraph will continue to allow gifts of the value of $2 or more of money or property purchased within 12 months, made to the Royal College of Pathologists of Australasia to be tax deductible.

The amendment applies in relation to gifts made on or after 16 January 1980 *[Clause 6]*.

Chapter 3

Dividend streaming arrangements amendment

Dividend Streaming Arrangements

Summary of proposed amendments

Purpose of amendment: to bring into the required franking amount calculation for a franked dividend paid by a resident company, dividends paid by non-resident associates, that are substituted for, or by, the franked dividend under a dividend streaming arrangement.

Date of Effect: the amendment will apply to dividends paid by a resident company on or after the date the Bill receives Royal Assent.

Background to the legislation

It is a general requirement of the imputation system that companies frank to the same extent all dividends paid as part of the same distribution on a particular class of shares. Further, when a company pays a dividend to shareholders, it is generally required to frank the dividend to the extent of the surplus in the franking account on the day that dividend is paid. This amount is known as the required franking amount.

It is important to note that when a company has to calculate this required franking amount for the dividend the provisions allow the company to take into account, broadly, other dividends that are to be paid on the same day and dividends the company is committed to pay in the future.

Prior to the introduction of the dividend streaming provisions, companies were able to avoid franking dividends paid on a single class of shares to the same extent for all shareholders. This was achieved by using dividend selection schemes to stream franked dividends to those shareholders able to benefit from them most.

However, the dividend streaming provisions now treat a resident company involved in a dividend streaming arrangement as having franked to the same extent all dividends paid under the arrangement, including dividends paid by another company.

For example, an Australian resident parent company with a dividend streaming arrangement in place incurs a franking debit in its franking account, for the franked dividend it pays to the Australian shareholders and also for the unfranked dividend that its non-resident subsidiary pays to the non-resident shareholders.

Currently, where the dividend substituted for, or by, the franked dividend is paid at the same time as, or after, the franked dividend under a streaming arrangement, the debit imposed by the streaming provisions arises only after the required franking amount calculation for the franked dividend has been made.

In the above example, if the Australian parent company pays its dividend first, that dividend is required to be franked to the extent permitted by the franking surplus in the franking account. The franking debit that is subsequently imposed by the dividend streaming provisions (in this instance subsection 160AQCB(3)) when the non-resident subsidiary company pays its dividend, may put the franking account of the Australian parent company in debit. If the company does not receive franking credits to cover that franking debit a franking deficit may arise at the end of the franking year. In that event the company may be liable to franking deficit tax under section 160AQJ.

Explanation of proposed amendments

The proposed amendments will bring the dividends substituted for, or by, the franked dividends under a streaming arrangement into the calculation of the required franking amount calculation of that franked dividend.

This will be achieved by including as components in the required franking amount formula in subsection 160AQE(2) the dividends substituted for,or by, the franked dividend. That is the dividends substituted for, or by, the franked dividend will be brought into the calculation in the same way as dividends paid on the same day or committed future dividends.

Note that the proposed amendments to the required franking amount formula in subsection 160AQE(2) will only affect companies paying dividends as part of an international dividend streaming arrangement. For all other companies the value of the proposed new components in that formula will be nil. Their calculations will remain unaffected by these amendments.

Therefore, the proposed legislation will apply to companies that are involved in arrangements described in paragraphs (b)(ii)(C) and (b)(ii)(D) of the definition "dividend streaming arrangement" in section 160APA, as they relate to international arrangements.

Broadly, international dividend streaming arrangements will be encapsulated by the amendments by reference to dividends paid by a company not resident at the time of payment, being the dividends substituted for, or by, the relevant franked dividend ***[Clause 7, new subparagraph (a)(i)(B) of the definition of "LD" in subsection 160AQE(2) and new subparagraph (a)(ii)(B) of the definition "SD" in subsection 160AQE(2)].***

After the proposed amendments the formula in subsection 160AQE(2) will look like this:

$$CD \quad X \left[\frac{RFS}{D + CFD + SDD + LD + SD} \right]$$

The first of the new components is "**LD**", meaning "proposed linked dividends", and is defined as one or more dividends that will be paid by a non-resident company and will give rise to a franking debit under subsection 160AQCB(3). ***[Clause 7, new subparagraph (a)(i) in the definition of "LD" in subsection 160AQE(2)]***

Broadly, this is the dividend payable by the non-resident company in substitution for the franked dividend for which we are calculating the required franking amount.

Current dividend in relation to "**LD**" is defined as one of the substituted dividends under subsection 160AQCB(3) which is paid on or after the date of Royal Assent of this Bill ***[Clause 7, new subparagraph (a)(ii) in the definition of "LD" in subsection 160AQE(2)].***

For the purposes of subsection 160AQE(2), the total amount of the proposed linked dividends is to be taken into account when calculating the provisional required franking amount.

The second of the new components is"**SD**", meaning "eligible substituted dividends", and is defined as one or more dividends that are covered by subsection 160AQCB(4) and were paid, are paid or proposed to be paid by another company when that other company is not a resident.

Broadly, this is the dividend payable by another company that has been substituted by the dividend for which we are calculating the required franking amount.

Current dividend in relation to "**SD**" is defined as one of the scheme dividends under subsection 160AQCB(4) - the payment of which is the trigger for a franking debit to arise under that subsection - which is paid on or after the date of Royal Assent of this Bill ***[Clause 7, new subparagraph (a)(i) in the definition of "SD" in subsection 160AQE(2)].***

For the purposes of subsection 160AQE(2), the total amount of the eligible substituted dividends is to be taken into account when calculating the provisional required franking amount.

Example

An Australian parent company has franking surplus in its franking account of $50,000 at the time it is to pay an $80,000 dividend to its Australian shareholders. The company has an arrangement with its non-resident subsidiary company to pay a linked dividend to non-resident shareholders in substitution for the first dividend. After the parent company pays its dividend to Australian shareholders, the subsidiary company pays non-resident shareholders a $20,000 linked dividend.

Under the current provisions of subsection 160AQE(2) the provisional required franking amount would be calculated at the time when the first dividend is paid as:

$$80{,}000 \times \frac{50{,}000}{80{,}000} = \$50{,}000$$

This means that the parent company has to frank the dividends, at least, to the extent of $50,000 or 62.5%.

When the subsidiary company pays the linked dividend, a franking debit of $12,500 (being $20,000 x 62.5%) would arise to the parent company under subsection 160AQCB(3). If no other franking credits become available to the company, a franking deficit would arise at the end of that franking year and franking deficit tax may be payable under section 160AQJ.

Under the proposed amendment the parent company will be able to take into account the proposed linked dividend when determining the provisional required franking amount for the dividend to be paid to Australian shareholders. Thus, the provisional required franking amount would be calculated as follows:

$$80{,}000 \times \frac{50{,}000}{80{,}000 + 20{,}000} = \$40{,}000$$

The parent company would be required to frank its dividend to, at least, $40,000 or 50%. There would remain in the franking account a surplus of $10,000. When the linked dividend is paid by the subsidiary company, a franking debit of $10,000 (being $20,000 x 50%) will arise. In the absence of other movements in the franking account this debit will be offset against the available franking surplus bringing the franking account balance to nil.

Chapter 4

Taxation of limited partnerships as companies

Taxation of limited partnerships as companies

Summary of proposed amendments

Purpose of amendment: To treat limited partnerships formed on or after 19 August 1992 as companies for taxation purposes. Limited partnerships formed prior to 19 August 1992 will be taxed as companies from the 1995-96 year of income; they must satisfy both a continuity of business test and a continuity of ownership test until then, and if they fail they will be taxed as companies from the year of income in which they first fail.

Date of Effect: 19 August 1992.

Background to the legislation

Under the existing law, limited partnerships are treated as partnerships for taxation purposes. However, the structure of a limited partnership is comparable to that of a limited liability company in that there are "limited partners" who are similar to shareholders in a company; they do not take part in the management of the business, and their liability generally is limited to the extent of their investment.

Limited partners are not at risk beyond the limit of their liability. Generally, their liability is limited to their investment. They are not required to make good losses of their partnership, nor are they liable to meet the obligations of the partnership. If limited partners are treated in the same way as partners in any other partnership, however, they may benefit from distributions of losses that exceed their limited liability. Those losses could be used to reduce taxable income, and so tax paid, even though the loss is not one that exposes the partner to any risk of having to meet obligations or make good losses.

State legislation enabling the formation of limited partnerships currently exists in New South Wales, Victoria, Western Australia, Queensland and Tasmania.

Explanation of proposed amendments

The Bill will amend the Principal Act to introduce taxation arrangements in new Division 5A of Part III of the Act for taxing limited partnerships *[Clause 8]*.

The object of this new Division is to ensure that limited partnerships will be treated as companies for taxation purposes. This is not confined to the payment of income tax by limited partnerships, but includes all other purposes under income tax law, including the payment of tax by partners in limited partnerships; for instance, imputation and the taxation of dividends to shareholders *[new section 94A]*.

What is a limited partnership?

A limited partnership is any partnership in which the liability of at least one partner is limited. This definition is needed, because limited partnerships formed in Australia also include a general partner or partners, whose liability is not limited. The new Division is not confined to limited partnerships formed in Australia, so the definition is sufficiently general to apply to limited partnerships as formed under many legal systems, although the States with limited partnership legislation have so far enacted in similar terms to one another *[new section 94B]*.

In working out whether a limited partnership is subject to the new Division, limited partnerships are treated as continuous even though there may be changes in the membership of the limited partnership. This avoids the need to treat a limited partnership as ending, and a fresh partnership commencing, on every change in the membership of the partnership *[new section 94C]*.

So, for example, where a limited partnership was formed before 19 August 1992 and a partner leaves or another partner joins the partnership after that date, the new arrangements will not apply automatically to the partnership and it will continue to be treated as a partnership formed prior to 19 August 1992, rather than as a new partnership. It may still be treated as a company for tax purposes, but only when it fails the continuity of business test, the continuity of ownership test, or from the 1995-96 year of income.

Which limited partnerships are affccted?

Partnerships that qualify as corporate limited partnerships will be affected by the new arrangements and subject to the same taxation provisions as companies.

Limited partnerships can be corporate limited partnerships first in the year of income in which 19 August 1992 occurred; generally, that will be the 1992-93 year of income, but it could be a different year of income for limited partnerships with a substituted accounting period ***[new definition of year of income, in new section 94B].***

Limited partnerships formed on or after 19 August 1992 will be corporate limited partnerships ***[new paragraph 94D(b)].***

All limited partnerships are corporate limited partnerships in the 1995-96 year of income and subsequent years ***[new paragraph 94D(a)].***

Until then, limited partnerships formed prior to 19 August 1992 may continue to be treated as partnerships for taxation purposes.

However, if a limited partnership formed prior to 19 August 1992 does not satisfy a continuity of business test, it will be a corporate limited partnership in the year of income in which it fails to satisfy the test and subsequent years ***[new paragraph 94D(c)].***

Where a limited partnership is formed prior to 19 August 1992 and there is a change in the composition of a limited partnership after that date, the partnership will be deemed to be a corporate limited partnership unless the partners elect that the partnership is not to be treated as a corporate limited partnership ***[new paragraph 94D(d)].***

The partners will not be able to elect not to be treated as a corporate limited partnership unless the partnership passes a continuity of ownership test ***[new paragraph 94F(a)]***.

The partners must also make the election within six months after the end of the year of income to which the election relates, or the year of income in which the amendments receive the Royal Assent, whichever is the later; the Commissioner of Taxation may allow further time for the making of an election ***[new paragraph 94F(b)]***.

Continuity of business test

This test is relevant in determining whether the new arrangements will apply to a limited partnership formed prior to 19 August 1992 during the transition period (until the 1995-96 year of income). To satisfy this test, the limited partnership must carry on the same business that it carried on before 19 August 1992 until the end of the period. As well, the limited partnership must not, during the transition period, derive any income from a different kind of business, or from a different kind of transaction in its business, to those it engaged in before 19 August 1992 ***[new section 94E]***.

If a limited partnership stops carrying on the same business it carried on before 19 August 1992, or begins to derive income from a new business or new business transactions, it will be a corporate limited partnership for the whole of that year of income under new paragraph 94D(c). As such, it will be treated as a company for taxation purposes for that year. In any later year, it will be treated also as a company - once the continuity of business test has been failed, it can never be passed again.

The importance of the continuity of business test is that it prevents limited partnerships formed prior to 19 August 1992 from exploiting their partnership taxation status by embarking on new businesses or new business transactions.

The continuity of business test is in similar terms to the tests applied in sections 63C (used to limit availability of deductions for bad debts), 80E (used to limit access to losses of previous years), and 160Z and 160ZP (used to limit access to capital losses, and transfer of capital losses, respectively).

Continuity of ownership test

This test is relevant in determining whether the new arrangements will apply to a limited partnership formed before 19 August 1992 during the transition period (until the 1995-96 year of income). The partnership will pass the continuity of ownership test in a particular year of income only if, at all times from 19 August 1992 to the end of the year, more than half the interests in the partnership were held by persons who held more than half the interests in the partnership immediately before 19 August 1992. "Interests" are not defined, but the term is appropriate to compare the various interests of general and limited partners, and is meant to cover the range of interests possible in a limited partnership ***[new paragraph 94G(a)].***

However, the partnership will not fail the continuity of ownership test only because interests in the partnership are acquired before 1 July 1993, if the interests are acquired in response to and in accordance with the terms of a prospectus, offer or invitation issued before 19 August 1992, as those terms stood immediately before that day.

A prospectus, offer or invitation to acquire interests in a limited partnership, while not defined, certainly will include the kinds of prospectus, offer and invitation subject to regulation by the securities law.

This will ensure that a limited partnership formed before 19 August 1992 may continue to sell shares or interests in the limited partnership, up to the maximum number of shares or interests offered for sale to the public before 19 August 1992. However, this concession will apply only until 30 June 1993 ***[new paragraph 94G(b)].***

This modification of the continuity of ownership test ensures that limited partnerships already in the course of marketing interests in their operations before 19 August 1992 will be able to continue to market those interests, knowing that they will not be treated as companies for tax purposes even though substantial interests are sold after that date. Their business operations will continue to be dealt with in the same way. It allows such acquisitions of interests in limited partnerships until 30 June 1993, because this is the end of the main selling period for interests in limited partnerships and other tax-effective investments, regardless of any substituted accounting period of the limited partnership or of any particular investor.

As with the continuity of business test, the continuity of ownership test precludes abuse of the continuing tax treatment of existing limited partnerships. Without such a test, new partners could buy out existing limited partners for the sake of the possible losses in excess of investment that could be available.

Corporate Taxation Modifications

Broadly, limited partnerships to which these provisions apply - corporate limited partnerships - are treated as companies for the purposes of the income tax law. They are not treated as partnerships. Because of this approach, most provisions of the income tax law do not need changes to deal with limited partnerships; the existing provisions generally apply without modification. However, in some areas changes are needed.

Subdivision C of Division 5A sets out certain modifications to the existing provisions of the income tax law.

If a limited partnership is a corporate limited partnership in respect of a year of income, the income tax law has effect, subject to the changes set out in the provisions of the new Subdivision C ***[new section 94H]***.

What is an income tax law?

Income tax law is defined to include the *Income Tax Assessment Act 1936*, any Act imposing a tax payable under that Act, the *Income Tax Rates Act 1986*, the parts of the *Taxation Administration Act 1953* that relate to any of those Acts, and any related parts of any other Acts. It also includes any related regulations. However, it does not include a number of other taxing laws, which already deal with limited partnerships and other partnerships effectively. For instance, the *Fringe Benefits Tax Assessment Act 1986* treats all partnerships as individuals in their own right, in subsection 165(1) ***[definition, "income tax law", new section 94B]***.

"Company" includes corporate limited partnership

A reference in the income tax law, other than in respect of the definition of "resident" or "resident of Australia" in section 6 of the Act, to a company or body corporate shall include a reference to a limited partnership. (There is no need to refer to the definitions of resident or resident of Australia, as the residence of corporate limited partnerships is specifically dealt with.) ***[new section 94J]***.

"Partnership" does not include corporate limited partnership

A reference in the income tax law to a partnership does not include a reference to a corporate limited partnership. So the provisions in this Act that apply to other partnerships will not apply to a corporate limited partnership. Key provisions include Division 5 of Part III of the Act, but many other areas of the income tax law have special provisions to deal with the tax treatment of partnerships, which will not apply to corporate limited partnerships ***[new section 94K]***.

"Dividend" includes distribution of corporate limited partnership

A reference in the income tax law to a dividend includes a reference to any distribution made to a partner by a corporate limited partnership, whether the distribution is in money or in other property. This extends the ordinary meaning of "dividend" to create consistency between corporate limited partnerships and companies ***[new paragraph 94L(a)]***.

However, any distribution that is attributable to profits or gains arising during a year of income when the partnership was not deemed to be a corporate limited partnership will not be regarded as a dividend. This will ensure that a partner's share in the net income of a limited partnership in a year of income in which it is not a corporate limited partnership for taxation purposes will not be regarded as a dividend, even if it is paid to the partner in a year of income in which the limited partnership is treated as a company for taxation purposes. It will ensure also that no franking credits will arise as a result of the payment of tax in respect of a year of income for which the partnership was not a corporate limited partnership ***[new paragraph 94L(b)]***.

What distributions are paid out of profits?

If a corporate limited partnership pays or credits an amount to a partner in the partnership from profits or anticipated profits, or in anticipation of profits, the amount paid or credited will be deemed to be a dividend paid by the partnership to the partner out of profits derived by the partnership. Assessable income of shareholders includes certain dividends paid out of profits, under subsection 44(1); companies generally pay dividends only out of profits, as a matter of corporations law, but limited partnerships could pay dividends from other sources more readily. Moreover, one view of partnership law as it applies to corporate limited partnerships suggests that their income only arises when accounts are taken, despite their treatment as companies for taxation purposes. It could also be argued that profits don't arise until their amount can be finally ascertained. As corporate limited partnerships can make distributions before the taking of accounts, out of anticipated profits or in anticipation of profits, the provision ensures that such distributions will be taken to be made out of profits ***[new subsection 94M(1)].***

If the partnership makes a subsequent distribution of profits which includes an amount paid or credited in anticipation of profits, the Commissioner of Taxation is required to take such steps, if any, as are necessary to ensure that a partner is not subject to double taxation. This ensures that, if a partner has already been taxed on a distribution when it was credited, the partner will not face income tax again when the distribution is actually paid ***[new subsection 94M(2)].***

"Private Company" does not include corporate limited partnership

The provisions in the income tax law which apply only to private companies rather than to companies generally have no application to corporate limited partnerships ***[new section 94N].***

"Share" includes interest in corporate limited partnership

A reference in the income tax law to a share shall include a reference to an interest in a corporate limited partnership ***[new section 94P].***

"Shareholder" includes partner in corporate limited partnership

A reference in the income tax law to a shareholder includes a reference to a partner in a corporate limited partnership. This, combined with the extended meaning of "dividend" and "company", ensures that many key provisions for the taxation of companies and shareholders apply correctly to corporate limited partnerships and their partners ***[new section 94Q].***

"Liquidator" may include partner in corporate limited partnership

In relation to the application of section 47 of the Act, in the event of a winding-up of a corporate limited partnership, whoever is responsible for the taking of accounts and making payments does so as a liquidator within the extended meaning of 'liquidator' in the Act. This is so, even if several persons do different things in the winding-up; each will be a 'liquidator'.

For the purposes of the income tax law, a reference to a liquidator includes a partner in a corporate limited partnership who carries out the winding-up of the partnership ***[new paragraph 94R(a)]***.

Also for the purposes of the income tax law, a reference to distributions made by a liquidator in the course of winding-up a corporate limited partnership includes a reference to distributions made by the partner who carries out the winding-up to himself or herself in the course of winding-up the partnership ***[new paragraph 94R(b)]***.

Together, these provisions ensure that payments by a partner in the course of the taking of accounts and winding up of a corporate limited partnership are treated in the same way as payments by any other liquidator of the partnership, or as payments by the liquidator of a company. All such payments generally will be dividends out of profits or income, to the extent to which they are made from profits or income.

Continuity of corporate limited partnership not affected by changes in composition

For the purposes of the income tax law, a change in the composition of a corporate limited partnership does not affect the continuity of the partnership. So a new corporate limited partnership is not created, or a former partnership extinguished, on the retirement, substitution or addition of a partner to a corporate limited partnership ***[new section 94S]***.

Residence of corporate limited partnership

For the purposes of the income tax law, a corporate limited partnership is a resident of Australia if, and only if, the partnership was formed in Australia, or it either carries on business in Australia or has its central management and control in Australia. This gives a test of residence for corporate limited partnerships that is closely comparable to the test of residence for companies. Partnerships generally did not need to be considered as having a place of residence, under the provisions applicable to other partnerships; as their net income, loss, exempt income and so on were attributed to the partners, it was the residence of the particular partner that mattered ***[new section 94T]***.

Incorporation

For the purposes of the income tax law, a corporate limited partnership is taken to have been incorporated in the place where it was formed and under a law in force in that place. This rule is needed to clarify the operation of several provisions relating to companies, as they apply to corporate limited partnerships ***[new section 94U]***.

Obligations and offences of limited partnerships

Broadly, obligations and offences of limited partnerships are taken to be those of the individual partners, with certain joint and several liabilities. The reason for this approach is that, while corporate limited partnerships are generally treated as companies for the purposes of the income tax law, this does not convert them into companies for other purposes, including criminal law, monetary claims, and so on. So the obligations and offences of limited partnerships continue to be dealt with broadly as before these amendments. The law will provide for limited partnerships in much the same way as for other partnerships.

Where, as an entity, a corporate limited partnership is subject to an obligation under the income tax law, that obligation is imposed on each of the partners, but it may be discharged by any one of them ***[new paragraph 94V(1)(a)]***.

Where, as an entity, any amount is payable under the income tax law by a corporate limited partnership, the partners are jointly and severally liable to pay that amount ***[new paragraph 94V(1)(b)].***

Where, as an entity, any offence against the income tax law would have been committed by a corporate limited partnership, each partner will be deemed to have committed the offence ***[new paragraph 94V(1)(c)].***

However, it will be a defence against a prosecution of a partner for such an offence if the person proves that he or she did not aid, abet, counsel or procure the particular act or omission, and was not in any way knowingly concerned in, or party to, that act or omission (whether directly or indirectly or by act or omission of the person). Limited partners will generally be able to establish that defence with ease; limited partnerships established in Australia preclude limited partners from taking part in the management of their partnerships, although cases can be imagined where a limited partner would be denied the defence by aiding, abetting, counselling or procuring the offence ***[new subsection 94V(2)].***

The general liability of partners for offences of their partnership is in accord with the accepted law. However, the statutory defence allows an innocent partner to rebut the presumption. The matters to be proved, to establish the defence on the balance of probabilities, will be peculiarly within the knowledge of the partner and extremely difficult for the prosecution to negative. So what might be thought a reverse onus of proof for partners charged with offences is justified.

This proposed onus of proof for a partner defending proceedings for an offence of the partnership is similar to that in other taxation laws. Sections 102AAZG, 221YHZN and 468 of this Act, sections 165 and 166 *Fringe Benefits Tax Assessment Act 1986*, and sections 12 and 13 *Petroleum Resource Rent Tax Assessment Act 1987* all operate similarly.

Pre-1995-96 years of income - certain corporate obligations do not arise

Where a limited partnership is formed before 19 August 1992, and an event occurs whereby the partnership becomes a corporate limited partnership for a year of income prior to the 1995-96 year of income, certain obligations may be imposed under the income tax law on the partnership in its capacity as a company. However, it is not intended that a corporate limited partnership should be liable for any obligations to act as a company before the event which results in the partnership being a corporate limited partnership for that year of income.

Accordingly, where, in a year of income prior to the 1995-96 year of income, a limited partnership is deemed to be a corporate limited partnership because it failed either the continuity of business test or the continuity of ownership test, the income tax law has effect as if any obligation imposed on corporate limited partnerships because they are taxed as companies which arose before the corporate limited partnership first failed to meet either of those tests had never arisen ***[new section 94W]***.

The provision applies only in respect of any obligations arising between the beginning of the relevant year of income and the time at which the first event occurs.

Modification of loss provisions

In determining whether a disqualifying event has occurred for the purposes of section 50H or whether the continuity of ownership test for the purposes of section 80A has been satisfied, the parts of those provisions relating to voting power will not be taken into account ***[new section 94X]***.

Modification of provisions relating to the collection of company tax

Irrespective of anything in Division 1B of Part VI, relating to the collection of company tax, the notional tax of a limited partnership will be nil in respect of the first year of income for which it is taxed as a corporate limited partnership. The notional tax is nil if the year of income is the one in which 19 August 1992 occurred, or if the partnership was not a corporate limited partnership in the year of income before the particular year ***[new section 94Y].***

Because of the definition of a "year of income", the first possible year of income for a corporate limited partnership is the year of income in which 19 August 1992 occurred. In effect, a limited partnership will be treated as a new entity in the year of income in which it first becomes assessable as a company under these provisions ***[definition, "year of income", new section 94B].***

Transitional

Clause 9 provides that any act or omission on the part of any person before Royal Assent to this provision will not result in a person being guilty of any offence under the income tax law, merely because of the changes made here. In effect, before Royal Assent, no offences arise from a limited partnership failing to discharge obligations imposed on it as a corporate limited partner. The only relevant actions or omissions will be in relation to the law affected by the changes - that is, the areas of income tax law to which the treatment of certain limited partnerships as companies is relevant ***[Clause 9].***

Chapter 5

Exemption from Income Tax: Family payment advance

Exemption from income tax: family payment advance

Summary of proposed amendments

Purpose of amendment: To exempt family payment advance from income tax.

Date of Effect: On or after 1 January 1993.

Background to the legislation

The Table in section 24AB of the Income Tax Assessment Act (the Act) is an index of payments made under the Social Security Act 1991 which are generally exempt from income tax. At present it lists, among other things, the "family allowance" and the "family allowance supplement" which are exempt from income tax under sections 24ABW and 24ABX of the Act respectively.

The Social Security Act has been amended to replace these two payments with one payment, the "family payment". This amendment has effect from 1 January 1993. That amending Act also amended the Income Tax Assessment Act, with effect from the same date, to replace the exemption for "family allowance" and "family allowance supplement" with an exemption for "family payment". The exemption for family payment will be provided for by section 24ABW of the Act.

As a result of these amendments the "family allowance" and "family allowance supplement" are to remain in the Table in section 24AB of the Act until 1 January 1993 when they will be replaced by "family payment". The existing sections 24ABW and 24ABX will also remain in the Act until 1 January 1993 when they will be replaced by a new section 24ABW which will exempt the "family payment" from income tax.

The Social Security Amendment Bill (No. 2) 1992, presently awaiting Royal Assent, proposes to allow, from 1 January 1993, recipients of family payment an option to receive part of their entitlement as a lump sum advance for up to six months. As a result of this initiative there is a need to make a consequential amendment of the Act to ensure that the advance is exempt from income tax. This will result in the advance being treated in the same manner as the family payment.

Explanation of proposed amendments

The Bill proposes to amend section 24AB of the Act to include "family payment advance" in the index of payments covered by Subdivision B. Generally such payments are exempt from income tax ***[Clause 10]***.

The Bill proposes to insert a new section 24ABX in to Subdivision B to exempt family payment advance from income tax ***[Clause 11]***.

These amendments will commence on 1 January 1993, immediately after the the commencement of the Social Security Amendment Act (No.2) 1992 ***[Clause 12]***.

Chapter 6

Prescribed Payments System (PPS) Simplification

Prescribed Payments System (PPS) simplification

Summary of proposed amendments

Purpose of amendment: To reduce the amount of paperwork involved in the administration of the Prescribed Payments System (PPS). The changes will make it easier for taxpayers to comply with their tax obligations.

Under the proposed amendments:

- payers will report payments made, during a year of income, on an annual instead of the present monthly basis;
- payees may complete a new Payee Declaration. Also payees may elect to have a higher percentage deducted from prescribed payments than is currently permitted; and
- the current deduction variation certificate, deduction exemption certificate and reporting exemption arrangements will be modified.

Date of Effect: The amendments will apply on or after 1 January 1993 except for those relating to deduction variation certificates which will apply on or after 1 July 1992.

Background to the legislation

The Government introduced the PPS in 1983 to collect tax at source from certain prescribed payments for labour and services in the building and construction and other specified industries made on or after 1 September 1983.

Householders who enter into building or construction projects worth more than $10,000 are eligible paying authorities (subsections 221YHA(3) &(4)) and must report payments made in connection with the project on a monthly basis. However, unlike other PPS payers those householders are not required to deduct tax.

The current legislative framework uses the term "eligible paying authority" (subsection 221YHA(4)) to describe payers who have obligations under the legislation. The term "paying authority" is defined in subsection 221YHA(1).

Householders making prescribed payments under contracts less than $10 000 are paying authorities but not eligible paying authorities.

The term "payer" in this chapter in relation to PPS obligations will mean eligible paying authorities including householders making prescribed payments under contracts greater than $10 000.

Rate of deduction

A payer making a prescribed payment is required to deduct tax from the payment at the prescribed rate of 20% (subregulation 128(1)). Where the payee fails to complete a deduction form, the payer is required to deduct tax at the highest marginal tax rate plus medicare levy. The payer is also required to send the tax deducted together with other information including reconciliation forms to the Commissioner monthly. These and other duties of payees are set out in section 221YHD.

Deduction variations

The Commissioner may issue a deduction variation certificate (section 221YHP) where special circumstances exist so that tax at a rate lower than 20% can be deducted. The payee is currently required to apply for a new variation certificate annually.

Deduction exemptions

The Commissioner may issue a deduction exemption certificate (section 221YHQ) where certain circumstances exist and where the payee satisfies certain tests which include having a good compliance record. The certificate is usually valid for three years and entitles the payee to receive prescribed payments without the deduction of tax.

Reporting Exemptions

Payees who have obtained a deduction exemption certificate are currently entitled to apply for a reporting exemption (section 221YHR). A reporting exemption is generally valid for three years and frees payees from having their payments reported.

Why change the law?

The amendments proposed will ease the administrative burden on payers, payees and the Australian Taxation Office (ATO) and reduce the amount of paperwork involved under the proposed arrangements.

For example, there were in excess of 140,000 deduction variation certificates in force on 30 June 1992 which, until the changes were announced by the Treasurer on 1 July 1992, were reviewed annually. Further, there are 6 million deduction forms used per annum.

The administrative requirements placed on PPS payers under the current system (through monthly reporting and reconciliation) are considerably greater than the comparable requirement for their PAYE counterparts.

Explanation of proposed amendments

Interpretation

The proposed simplification of the PPS requires the introduction of new definitions and the deletion of current definitions (section 221YHA) which are no longer required ***[clause 16]***.

The new terminology in relation to amounts deducted from prescribed payments is explained later in the Chapter. The main modifications to the PPS arrangements concern the manner in which payers and payees are identified. Under the amendments proposed, information currently obtained from the deduction forms will be obtained from the new payee declaration.

Payee Declarations

Who can make a payee declaration?

On or after 1 January 1993, payees other than:

- those dealing with householders; and
- payees who have approval to quote a reporting exemption number

may make a payee declaration in respect of prescribed payments to be received ***[new subsections 221YHB(1), (2), (4) and paragraph 221YHQ(1A)(b)].***

How is a payee declaration made?

In order to make a payee declaration, a payee must complete the new payee declaration form and give it to the payer ***[new subsections 221YHB(1)&(4)].***

The new form is similar to the employee declaration form (section 202C) on which employees may give information to employers which is relevant in ascertaining the amount of PAYE tax instalments to be deducted from payments made. As with the employment declaration, the new PPS payee declaration will enable the payee's tax file number (TFN), as well as details of deduction variation and deduction exemption certificates to be given to the payer so that the correct PPS deductions can be made from prescribed payments ***[new subsection 221YHB(3)].***

How long does the declaration stay in force?

A payee declaration will remain in force for 1 year after the last payment is made by the payer to the payee. This will avoid the situation of the payer not knowing whether an earlier declaration made by that payee is still in force. A payee declaration can also cease if the payee makes another payee declaration or quotes a reporting exemption number to the payer ***[new paragraphs 221YHB(5)(a),(b)&(c)].***

To parallel the employment declaration arrangements (section 202CA), it is proposed that the Commissioner may, by notice published in the Gazette, determine that all or some classes of payee declarations cease to be in force ***[new paragraph 221YHB(5)(d)].*** Payee declarations will also cease where TFN information is not provided to the payer within 28 days after the making of a declaration ***[new subsection 221YHB(6)].***

A payee declaration will also cease if the Commissioner notifies the payee that he is:

- satisfied that the TFN in the declaration provided has been cancelled or it is not the payee's TFN; and
- not satisfied that the payee has a TFN

[New subsections 221YHB(8)&(9)]

Consistent with the existing arrangements for employment declarations (subsection 202CE(3) and paragraph 202F(1)(c)), decisions of the Commissioner under ***new subsection 221YHB(8)*** can be objected to ***[clause 28].***

What if the payee's TFN is incorrectly stated in the declaration?

When this occurs and the Commissioner is satisfied that the payee has a TFN, the Commissioner may notify the payer who has the declaration with the incorrect TFN of the correct TFN ***[new subsection 221YHB(10)].***

What is the payer to do when a payee declaration is received?

The obligations for payers, when given a payee declaration, are set out in ***new section 221YHC.***

For example, on receiving a declaration, the payer is required to sign and retain a copy. The payer is also required to write the payee's TFN on the declaration if subsequently given by the payee. The payer will be required to send the declaration to the Commissioner within the forwarding period. The forwarding period for payee declarations is similar to the term used for employee declarations (section 202CD). That is, generally 28 days after the payee gives the declaration to the payer or longer when the payee's TFN is not stated on the declaration ***[new subsections 221YHC(1) & (2)].***

The payer is also required to retain the declaration until the second 1 July after the declaration ceases to be in force ***[new paragraph 221YHC(1)(e].***

New terminology in relation to amounts to be deducted

The amendments proposed for prescribed payments made on or after 1 January 1993 will replace the existing terms that describe the amount or percentage to be deducted from prescribed payments.

The current prescribed rate of 20% (subregulation 128(1)), applicable when a deduction form is properly furnished, will be called the "ordinary percentage". The rate of 48.25% (subregulation 128(2)) which is currently deducted when the payee's deduction form is not completed properly, for example when the payee's TFN is not provided, will be called the"non-declaration percentage" ***[clause 16].***

Under the proposed arrangements, the new payee declaration form will be the mechanism whereby the payee's TFN is provided to the payer.

What is a higher deduction percentage election?

A payee who has made a payee declaration may give a higher deduction percentage election form to a payer at any time before a payment is made ***[new subsections 221YHR(1) and (2)].***

A higher deduction percentage election form is a document in which the payee elects the percentage to be deducted from one or more specified payments, or all payments made before a specified date ***[new subsection 221YHR(3)].***

Where a higher deduction percentage election is in force in relation to a payment when it is made, the payer must deduct the percentage of the payment stated in the election form ***[new subsection 221YHD(5)].***

Consistent with the other record keeping requirements, the payer must retain a copy of the higher deduction election percentage form for a period of 5 years ***[new subsection 221YHR(7)].*** A payee may at any time cancel the election by advising the payer in writing ***[new subsection 221YHR(5)].***

Deductions where there is a payee declaration in force

Where a payee declaration is in force, a payer, other than a householder, will be required to make a deduction at the ordinary percentage from prescribed payments made to a payee ***[new subsections YHD(1)&(2)].***

What if the payee is the holder of a deduction variation certificate?

Where a payee states a deduction variation certificate number and a deduction variation certificate percentage in the payee declaration, and the payer reasonably believes the certificate is in force, the payer must deduct the deduction variation certificate percentage (see definition in subsection 221YHA(1)) of the payment unless the payee has made a higher deduction percentage election in respect of the payment ***[new subsection 221YHD(3)].***

What if the payee is the holder of a deduction exemption certificate?

Where a payee states a deduction exemption certificate number in the payee declaration, and the payer reasonably believes the certificate is in force, the payer must not deduct anything from the payment unless the payee has made a higher deduction percentage election in respect of the payment ***[new subsection 221YHD(4)].***

Example

The holder of a deduction variation certificate stating a deduction variation certificate percentage of 5% (or the holder of a deduction exemption certificate) may make a higher deduction percentage election to have a rate of 15% deducted from all payments made between 1 January 1993 and 30 June 1993 to build up sufficient credit to offset the tax payable on assessment.

Deductions where no payee declaration

A payer, other than a householder, is required to deduct the non-declaration percentage of the payment where a payee declaration is not in force and the payee has not quoted an in force reporting exemption number when the payment is made ***[new section 221YHDA]***.

Payers (other than householders) reporting etc obligations

New section 221YHDC replaces the current reporting requirements for payers, other than householders. To reduce repetition in the legislation, ***new subsection 221YHDC(1)*** introduces the concept of a reportable payment as a prescribed payment made by an eligible paying authority (other than a householder) to a payee who has not quoted a reporting exemption number. The current reporting requirements are in sections 221YHAA to 221YHD inclusive which the Bill proposes to repeal ***[Clause 17]***.

Monthly obligations

On or after 1 January 1993, a payer will still be required to send to the Commissioner all amounts deducted from prescribed payments no later than 14 days after the end of the month to which the payment relates ***[new subsection 221YHDC(2)]***. However, the existing monthly reconciliation form will not be required under the proposed arrangements and will be replaced with the new remittance advice form which must accompany amounts sent to the Commissioner ***[new subsection 221YHDC(4)]***.

Annual obligations for non-owner-builders

Payers, other than owner-builders must, unless the payee has quoted an in force reporting exemption number, no later than 14 July after the end of the financial year:

- complete and sign a payment summary form in respect of payments in relation to which the payer is not an owner-builder; and copy the form and make reasonable efforts to give the form to the payee ***[new paragraph 221YHDC(5)(a)]***.

Example

It would be considered reasonable if the payer was to post the payment summary to the address stated on the payee declaration or the address stated on an invoice prepared by the payee where there is no payee declaration in force.

Those payers are also required no later that 14 August after the end of the financial year to send to the Commissioner a copy of the payment summary form together with a completed and signed reconciliation statement in respect of payments made to all payees ***[new paragraph 221YHDC(5)(b)]***.

Obligations for owner-builders

Payers who are owner-builders in relation to payments made under a contract and the project is not completed at the end of the financial year are subject to the same reporting requirements as non-owner-builders explained above ***[new subsection 221YHDC(6)]***.

In relation to projects completed during the year of income, the same information described above is to be provided within 6 weeks after completion of the project ***[new subsections 221YHDC(7) and (8)]***.

Which records must payers other than householders retain?

Payers, other than householders, must retain a copy of documents they send to the Commissioner for at least 5 years after the end of the financial year to which the prescribed payments to which they relate were made ***[new subsection 221YHDC(9)]***.

Can a payer extend the reporting time?

Yes. The Bill proposes to retain the existing provision (paragraph 221YHD(2)(a)) whereby, the Commissioner advises the payer in writing that an extension is granted ***[new subsection 221YHDC(11)].***

Can a payer vary the reporting requirements?

Yes. As with the existing provisions (paragraph 221YHD(2)(b)), where the payee has made a payee declaration quoting an in force deduction exemption certificate to the payer and the Commissioner advises the payer in writing that they may vary some or all of the reporting requirements ***[new subsection 221YHDC(12)].***

Householders

Proposed ***new section 221YHDD*** replaces the current reporting arrangements for householders which are also contained in existing sections 221YHAA to 221YHD inclusive which the Bill proposes to repeal ***[clause 17]***.

Payee obligations

Where a payee enters into a contract with a householder, and the payee has not quoted an in force reporting exemption number to the householder, the payee must give the householder a householder payment summary form, with the payee part completed, before the first prescribed payment is made ***[new subsections 221YHDD(1)&(2)].***

Householder obligations

From 1 January 1993, it is proposed that householders will no longer be required to report to the Commissioner on commencement and completion of a construction project and on a monthly basis. Instead, householders will be required to report to the Commissioner only once on completion of the project.

The proposed amendments will require householders to complete the householder part of the householder payment summary form and send it to the Commissioner within

6 weeks after the completion of the project. If the payee has not completed the payee's part of the householder payment summary form, the householder should try to fill out as much information as they can in relation to that part before sending the form to the Commissioner ***[new subsections 221YHDD(4)&(5)].***

How long should householders retain records?

A householder should retain a copy of the householder payment summary form for the payee for period of 6 months after the end of the financial year in which the project was completed unless the payee requested and was given the copy before the end of the 6 months ***[new subsections 221YHDD(6)&(7)].***

Deduction Variation certificates

Under the existing law a payee can apply to the Commissioner for a deduction variation certificate where special circumstances exist. A deduction variation certificate enables a payee to have tax deducted from prescribed payments at a rate lower than the prescribed rate of 20%. A payee must apply for a deduction variation certificate annually. The circumstances necessary for the issue of existing certificates are specified in Income Tax Ruling IT2448.

Proposed law

Under the proposed amendments, a deduction variation certificate issued on or after 1 July 1992 will remain in force indefinitely unless it is subsequently revoked ***[new subsection 221YHP(4) and subclause 31(6)].***

The circumstances which must be satisfied before a deduction variation certificate will be granted are detailed in ***new paragraph 221YHP(2).***

Example

A payee applies to the Commissioner for a deduction variation certificate under section 221YHP as amended.

The payee's expected annual income from all sources for the year of income is $50,000 of which $10,000 will be PPS income in respect of 6 months PPS work. Further the payee has complied satisfactorily with tax obligations for the 12 month period prior to application ***[new paragraph 221YHP(2)(b)]***.

In this situation, the payee's deduction variation certificate percentage will be 15% (assuming a tax rate of 20% for income in excess of $5,400), being the tax rate applicable to the payee's annualised PPS income ($20,000) and assuming the payee's assessable income for the year consisted only of PPS income ***[new paragraph 221YHP(2)(a)]***.

When the circumstances giving rise to the issue of a deduction variation certificate are no longer applicable the certificate may be revoked (section 221YHS). An example would be where the rate contained in the certificate no longer reflects the taxpayer's PPS circumstances.

Deduction exemption certificates

Current law

The Commissioner currently has discretion (section 221YHQ) to issue a deduction exemption certificate where certain circumstances exist and the where the payees satisfies certain tests including a good compliance record. The certificate is usually valid for 3 years.

Proposed law

Under the proposed law a deduction exemption certificate issued on or after 1 January 1993 will remain in force until it is revoked ***[new subsection 221YHQ(8)]***. A certificate remains in force regardless of whether the payee is granted an approval to quote a reporting exemption number after the certificate is issued.

It is also proposed to remove the tests in subparagraph 221YHQ(2)(a)(iv) as they relate to future events which could not be reasonably be ascertained given the indefinite nature of the certificate ***[paragraph (c) in clause 24]***.

A deduction exemption certificate issued prior to 1 January 1993 which is still in force on 1 January 1993 will run its course unless it is revoked ***[subclause 31(7)]***.

Reporting exemption approvals

Current law

Under the existing law, a payee who has obtained a deduction exemption certificate under section 221YHQ is entitled to a reporting exemption under section 221YHR.

The payee may either furnish a reporting exemption declaration to each payer or alternatively, by application to the Commissioner quote a reporting exemption number to each payer. A reporting exemption is generally valid for three years and ceases to be in force when the deduction exemption certificate expires or is revoked.

Payees who are the holders of reporting exemptions are absolved from completing deduction and other PPS forms. Payers are not required to deduct tax or report payments made where the payee furnishes a reporting exemption declaration or quotes a reporting exemption approval number.

Proposed law

Under the proposed amendments, ***clauses 24 and 25*** will result in the reporting exemption provisions in section 221YHR being combined with the existing deduction exemption certificate provisions in section 221YHQ under existing section 221YHQ as amended.

As with the existing law, a payer will not be required to make deductions from prescribed payments made to a payee who has a reporting exemption.

Under the proposed law a taxpayer may, on or after 1 January 1993, apply to the Commissioner separately for approval to quote to payers a reporting exemption approval number ***[new paragraph 221YHQ(1)(b)]***.

The payee will be required to meet the same tests as applicants for deduction exemption certificates. If the payee satisfies the tests the Commissioner must notify the payee in writing of the approval to quote a specified reporting exemption number and the period to which the approval is in force ***[new paragraph 221YHQ(1A)(b)]***.

An approval to quote a reporting exemption number will remain in force for the period, not exceeding 3 years, specified in the approval unless the Commissioner revokes the approval ***[new subsection 221YHQ(9) & new section 221YHSA]***.

Example

There would be nothing to prevent the holder of a deduction exemption certificate applying under ***new paragraph 221YHQ(1)(b)*** for approval to quote a reporting exemption number. Further, as discussed above, the deduction exemption would continue to be in force until it is revoked.

How does a payee quote a reporting exemption number to a payer?

A payee who is the holder of an approval to quote a reporting exemption number will be required to notify the payer, in writing, of the reporting exemption number and the day on which the approval ends ***[new subsection 221YHQ(10)]***.

Example

A payee may wish to include the reporting exemption approval number on an invoice sent to the payer during the period in which the approval is in force or alternatively, the payee may advise the payer in a separate advice before any payments are made.

How long does the payer retain the notification for?

Under the proposed arrangements, a payer (other than a householder) will be required to retain a copy of the notification of the reporting exemption approval number for 5 years after the financial year in which the notification expires. For householders, the retention period will be 1 year ***[new subsection 221YHQ(11)].***

Revocation of approval to quote a reporting exemption number.

Section 221YHS currently permits the Commissioner to revoke a deduction exemption certificate or a deduction variation certificate at any time. These certificates are within the definition of 'prescribed certificate' in subsection 221YHA(1).

Proposed ***new section 221YHSA*** will permit the Commissioner to revoke an approval to quote a reporting exemption number. For example, the Commissioner may revoke an approval where a payee did not comply with any of their obligations under an Act administered by the Commissioner.

What happens to reporting exemptions which were granted before 1 January 1993?

Where a payee has given a payer a reporting exemption declaration prior to 1 January 1993 under the existing subsection 221YHR(1) the declaration will remain in force until the declaration expires ***[subclause 31(8)].***

An existing reporting exemption approval number granted prior to 1 January 1993 under subsection 221YHR(5) will remain in force in the manner specified by the Commissioner until the approval expires or is revoked ***[subclause 31(9)].***

Technical amendments

In addition to the amendments explained in this chapter, the Bill also contains several amendments, of a minor technical nature. These amendments were required in the restructure of the PPS provisions. For example, existing section 221YHB covers the provision of information to the Commissioner by householders and eligible paying authorities other than householders.

In the proposed amendments, ***new section 221YHB*** deals with the making of payee declarations. It was therefore necessary to retain some of the section 221YHB provisions under the new arrangements. For example, the requirement for eligible paying authorities to notify the Commissioner within 14 days after entering a contract under which they are liable to make a prescribed payment is contained in ***new section 221YHDB***. The Bill also ensures that existing notifications are not affected by the amendments proposed ***[subclause 94(3)]***.

New section 221YHDE contains the existing provisions in subsection 221YHB(10) which require "issuing authorities" to provide to the Commissioner details of construction permits issued.

A further illustration is in the area of offences currently applicable when payers do not comply with their statutory obligations. Existing subsections 221YHB(11) and 221YHD(3) contain the penalties applicable when payers fail to meet their obligations. Under the restructured provisions, the duties of the different categories of payers (owner-builders and other payers) are separated and carry their own penalty provisions. For example see, ***new subsections 221YHDB(2), 221YHDC(3) & (9)*** and ***221YHDD(3)***.

Other amendments not explained in the chapter but described in the section of this Explanatory Memorandum concerning **Clauses involved in the proposed amendments** include:

Interim notices	*Clause 14*
Credits in respect of deductions	*Clause 18*
Failure to pay amounts deducted to the Commissioner	*Clause 19*
Failure to furnish deduction forms	*Clause 20*
Remission of certain amounts	*Clause 21*
Persons liability discharged from making deductions	*Clause 22*
Offences	*Clause 23*

Chapter 7

Medicare levy rate increase and technical amendment of the Act

Medicare levy rate increase and technical amendment of the Act

Medicare Levy Rate

Summary of proposed amendments

Purpose of amendment: This Bill proposes to amend sections 6 and 8 of the Medicare Levy Act 1986 to raise the rate of Medicare levy from 1.25% to 1.4%.

Date of effect: 1 July 1993.

Background to the legislation

Under existing law the Medicare levy is assessed at a rate prescribed in the Medicare Levy Act 1986. There is provision for separate prescription of the rate of levy payable by:

- individual taxpayers;
- the trustee of a trust estate on trust income assessable under section 98 of the Income Tax Assessment Act 1936 (ITAA); trustees are liable to be assessed under that section on income to which a beneficiary who is under a legal disability, for example infancy, is presently entitled;
- a trustee of a trust estate on trust income assessable undersection 99 or 99A of the ITAA; under those sections a trustee is assessable on trust income to which no beneficiary is presently entitled.

Explanation of the proposed amendments

Clause 3 will amend the three subsections of section 6 of the Act, corresponding to the three groups of taxpayers liable to pay the levy by omitting "1.25%" and substituting "1.4%". This will raise the rate of levy from 1.25% to 1.4% *[Clause 3]*.

Subsection 8 (2) "shades-in" the amount of levy payable by a couple, or a sole parent, where the couple or sole parent is not entitled to exemption from the levy because the family income exceeds the family income threshold by a small or moderate amount. In such circumstances the amount of levy payable by the taxpayer is to be reduced in accordance with a formula specified in the subsection. The effect of the subsection is to limit the levy payable by the taxpayer to 20 per cent of the family income over the family income threshold.

The increase in the rate of levy makes necessary the amendment of figures used in the formula to ensure that the formula continues to give the same result. This will be achieved by:

- subsubclause 4(1)(a) omitting "0.1875" from the formula and substituting "0.186" ***[Sub-subclause 4(1)(a)]***; and
- subsubclause 4(1)(b) omitting "1.25%" from the definition of component A in the formula and substituting "1.4%" ***[Sub-subclause 4(1)(b)]***.

The amendments will be effective as from 1 July 1993 ***[Subclause 5(1)]***.

Technical amendment to the Medicare Levy Act 1986

Summary of proposed amendment

Purpose of amendment: This Bill proposes to amend terminology in the Medicare Levy Act 1986 consequent on an amendment to the Social Security Act 1991.

Date of effect: 1 January 1993

Background to the legislation

The Medicare Levy Act provides that where the "family income" is at or below the "family income threshold" there is no liability to pay the Medicare levy. For a couple the "family income" is the sum of their taxable incomes and for a sole parent it is the taxable income.

The "family income threshold" is a specified amount increased by a specified amount for each dependent child or student. To avoid each member of a separated couple increasing their threshold on account of a child or student, the Act provides that the child or student shall not be taken in to account unless the taxpayer is receiving the family allowance for that person.

Explanation of the proposed amendment

Earlier this year the Social Security Act was amended so that the "family allowance" was replaced by the "family payment". The amendment, effective from 1 January 1993, does not change coverage of this assistance.

Subclause 4 (2) will amend subsection 8(6) of the Medicare Levy Act by omitting "family allowance" and substituting "family payment" ***[Subclause 4(2)].*** This amendment is to be effective from 1 January 1993 ***[Subclause 5(2)].***

Glossary of Commonly Used Terms

Glossary of commonly used terms

Term	Definition
Change in composition	Retirement, substitution or addition of a partner
Continuity of business test	requirement that existing limited partnerships not change their business if they are to continue to be treated as partnerships for income tax purposes until the 1995-96 year of income
Continuity of ownership test	requirement that existing limited partnerships not change their ownership if they are to continue to be treated as partnerships for income tax purposes until the 1995-96 year of income
Corporate limited partnership	a limited partnership treated as a company for income tax purposes
limited partnership	any partnership in which the liability of at least one member is limited

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