

1993

THE PARLIAMENT OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAXATION (DEFICIT REDUCTION) BILL (NO. 1) 1993

EXPLANATORY MEMORANDUM

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

Overview of the Government's deficit reduction package of legislation

The deficit reduction package comprises 8 Bills, which will give effect to changes to the tax law announced in the 1993-4 Budget.

Taxation (Deficit Reduction) Bill (No. 1) 1993

This Bill will make the amendments necessary to give effect to the following measures:

- increase the Medicare low income thresholds;
- remove the concessional treatment that applies to the taxation of unused annual and long service leave;
- changes to the taxation treatment of excess domestic travel allowances and expenses, and of certain non-deductible expenses;
- denial of income tax deductions for car parking expenses for self-employed persons;
- changes to the taxation treatment of credit unions.

This Bill will commence on the date on which it receives the Royal Assent.

Taxation (Deficit Reduction) Bill (No. 2) 1993

This Bill contains amendments to give effect to the following 2 measures:

- increase the rate of fringe benefits tax;
- change the taxation treatment of friendly societies, including bringing the rate of tax on their life insurance business into line with the rate of tax on similar business undertaken by life companies.

This Bill will commence on the date on which it receives the Royal Assent.

Taxation (Deficit Reduction) Bill (No. 3) 1993

This Bill will contain the amendments necessary to:

- bring forward the first round of personal tax cuts, and to defer the second round; and
- introduce the \$150 low income rebate.

This Bill will not commence until all of the other Bills in this package, except for the Taxation (Deficit Reduction) Bill (No. 2) 1993, receive the Royal Assent.

Sales Tax (Customs) (Deficit Reduction) Bill 1993

Sales Tax (Excise) (Deficit Reduction) Bill 1993

Sales Tax (In Situ Pools) (Deficit Reduction) Bill 1993

Sales Tax (General) (Deficit Reduction) Bill 1993

Each of these Bills will modify the *Sales Tax (Exemptions and Classifications) Act 1992* to the extent necessary to give effect to the following changes to the sales tax laws:

- the general percentage increases in sales tax rates;
- the change of rates on wine;
- the changes to the tax treatment of luxury motor vehicles.

These Bills will be taken to have come into operation on 18 August 1993, for those measures announced to take effect from that date.

Sales Tax Assessment Amendment (Deficit Reduction) Bill 1993

This Bill will make the consequential changes to the *Sales Tax Assessment Act 1992* that are necessary to give effect to the changes to the taxation treatment of luxury motor vehicles.

This Bill will be taken to have come into operation on 18 August 1993.

GENERAL OUTLINE AND FINANCIAL IMPACT

The Taxation (Deficit Reduction) Bill (No. 1) 1993 will amend various Acts (unless otherwise indicated all amendments refer to the *Income Tax Assessment Act 1936*) by making the following changes:

Fringe Benefits Tax

Excess Domestic Travel

Amends the *Fringe Benefits Tax Assessment Act 1986* to create an Excess Domestic Travel Allowance Fringe Benefit. Denies a deduction for travel expenses in excess of a reasonable amount. Both measures relate only to travel within Australia.

Date of effect: 1 April 1994

Proposal announced: 1993-94 Budget, 17 August 1993

| | | | | |
|------------------------|-------|-------|-------|-------|
| <i>Financial Gain:</i> | 93-94 | 94-95 | 95-96 | 96-97 |
| | - | \$60m | \$45m | \$45m |

Non-deductible Expenses

- Allows deductions for expenses relating to the provision of entertainment, club fees, leisure facilities, travel expenses of accompanying relatives, Higher Education Contribution Scheme payments and Student Financial Supplement Scheme payments incurred by employers in providing fringe benefits to their employees.

Makes reciprocal amendments to the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) to ensure those fringe benefits provided to the employees are subject to fringe benefits tax under the FBTAA.

Date of effect: 1 April 1994

Proposal announced: 1993-94 Budget, 17 August 1993

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|------------------------|-------|--------|--------|--------|
| <i>Financial Gain:</i> | 93-94 | 94-95 | 95-96 | 96-97 |
| | - | \$435m | \$240m | \$240m |

Car Parking deductions

Denies a deduction for car parking expenses for certain non-employees.

Date of effect: 1 July 1994

Proposal announced: 1993-94 Budget, 17 August 1993

| | | | | |
|------------------------|-------|-------|-------|-------|
| <i>Financial Gain:</i> | 93-94 | 94-95 | 95-96 | 96-97 |
| | - | - | \$70m | \$35m |

Unused annual leave and unused long service leave payments

- Removes the concessional tax treatment that applies to lump sum payments of unused annual leave and unused long service leave made on termination of employment.

Date of effect: Payments in respect of unused annual leave made on or after 18 August 1993 and payments in respect of unused long service leave accrued on or after 18 August 1993.

Proposal announced: 17 August (1993-94 Budget), and 30 August 1993

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|------------------------|-------|--------|--------|--------|
| <i>Financial Gain:</i> | 93/94 | 94/95 | 95/96 | 96-97 |
| | \$80m | \$180m | \$165m | \$180m |

Credit Unions - Removal of exemption for interest received from non-corporate members and taxation as co-operatives or companies

- Provides for the phasing out of the exemption for income in the nature of interest received by credit unions from their non-corporate members on loans made to those members and allows credit unions to be taxed as co-operatives.

Date of effect: For large credit unions (those with total assets in excess of \$30 million), the exemption will be removed with effect from the 1994-95 year of income (subject to a concessional rate of 20% for the 1994-95, 1995-96 and 1996-97 years of income); and for all other credit unions, the exemption will be removed with effect from the 1995-96 year of income (subject also to a concessional rate of 20% for the 1995-96 and 1996-97 years

of income). All credit unions will be liable for the full corporate rate of tax with effect from the 1997-98 year of income and all later years of income.

Proposal Announced: Budget 1993-94, 17 August 1993.

| | | | | |
|------------------------|-------|-------|-------|-------|
| <i>Financial Gain:</i> | 93/94 | 94/95 | 95/96 | 96-97 |
| | - | - | \$25m | \$30m |

Income Tax Rates Act 1986

Provides for credit unions to be taxed at the concessional rate of 20% following the removal of the exemption from tax of income in the nature of interest received by credit unions from their non-corporate members on loans made to those members.

Date of effect: For large credit unions (those with total assets in excess of \$30 million), the concessional rate will apply for the 1994-95, 1995-96 and 1996-97 years of income; and for all other credit unions, the concessional rate will apply for the 1995-96 and 1996-97 years of income. The full corporate rate of tax will apply to all credit unions for the 1997-98 year of income and all later years of income.

Proposal announced: Budget 1993-94, 17 August 1993.

Changes to the Medicare levy threshold levels

Medicare Levy Act 1986

Amends the *Medicare Levy Act 1986* to increase the taxable income levels below which persons are exempt from the levy.

The new levels compare with the old as follows:

| Taxpayer | 1992-93 | 1993-94 |
|------------------------------|----------|----------|
| Individuals | \$11,887 | \$12,688 |
| Married couples/sole parents | \$20,070 | \$21,366 |

Date of effect: 1 July 1993

Proposal announced: 1993-94 Budget, 17 August 1993.

| | | | | |
|------------------------|-------|-------|-------|-------|
| <i>Financial Cost:</i> | 93-94 | 94-95 | 95-96 | 96-97 |
| | \$30m | \$60m | \$45m | \$45m |

CHAPTER ONE *Fringe Benefits Tax*

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EXCESS DOMESTIC TRAVEL ALLOWANCE

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Summary of Amendments

1.1 Purpose of the amendments: To amend the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) to create an Excess Domestic Travel Allowance Benefit where a relevant allowance is in excess of a prescribed amount [*Clause 4*]. The Bill will also amend the *Income Tax Assessment Act 1936* (ITAA) to deny a deduction for travel expenses in excess of a prescribed amount. Both measures relate only to travel within Australia [*Clause 17*].

1.2 The Bill inserts a *new Division 7A* into the FBTAA. Subdivision A of the new Division sets out what constitutes a domestic travel allowance and what constitutes an excess domestic travel allowance benefit. Subdivision B of the new Division sets out what is the taxable value of an excess domestic travel allowance fringe benefit.

1.3 The Bill inserts *new section 51AM* into the ITAA to deny deductions to employees for excess domestic travel expenses. The Bill also inserts *new section 51AN* into the ITAA to deny deductions to persons other than employees for excess domestic travel expenses.

1.4 Date of effect: The amendments to the FBTAA are to apply to FBT assessments from and including the FBT tax year commencing on 1 April 1994 [*Clause 7*].

1.5 The amendments to the ITAA are to apply to expenses incurred on or after 1 April 1994 [*Clause 19 and 22*].

Background to the legislation

1.6 A deduction under subsection 51(1) of the ITAA is available for expenditure incurred on the cost of food, drink, accommodation or incidentals on employment-related travel. This deduction, however, is subject to the substantiation provisions of the ITAA being satisfied. The relevant substantiation provisions are sections 82KZ and 82KZA.

1.7 In the case of domestic travel, subsection 82KZ(4) provides relief from the substantiation requirements contained in subsections 82KZ(2) and 82KZA where the taxpayer has received an allowance in respect of those expenses (whether or not the allowance was paid under an industrial instrument) and the following conditions are satisfied:

- the expenditure incurred does not exceed the allowance; and
- the Commissioner of Taxation considers the allowance to be reasonable.

1.8 The Commissioner provides guidelines on what he considers to be a reasonable travelling allowance by way of rulings, the most recent being Taxation Ruling TR 93/22 issued on 15 July 1993.

1.9 Where a taxpayer claims expenditure on food, drink, accommodation and incidentals in excess of a reasonable travel allowance and/or the travel allowance received by the taxpayer exceeds what the Commissioner considers to be reasonable, a deduction will be denied for all of the expenditure where the amounts are not fully substantiated.

1.10 Under the existing law, there is no limit imposed as to the amount of expenditure a taxpayer can claim with regard to these expenses. A taxpayer will be entitled to a deduction for expenditure incurred which is in excess of what the Commissioner considers reasonable provided the substantiation requirements (as outlined above) are satisfied.

Explanation of the amendments

Fringe Benefits Tax Assessment Act 1986

1.11 *New Division 7A* of the FBTAA provides for a new type of fringe benefit - an excess domestic travel allowance fringe benefit. *[Clauses 5 and 6]*

1.12 Generally, travel provided by an employer to an employee is already subject to the fringe benefits tax provisions. Most allowances, however, are not subject to the fringe benefits tax as they fall within the definition of "salary or wages" in subsection 221A(1) of the ITAA and "salary or wages" are excluded from the definition of "fringe benefit" in subsection 136(1) of the FBTAA. This Bill partially withdraws that exclusion from the definition of "fringe benefit" by amending subsection 221A(1) of the ITAA so that the excess domestic travel allowance is excluded from the definition of "salary or wages". *[Clauses 20 and 21]*

1.13 The Bill defines a domestic travel allowance in terms similar to the substantiation provisions definition of travel allowance in subsection 82KT(1) of the ITAA. The three main conditions for such an allowance to exist are:

- the travel must be away from the employee's ordinary place of residence;
- the travel must be undertaken in the course of performing the employee's duties; and
- the travel must be within Australia. *[New subsection 31A(1)]*

1.14 An excess domestic travel allowance benefit is that part of a domestic travel allowance which exceeds a limit which is to be prescribed by Regulation. *[New subsection 31A(2)]*

1.15 The taxable value of an excess domestic travel allowance fringe benefit is the amount of the domestic travel allowance which exceeds the prescribed limit. *[New section 31B]*

Income Tax Assessment Act 1936

1.16 *New sections 51AM and 51AN* operate to deny a deduction to taxpayers who claim domestic travel expenses that are in excess of a prescribed limit. *[Clause 18]*

1.17 Where an employee would otherwise be entitled to a deduction for domestic travel expenses, that part of the deduction which exceeds a limit

which is to be prescribed by Regulation will no longer be allowable.
[New subsection 51AM(2)]

1.18 Where a person other than an employee would otherwise be entitled to a deduction for domestic travel expenses, that part of the deduction which exceeds a limit which is to be prescribed by Regulation will no longer be allowable. *[New subsection 51AN(2)]*

1.19 *New section 51AN* applies to a traveller who is a natural person, a partner who is a natural person, or a trustee who is a natural person.
[New subsection 51AN(1)]

1.20 The Bill defines domestic travel expenses in terms similar to the definition of travel allowance in the substantiation provisions of subsection 82KT(1) of the ITAA, i.e. the expenses were incurred in respect of travel:

- away from the person's ordinary place of residence;
- undertaken for employment (section 51AM) or other income-producing (section 51AN) purposes; and
- within Australia. *[New subsection 51AM(3) and subsection 51AN(3)]*

NON-DEDUCTIBLE EXPENSES

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Summary of amendments

1.21 **Purpose of amendment:** To amend the *Income Tax Assessment Act 1936* (ITAA) to allow deductions for expenses relating to the provision of entertainment, club fees, leisure facilities, travel expenses of accompanying relatives, Higher Education Contribution Scheme (HECS) payments and Student Financial Supplement Scheme (SFSS) payments incurred by employers in providing fringe benefits to their employees. The Bill will also make reciprocal amendments to the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) to ensure those fringe benefits provided to the employees are subject to fringe benefits tax under the FBTAA. [Clause 8]

1.22 Subsection 51(6), subsection 51AB(4), subsection 51AE(4), subsection 51AG(1) and subsection 54(3) of the ITAA deny deductibility for relevant expenses which would otherwise be deductible. The Bill will insert into section 51, section 51AB, section 51AE, section 51AG and section 54 of the ITAA, a new subsection which will allow deductibility of those expenses where the expense was incurred in providing a fringe benefit. [Clause 27]

1.23 As a result of these amendments to the ITAA, section 64, section 64A, section 65 and some definitions in subsection 136(1) of the FBTAA will have no further application. The Bill repeals these redundant provisions [Clauses 9 and 10]. The Bill also repeals section 65CAA and amends a number of other sections to delete reference to that section. [Clauses 12 to 15]

1.24 **Date of effect:** The amendments to the FBTAA are to apply to FBT assessments from and including the FBT tax year commencing on 1 April 1994.[Clause 11]

1.25 The amendments to the ITAA are to apply in relation to fringe benefits provided on or after 1 April 1994.[Clause 33]

Background to the legislation

1.26 An employer's costs incurred in providing fringe benefits to an employee (or an associate of an employee) are generally allowable deductions under subsection 51(1) of the ITAA.

1.27 However, there are certain benefits where the cost to the employer of providing those benefits to the employee is not allowable as a deduction under subsection 51(1) of the ITAA. While these benefits are included as fringe benefits for purposes of the FBTAA, the taxable value of the benefits are nil as their value is reduced to the extent to which they are non-deductible for income tax purposes.

1.28 The following types of fringe benefits are subject to these arrangements:

1.29 *Entertainment Expenses*

- Subsection 51AE(4) operates to deny deductions to the extent to which the relevant loss or outgoing is in respect of the provision of entertainment. Section 64 of the FBTAA operates so that the taxable value in respect of the entertainment component of relevant fringe benefits is reduced by the amount of "eligible entertainment expenditure".

1.30 *Club fees and expenditure relating to leisure facilities*

- Section 65 of the FBTAA applies to reduce the taxable value of these fringe benefits where the amount of any expenditure incurred by the employer on the benefit is expenditure in respect of which a deduction is denied under section 51AB or subsection 54(3) of the ITAA.

1.31 *Expenditure on Higher Education Contribution/Students Financial Supplement Scheme*

- Section 64A of the FBTAA applies to reduce the taxable value of these fringe benefits where the amount of any expenditure incurred by the employer on the benefit is expenditure in respect of which a deduction is denied under subsection 51(6) of the ITAA. Payments affected by subsection 51(6) include both HECS payments and SFSS payments.

1.32 *Travel expenses of accompanying relatives*

- Section 65 of the FBTAA applies to reduce the taxable value of these fringe benefits where the amount of any expenditure incurred by the employer on the benefit is expenditure in respect of which a deduction is denied under 51AG of the ITAA.

Explanation of the amendments

1.33 The Bill ensures that subsection 51(6), subsection 51AB(4), subsection 51AE(4), subsection 51AG(1) and subsection 54(3) of the ITAA which deny deductibility for expenses relating to the provision of entertainment, club fees, leisure facilities, travel expenses of accompanying relatives, HECS payments and SFSS payments do not apply where the expense was incurred in providing a fringe benefit. *[New subsection 51(6A), new subsection 51AB(5A), new subsection 51AE(5AA), new subsection 51AG(1A) and new subsection 54(3A)] [Clauses 28 to 32]*

1.34 The Bill also repeals section 64, section 64A, and section 65 of the FBTAA. As the expenses incurred in providing a fringe benefit relating to entertainment, club fees, leisure facilities, travel expenses of accompanying relatives, HECS payment and SFSS payments are no longer subject to subsection 51(6), subsection 51AB(4), subsection 51AE(4), subsection 51AG(1) and subsection 54(3) of the ITAA, these FBTAA provisions are redundant. *[Clause 9]*

1.35 As a consequence of these amendments, the taxable value of fringe benefits provided in the form of entertainment, club fees, leisure facilities, travel expenses of accompanying relatives, HECS payments and SFSS payments will no longer be subject to any reduction. The taxable value of the relevant fringe benefit will, therefore, be subject to fringe benefits tax in the usual manner.

CAR PARKING

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Summary of amendments

1.36 *Purpose of the amendment:* To amend the *Income Tax Assessment Act 1936 (ITAA)* to deny a deduction for car parking expenses for certain non-employees. *[Clause 23]*

1.37 The Bill will insert a *new section 51AGB* into the ITAA. The new section, which applies to certain non-employees, denies a deduction for car parking expenses where conditions similar to those in section 39A of the *Fringe Benefits Tax Assessment Act 1986 (FBTAA)* apply. While the amount of the deduction denied is the actual amount of the expense incurred in providing the car parking facilities, a taxpayer may elect to choose an alternate amount based on either the commercial parking station method of valuation or the market value method of valuation.

1.38 *Date of effect:* The amendments are to apply to car parking expenses incurred by taxpayers on or after 1 July 1994. *[Clause 26]*

Background to the legislation

1.39 From 1 July 1993, car parking benefits provided under certain circumstances by an employer to an employee were made subject to Fringe Benefits Tax (FBT). To ensure that the overall tax effect of providing either a car parking benefit or an allowance to an employee to cover car parking is substantially similar, section 51AGA of the ITAA was inserted to deny a deduction to employees who incur car parking expenses under similar circumstances to those that give rise to an FBT liability.

1.40 Under these arrangements, persons other than employees are more favourably treated because they are able to claim an income tax deduction for car parking.

1.41 The rationale for imposing FBT, and denying a tax deduction to employees, for car parking under certain circumstances is equally relevant to persons other than employees. It is inequitable that some persons receive a tax deduction for the cost of car parking facilities while others must bear the

cost of equivalent facilities without tax relief. Accordingly, the amendment in this Bill is required to restore equity in relation to the taxation treatment of these expenses.

Explanation of the amendments

Denial of deduction for certain non-employees

1.42 *New section 51AGB* will operate to deny a deduction for certain car parking expenses to non-employees. [Clause 24]

Application

1.43 The denial of deductions under section 51AGA of the ITAA applies only to employees who incur expenditure in providing car parking facilities to themselves. This amendment extends that denial of deduction for car parking facilities to any other taxpayer (a non-employee) who incurs expenditure on providing car parking facilities to themselves, including partners and trustees. [New paragraph 51AGB(1)(b)]

1.44 The new section will only apply if the conditions set out in *new subsection 51AGB(1)* apply. They are:

- a deduction for expenditure incurred in the provision of car parking facilities is, apart from this section, deductible;
- the person to whom the car parking expenses relate is a natural person, a partner who is a natural person, or a trustee who is a natural person, and that person has a primary place of self-employment;
- a permanent commercial car parking facility available for all-day parking is located within 1 kilometre of the premises where the car is parked;
- the car is parked at, or in the vicinity of, the primary place of self-employment and is parked at that place for more than four hours during the period between 7.00am and 7.00pm on that day;

the expenditure is in respect of the provision of the relevant car parking facilities;

- the car is used on that day to commute between the person's place of residence and their primary place of self-employment;
- the provision of car parking facilities is not excluded by Regulation; and
- the day the car is parked is on or after 1 July 1994.

Valuation

1.45 The value of the amount of deduction to be denied is, unless the taxpayer makes an election, the actual amount spent on the provision of the car parking facilities. *[New subsection 51AGB(2)]*

1.46 Where an election is made by the taxpayer, a deduction for the actual amount spent on the provision of car parking facilities is not denied in total. The actual amount that would be deductible but for new section 51AGB is reduced by either:

- the commercial parking station amount; or
- the market value amount. *[New subsection 51AGB(3)]*

The commercial parking station amount

1.47 The commercial parking station amount is the lowest fee for all-day parking charged by any commercial parking station operator within a 1 kilometre radius of the car parking facilities. *[New subsection 51AGB(4)]*

1.48 The Bill specifies that the 1 kilometre distance between the commercial parking station and the premises on which the car is parked is measured by the shortest practicable route. This route can be travelled by foot, car, train, boat, etc., whichever produces the shortest route. The 1 kilometre distance starts from the car entry point at parking premises and extends to the car entry point at the commercial parking station. *[New subsection 51AGB(8)]*

1.49 The Bill also provides a formula for converting longer term parking rates into daily rate equivalents for the purpose of determining the commercial parking station amount. *[New subsection 51AGB(9)]*

The market value amount

1.50 The market value amount is calculated on an arm's length valuation and needs to be based on a report from a suitably qualified valuer. *[New subsection 51AGB(7)]*. The report must be retained for five years after its receipt. *[Clause 25]*

Anti-avoidance

1.51 The Bill includes anti-avoidance provisions which will ensure that the commercial parking station amount is not undervalued. *[New subsection 51AGB(10)]*

CHAPTER TWO *Unused annual leave and unused long service leave payments*

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Unused annual leave and unused long service leave payments

2.1 Purpose of amendment: The Bill will amend the *Income Tax Assessment Act 1936* to remove the concessional tax treatment that applies to lump sum payments in respect of unused annual leave and unused long service leave made on termination of employment. [Clause 34]

2.2 Lump sum payments in respect of unused annual leave made on or after 18 August 1993 will be included in a taxpayer's assessable income in full and taxed at marginal rates unless the taxpayer's termination of employment is as a consequence of bona fide redundancy or invalidity or is under an approved early retirement scheme. If the taxpayer's termination of employment is as a consequence of bona fide redundancy or invalidity or is under an approved early retirement scheme, payments in respect of unused annual leave will continue to be included in assessable income in full and subject to tax at a maximum rate of 30% plus medicare levy.

2.3 Lump sum payments in respect of unused long service leave made on termination of employment will be taxed as follows:

- only 5% of that portion of unused long service leave which accrued prior to 16 August 1978 will be included in assessable income and taxed at marginal rates;
- that portion of unused long service leave which accrued between 16 August 1978 and 17 August 1993 will be included in assessable income in full and subject to tax at a rate not exceeding 30% plus medicare levy; and
- that portion of unused long service leave which accrued on or after 18 August 1993 will be included in assessable income in full and

taxed at marginal rates unless the taxpayer's termination of employment is as a consequence of bona fide redundancy or invalidity or is under an approved early retirement scheme. If the taxpayer's termination of employment is as a consequence of bona fide redundancy or invalidity or is under an approved early retirement scheme, that portion of unused long service leave which accrued on or after 18 August 1993 will be included in assessable income in full and subject to tax at a rate not exceeding 30% plus medicare levy.

2.4 The purpose of the proposed amendments is to ensure that the tax system does not discourage taxpayers from using their leave entitlements for their intended purpose. The proposed amendments will ensure that leave payments will be taxed no differently if they are received during employment than if they are received upon termination of employment. However, they recognise that some taxpayers will have less flexibility than others in using accrued leave entitlements for their intended purpose and ensure that amounts in respect of unused long service leave accrued prior to 18 August 1993 will continue to be taxed on a concessional basis.

2.5 *Date of effect:* The amendments will apply to payments in respect of unused annual leave made on or after 18 August 1993 and to that portion of payments in respect of unused long service leave that accrued on or after 18 August 1993.

Background to the legislation

Payments in respect of unused annual leave

What is annual leave?

2.6 Annual leave is defined in subsection 26AC(4) of the *Income Tax Assessment Act 1936* to mean:

- leave described as annual leave, recreation leave or annual holidays which a person has an entitlement to under the conditions of employment specified in:
 - a law of the Commonwealth or of a State or Territory;
 - an award, determination or industrial agreement in force under any such law;
 - a contract of employment; or
 - the terms of appointment to an office;

- leave not described as annual leave, recreation leave or annual holidays which a person has an entitlement to under the relevant conditions of employment but which is essentially the same as annual leave, recreation leave or annual holidays; and
- leave that is granted as a privilege (rather than an entitlement) which is determined by reference to matters similar to those to which entitlements to annual leave, recreation leave or annual holidays are ordinarily determined.

How are payments in respect of unused annual leave taxed under the current law?

2.7 Lump sum payments made on or after 16 August 1978 in consequence of termination of employment in respect of unused annual leave are included in a taxpayer's assessable income under section 26AC.

What rate of tax applies to unused annual leave payments?

2.8 A rebate is available under section 159SA to ensure that payments in respect of unused annual leave included in a taxpayer's assessable income under section 26AC are taxed at a rate not exceeding 30% plus medicare levy.

How are payments of this nature taxed on the death of an employee?

2.9 If a payment of this nature is made on the death of an employee, no tax is payable on the amount received directly by a beneficiary or by the trustee of the deceased's estate (subsection 101A(2)).

What is the rate of tax instalment deductions on these payments?

2.10 Subsection 221C(1AB) allows for tax instalment deductions to be taken out at special rates on amounts representing unused annual leave. Regulation 80 of the Income Tax Regulations specifies that tax instalment deductions are to be taken out of these amounts at a rate of 31.25% (to be increased to 31.4%).

Payments in respect of unused long service leave

What is long service leave?

2.11 Long service leave is defined in subsection 26AD(8) to mean:

long service leave, long leave, furlough, extended leave or leave of a similar kind (however described) which a person has an entitlement to under the conditions of employment specified in:

- a law of the Commonwealth or of a State or Territory;
 - an award, determination or industrial agreement in force under any such law;
 - a contract of employment; or
 - the terms of appointment to an office;
- leave (other than annual leave) which a person has an entitlement to under a scheme or arrangement which has allowed the employer to secure an exemption from obligations to comply with a law of the Commonwealth or of a State or Territory relating to long service leave, long leave, furlough, extended leave or leave of a similar kind (however described); and
 - leave that is granted as a privilege (rather than an entitlement) which is determined by reference to matters similar to those to which entitlements to long service leave, long leave, furlough, extended leave or leave of a similar kind (however described) are ordinarily determined.

How are payments in respect of unused long service leave taxed under the current law?

2.12 Lump sum payments made on or after 16 August 1978 in consequence of termination of employment in respect of unused long service leave are included in a taxpayer's assessable income under section 26AD. The amount included in assessable income depends on whether or not the eligible service period to which the long service leave relates commenced on or after 16 August 1978.

What is the eligible service period?

2.13 Broadly speaking, eligible service period is defined in subsection 26AD(7) to mean:

- if the taxpayer has not used any long service leave prior to retirement - the period by reference to which the lump sum amount is calculated; or
- if the taxpayer has used some of his or her long service leave prior to retirement - the period by reference to which the long service leave used by the taxpayer was calculated and the period on which the lump sum amount is calculated.

How much of an unused long service leave payment is included in assessable income if the eligible service period commenced on or after 16 August 1978?

2.14 If a taxpayer's eligible service period commenced on or after 16 August 1978, the whole amount he or she receives on termination of employment in respect of unused long service leave is included in his or her assessable income (subsection 26AD(2)).

How much of an unused long service leave payment is included in assessable income if the eligible service period commenced before 16 August 1978?

2.15 If a taxpayer's eligible service period commenced before 16 August 1978:

the whole amount he or she receives on termination of employment in respect of unused long service leave that accrued on or after 16 August 1978 is included in his or her assessable income (subsection 26AD(3) and subsection 26AD(4)); and

5% of any amount he or she receives on termination of employment in respect of unused long service leave that accrued before 16 August 1978 is included in his or her assessable income (subsection 26AD(5)).

What rate of tax applies to unused long service leave payments?

2.16 Ordinary rates of tax apply to 5% of that part of any payment in respect of unused long service leave that accrued before 16 August 1978 which is included in a taxpayer's assessable income under subsection 26AD(5).

2.17 A rebate is available under section 159SA to ensure that payments in respect of unused long service leave that accrued on or after 16 August 1978 which are included in a taxpayer's assessable income under subsections 26AD(2), (3) or (4) are taxed at a rate not exceeding 30% plus medicare levy.

How are payments of this nature taxed on the death of an employee?

2.18 If a payment of this nature is made on the death of an employee, no tax is payable on the amount received directly by a beneficiary or by the trustee of the deceased's estate (subsection 101A(2)).

What is the rate of tax instalment deductions on these payments?

2.19 Subsection 221C(1AB) allows for tax instalment deductions to be taken out at special rates on assessable retirement amounts. Assessable retirement amounts are defined in paragraph 221A(2)(a) to be any amount included in a taxpayer's assessable income under section 26AD. The amount

included in assessable income under section 26AD is 5% of any amount accrued before 16 August 1978 and the whole of the amount accrued on or after 16 August 1978. Regulation 80 of the Income Tax Regulations specifies that tax instalment deductions are to be taken out of these amounts at a rate of 31.25% (to be increased to 31.4%).

Explanation of the amendments

Unused annual leave payments

2.20 Lump sum payments made on or after 18 August 1993 in consequence of termination of employment in respect of unused annual leave will continue to be included in assessable income under section 26AC.

2.21 In most circumstances unused annual leave payments will be included in a taxpayer's assessable income and taxed at ordinary rates.

2.22 However, if the payment is a bona fide redundancy amount, an early retirement scheme amount or an invalidity amount the rate of tax payable on unused annual leave payments will be limited to a maximum of 30% plus medicare levy. [*Clause 35; amended definition of eligible assessable income in section 159S*]

Bona fide redundancy amounts

2.23 A payment will be a *bona fide redundancy amount* if it is paid to a person because of his or her dismissal from employment where:

- the dismissal was because of the bona fide redundancy of the person. Bona fide redundancy has the same meaning as in section 27F. Broadly speaking, dismissal carries with it the concept that the termination of employment is involuntary on the employee's part - that is, it will be instigated by the employer. However, it also includes the notion of constructive dismissal where an employer places an employee in a position in which the employee has little option but to tender his or her resignation. Redundancy is the situation where an employer no longer requires employees to carry out work of a particular kind or to carry out work of a particular kind at the same location. Redundancy does not extend to the dismissal of an employee for personal or disciplinary reasons or because the employee has been inefficient;
- the termination time was before the *last retirement date* in relation to the employment. The *last retirement date* is defined in subsection 27A(1) to mean the time that, under the conditions of employment, the employee's

service would have ordinarily terminated or the employee's 65th birthday, whichever is earlier; and

- at the time of dismissal there was no agreement between the person and the employer or between the employer and another person to subsequently employ the person.

[Clause 35]

Early retirement scheme amounts

2.24 A payment will be an early retirement scheme amount if it is paid to a person on the termination of employment where:

the termination was in accordance with an approved early retirement scheme in terms of section 27E; and

the termination time was before the *last retirement date* in relation to the employment. The *last retirement date* is defined in subsection 27A(1) to mean the time that, under the conditions of employment, the employee's service would have ordinarily terminated or the employee's 65th birthday, whichever is earlier; and

at the time of dismissal there is no agreement between the person and the employer or between the employer and another person to subsequently employ the person.

[Clause 35]

Invalidity amounts

2.25 A payment made to a person before 1 July 1994 will be an *invalidity amount* if it is paid to the person on termination of employment where that person's employment is terminated because of physical or mental incapacity to engage in that employment.

2.26 A different rule applies if the payment is made on or after 1 July 1994. In this case the person's employment must be terminated because of disability and two legally qualified medical practitioners have certified that the disability is likely to result in the person being unable ever to be employed in a capacity for which he or she is reasonably qualified because of training, education or experience.

2.27 In either case, the termination time must be before the *last retirement date* (as defined in subsection 27A(1)) in relation to the employment. That is, the employment must be terminated before the date on which the person's employment would necessarily have ended but for the invalidity. *[Clause 35]*

Date of application of amendments

2.28 The proposed amendments apply to payments made on or after 18 August 1993. Therefore, the tax treatment which applies ordinarily depends on when the payment is made. However, if an employee terminated his or her employment before 18 August 1993 but the employer did not make a payment in respect of unused annual leave until the first normal pay period after that date, the payment will be considered to have been made on the date of termination of employment.

Unused long service leave payments

2.29 Lump sum payments in respect of unused long service leave made in consequence of termination of employment will be taxed as follows:

- only 5% of that portion of unused long service leave which accrued prior to 16 August 1978 will be included in a taxpayer's assessable income and taxed at marginal rates;
- that portion of unused long service leave which accrued between 16 August 1978 and 17 August 1993 will be included in a taxpayer's assessable income in full and subject to tax at a rate not exceeding 30% plus medicare levy; and
- that portion of unused long service leave which accrued on or after 18 August 1993 will be included in a taxpayer's assessable income in full and taxed at marginal rates unless the taxpayer's termination of employment is as a consequence of bona fide redundancy or invalidity or is under an approved early retirement scheme. If the taxpayer's termination of employment is as a consequence of bona fide redundancy or invalidity or is under an approved early retirement scheme, that portion of unused long service leave which accrued on or after 18 August 1993 will be included in assessable income in full and subject to tax at a rate not exceeding 30% plus medicare levy.

2.30 Section 26AD of the Income Tax Assessment Act includes in a taxpayer's assessable income:

- the whole of any amount received on termination of employment in respect of unused long service leave that accrued on or after 16 August 1978 (subsections 26AD(2), (3) and (4)); and
- 5% of any amount received on termination of employment in respect of unused long service leave that accrued before 16 August 1978 (subsection 26AD(5)).

2.31 The whole of the assessable part of unused long service leave payments is included in a taxpayer's assessable income and taxed at ordinary rates unless it is *eligible assessable income* as defined in section 159S. A rebate applies to any amount that qualifies as *eligible assessable income* to limit the rate of tax on such amounts to a maximum of 30% plus medicare levy.

2.32 The definition of *eligible assessable income* is to be amended so that it includes only the post-15 August 1978 component of unused long service leave included in a taxpayer's assessable income under subsection 26AD(2), (3) or (4) that is:

- a *bona fide redundancy amount*, an *early retirement scheme amount* or an *invalidity amount*; or
- an amount (not being a *bona fide redundancy amount*, an *early retirement scheme amount* or an *invalidity amount*) in relation to unused long service leave that relates to employment which commenced prior to 18 August 1993 that exceeds the *post-1993 Budget component* of the amount.

[Clause 35; amended definition of eligible assessable income in section 159S]

2.33 The conditions for a payment to qualify as a *bona fide redundancy amount*, an *early retirement scheme amount* or an *invalidity amount* are described above.

2.34 The *post 1993 Budget component* in relation to the post-15 August 1978 component of an unused long service leave payment (that is, an amount included in an employee's assessable income under subsection 26AD(2), (3) or (4)) is that part, if any, of the total amount received by the employee in respect of unused long service leave that relates to service with the relevant employer on or after 18 August 1993. The amount is calculated by applying the formula in subsection 26AD(3) to the total amount of the payment assuming that the references to 15 August 1978 are references to 17 August 1993. The operation of the provision is demonstrated in the examples at the end of this commentary. **[Clause 35; new definition of post-1993 Budget component in section 159S]**

Application of the proposed amendments

2.35 The proposed amendments apply to assessments in respect of the 1993-94 year of income and all subsequent years of income. **[Clause 36]**

2.36 However, as a transitional measure in respect of assessments for the 1993-94 year of income, *eligible assessable income* will include any

amount paid before 18 August 1993 in respect of unused annual leave that is assessable under section 26AC. Such amounts paid on or after 18 August 1993 will be *eligible assessable income* only if they are *bona fide redundancy amounts, early retirement scheme amounts* or *invalidity amounts*. [Clause 37]

Summary of tax treatment of unused leave payments

Taxpayers who receive bona fide redundancy amounts, early retirement scheme amounts or invalidity amounts

2.37 Taxpayers who receive a payment in respect of unused annual leave or unused long service leave paid on termination of employment which includes a *bona fide redundancy amount, an early retirement scheme amount* or an *invalidity amount* will be taxed as follows:

- the whole amount of any unused annual leave payments will be included in assessable income and subject to tax at a rate not exceeding 30% plus medicare levy;
- 5% of the pre-16 August 1978 component of any unused long service leave payment will be included in assessable income and taxed at marginal rates; and
- the whole amount of the post-15 August 1978 component of any unused long service leave payment will be included in assessable income and subject to tax at a rate not exceeding 30% plus medicare levy.

Example

Abiona accepts an offer from her employer under an approved early retirement scheme. She leaves her employment on 16 August 1994 and receives a payment in respect of unused annual leave of \$4 000 and a payment in respect of unused long service leave of \$28 000.

She has not used any long service leave in the past. Abiona has been working for the same employer for 26 years. Therefore, she has 10 years service prior to 16 August 1978.

As the amounts paid to Abiona in respect of unused annual leave and unused long service leave are *early retirement scheme amounts*, she will retain the concessional treatment that applies to the pre-16 August 1978 component of her unused long service leave payment.

She will also be entitled to a rebate to limit the maximum rate of tax payable on the amount included in her assessable income in full to 30% plus medicare levy. Abiona will include the following amounts in her assessable income for the 1993-94 year:

Unused annual leave \$4000

Unused long service leave

5% x \$10769 (ie, 10/26 x \$28000) \$538

(\$28000 - \$10769) \$17231

Abiona will be entitled to a section 159SA rebate so that the rate of tax payable on the \$21231 included in her assessable income in full in respect of unused annual leave and unused long service leave will not exceed 31.4%.

Taxpayers who receive unused leave payments on ordinary termination of employment

2.38 Lump sum payments in respect of unused leave made on termination of employment in all other circumstances will be taxed as follows:

the whole amount of any unused annual leave payments will be included in assessable income and taxed at marginal rates;

only 5% of that portion of unused long service leave which accrued prior to 16 August 1978 will be included in assessable income and taxed at marginal rates;

that portion of unused long service leave which accrued between 16 August 1978 and 17 August 1993 will be included in assessable income in full and subject to tax at a rate not exceeding 30% plus medicare levy; and

- that portion of unused long service leave which accrued on or after 18 August 1993 will be included in assessable income in full and taxed at marginal rates.

2.39 Tax instalment deductions will continue to be taken out of these amounts at special rates (currently 30% plus medicare levy).

2.40 If a payment in respect of unused leave is made on the death of an employee, it will continue to be tax free in the hands of the beneficiary or the trustee of the deceased's estate.

2.41 As demonstrated by the following examples, the portion of unused long service leave attributable to service after 15 August 1978 and 17 August 1993 respectively is determined by using the formula $A/B[C(B+D)/E-F]$ where:

- A is the lump sum amount paid in respect of unused long service leave
- B is the number of whole days in respect of which the lump sum amount is paid
- C is the number of days in the eligible service period that occurred after 15 August 1978 and after 17 August 1993 respectively
- D is the number of days of long service leave accrued in the eligible service period that were used prior to retirement date
- E is the total number of days in the eligible service period
- F is the lesser of:
 - the number of days of long service leave used after 15 August 1978 and 17 August 1993 respectively; and
 - the amount calculated by the formula $C(B+D)/E$.

Example 1: Retirement after 17 August 1993; No long service leave used; No pre-16 August 1978 service.

Rachael retires on 31 December 1995. The details of the payment she receives in respect of unused long service leave is as follows:

| | |
|---|----------------------|
| Payment received: | \$8000 |
| Number of days of unused leave: | 40 |
| Total eligible service period: | 10 years (3652 days) |
| Number of days in eligible service period after 15 August 1978: | 3652 |
| Number of days in eligible service period after 17 August 1993: | 866 |
| Number of days of long service leave used after 17 August 1993: | 0 |

Calculation

Rachael's assessable income will include all of the amount she receives in respect of unused long service leave (ie, \$8000) under subsection 26AD(2).

Post 1993 Budget component

$$\begin{aligned} & A/B \times [C(B + D)/E - F] \\ &= \$8000/40 \times [866(40 + 0)/3652 - 0] \\ &= \$200 \times 9.49 \quad (\text{fraction disregarded - subsection 26AD(3A)}) \\ &= \$1800. \end{aligned}$$

Eligible assessable income

| | |
|--|--------|
| Amount taxable under subsection 26AD(2): | \$8000 |
| Less post 1993 Budget component: | \$1800 |
| Eligible assessable income: | \$6200 |

Summary

\$6200 of Rachael's unused long service leave payment will be included in her assessable income and subject to tax at a rate not exceeding 30% plus medicare levy; and
\$1800 will be included in her assessable income and taxed at marginal rates.

Example 2: Retirement after 17 August 1993; No long service leave used; Pre-16 August 1978 service.

Blake retires on 31 December 1995. The details of the payment he receives in respect of unused long service leave is as follows:

| | |
|---|----------------------|
| Payment received: | \$30000 |
| Number of days of unused leave: | 180 |
| Total eligible service period: | 20 years (7305 days) |
| Number of days in eligible service period after 15 August 1978: | 6347 |
| Number of days in eligible service period after 17 August 1993: | 866 |
| Number of days of long service leave used after 17 August 1993: | 0 |

Calculation

(1) Amount of post 15 August 1978 unused long service leave to be included under subsection 26AD(3):

$$\begin{aligned} & A/B \times [C(B + D)/E - F] \\ & = \$30000/180 \times [6347(180 + 0)/7305 - 0] \\ & = \$166.67 \times 156.39 \text{ (fraction disregarded - subsection 26AD(3A))} \\ & = \$26001. \end{aligned}$$

(2) Amount of pre 16 August 1978 unused long service leave to be included under subsection 26AD(5):

$$5\% \times (\$30000 - 26001) = \$200.$$

Post 1993 Budget component

$$\begin{aligned} & A/B \times [C(B + D)/E - F] \\ & = \$30000/180 \times [866(180 + 0)/7305 - 0] \\ & = \$166.67 \times 21.34 \text{ (fraction disregarded - subsection 26AD(3A))} \\ & = \$3500 \end{aligned}$$

Eligible assessable income

| | |
|--|---------|
| Amount taxable under subsection 26AD(3): | \$26001 |
| Less post 1993 Budget component: | \$3500 |
| Eligible assessable income: | \$22501 |

Summary

\$22501 of Blake's unused long service leave payment will be included in his assessable income and subject to tax at a rate not exceeding 30% plus medicare levy; and

\$3700 (ie, \$200 + \$3500) will be included in his assessable income and taxed at marginal rates.

Example 3: Retirement after 17 August 1993; Small amount of long service leave used after 17 August 1993; Pre-16 August 1978 service.

Christopher retires on 31 December 1995. The details of the payment he receives in respect of unused long service leave is as follows:

| | |
|---|----------------------|
| Payment received: | \$22000 |
| Number of days of unused leave: | 175 |
| Total eligible service period: | 20 years (7305 days) |
| Number of days in eligible service period after 15 August 1978: | 6347 |
| Number of days in eligible service period after 17 August 1993: | 866 |
| Number of days of long service leave used after 17 August 1993: | 5 |

Calculation

- (1) Amount of pre 15 August 1978 unused long service leave to be included under subsection 26AD(3):

$$\begin{aligned} & A/B \times [C(B + D)/E - F] \\ &= \$22000/175 \times [6347(175 + 5)/7305 - 5*] \\ &= \$125.71 \times [156.39 - 5] \\ &= \$125.71 \times 151.39 \text{ (fraction disregarded - subsection 26AD(3A))} \\ &= \$18982. \end{aligned}$$

[*F is the lesser of the number of days of leave used (5) and the amount calculated in the formula $C(B + D)/E$ (156.39)]

- (2) Amount of pre 16 August 1978 to be included under subsection 26AD(5):

$$5\% \times (\$22000 - \$18982) = \$151.$$

Post 1993 Budget component

$$\begin{aligned} & A/B \times [C(B + D)/E - F] \\ & = \$22000/175 \times [866(175 + 5)/7305 - 5^*] \\ & = \$125.71 \times [21.34 - 5] \\ & = \$125.71 \times 16.34 \text{ (fraction disregarded - subsection 26AD(3A))} \\ & = \$2011. \end{aligned}$$

[*F is the lesser of the number of days of leave used (5) and the amount calculated in the formula $C(B + D)/E$ (21.34)]

Eligible assessable income

| | |
|--|---------|
| Amount taxable under subsection 26AD(3): | \$18982 |
| Less post 1993 Budget component: | \$2011 |
| Eligible assessable income: | \$16971 |

Summary

\$16971 of Christopher's unused long service leave payment will be included in his assessable income and subject to tax at a rate not exceeding 30% plus medicare levy; and

\$2162 (ie, \$151 + \$2011) will be included in his assessable income and taxed at marginal rates.

Example 4: Retirement after 17 August 1993; Small amount of long service leave used before 17 August 1993; Pre-16 August 1978 service.

Nicholas retires on 31 December 1995. The details of the payment he receives in respect of unused long service leave is as follows:

| | |
|--|----------------------|
| Payment received: | \$25000 |
| Number of days of unused leave: | 150 |
| Total eligible service period: | 20 years (7305 days) |
| Number of days in eligible service period after 15 August 1978: | 6347 |
| Number of days in eligible service period after 17 August 1993: | 866 |
| Number of days of long service leave used before 17 August 1993: | 5 |
| Number of days of long service leave used after 17 August 1993: | 0 |

Calculation

- (1) Amount of post 15 August 1978 long service leave to be included under subsection 26AD(3):

$$\begin{aligned} & A/B \times [C(B + D)/E - F] \\ & = \$25000/150 \times [6347(150 + 5)/7305 - 5^*] \\ & = \$166.67 \times [134.67 - 5] \\ & = \$166.67 \times 129.67 \text{ (fraction disregarded - subsection 26AD(3A))} \\ & = \$21500. \end{aligned}$$

[*F is the lesser of the number of days of leave used (5) and the amount calculated in the formula $C(B + D)/E$ (134.67)]

- (2) Amount of pre 16 August 1978 unused long service leave to be included under subsection 26AD(5):

$$5\% \times (\$25000 - \$21500) = \$175.$$

Post 1993 Budget component

$$\begin{aligned} & A/B \times [C(B + D)/E - F] \\ & = \$25000/150 \times [866(150 + 5)/7305 - 0] \\ & = \$166.67 \times 18.38 \text{ (fraction disregarded - subsection 26AD(3A))} \\ & = \$3000. \end{aligned}$$

Eligible assessable income

| | |
|--|----------|
| Amount taxable under subsection 26AD(3): | \$21500 |
| Less post 1993 Budget component: | \$3000 |
| Eligible assessable income: | \$18500. |

Summary

\$18500 of Nicholas's unused long service leave payment will be included in his assessable income and subject to tax at a rate not exceeding 30% plus medicare levy; and

\$3175 (ie, \$175 + \$3000) will be included in his assessable income and taxed at marginal rates.

Example 5: Retirement after 17 August 1993; Large amount of long service leave used after 17 August 1978; Pre-16 August 1978 service.

Saul retires on 31 December 1995. The details of the payment he receives in respect of unused long service leave is as follows:

| | |
|---|----------------------|
| Payment received: | \$2000 |
| Number of days of unused leave: | 10 |
| Total eligible service period: | 20 years (7305 days) |
| Number of days in eligible service period after 15 August 1978: | 6347 |
| Number of days in eligible service period after 17 August 1993: | 866 |
| Number of days of long service leave used after 15 August 1978: | 170 |
| Number of days of long service leave used after 17 August 1993: | 0 |

Calculation

(1) Amount of post 15 August 1993 unused long service leave to be included under subsection 26AD(3):

$$\begin{aligned} & A/B \times [C(B + D)/E - F] \\ &= \$2000/10 \times [6347(10 + 170)/7305 - 156.39*] \\ &= \$200 \times [156.39 - 156.39] \\ &= \$166.67 \times 0 \\ &= \$0 \end{aligned}$$

[*F is the lesser of the number of days of leave used (170) and the amount calculated in the formula $C(B + D)/E$ (156.39)]

(2) Amount of pre 16 August 1978 unused long service leave to be included under subsection 26AD(5):

$$5\% \times \$2000 = \$100$$

Eligible assessable income

Saul will not have any eligible assessable income.

Summary

\$100 of Saul's unused long service leave payment will be included in his assessable income and taxed at marginal rates.

Example 6: Retirement after 17 August 1993; Long service leave used both before and after 17 August 1993; Pre-16 August 1978 service.

Amy retires on 31 December 1995. The details of the payment she receives in respect of unused long service leave is as follows:

| | |
|--|---------------------|
| Payment received: | \$20000 |
| Number of days of unused leave: | 120 |
| Total eligible service period: | 20 years(7305 days) |
| Number of days in eligible service period after 15 August 1978: | 6347 |
| Number of days in eligible service period after 17 August 1993: | 866 |
| Number of days of long service leave used before 18 August 1993: | 40 |
| Number of days of long service leave used after 17 August 1993: | 20 |

Calculation

(1) Amount of post 15 August 1978 unused long service leave to be included under subsection 26AD(3):

$$\begin{aligned} & A/B \times [C(B + D)/E - F] \\ &= \$20000/120 \times [6347(120 + 60)/7305 - 60*] \\ &= \$166.67 \times [156.39 - 60] \\ &= \$166.67 \times 96.39 \text{ (fraction disregarded - subsection 26AD(3A))} \\ &= \$16000. \end{aligned}$$

[*F is the lesser of the number of days of leave used (60) and the amount calculated in the formula $C(B + D)/E$ (156.39)]

(2) Amount of pre 16 August 1978 unused long service leave to be included under subsection 26AD(5):

$$5\% \times (\$20000 - \$16000) = \$200.$$

Post 1993 Budget component

$$\begin{aligned} & A/B \times [C(B + D)/E - F] \\ &= \$20000/120 \times [866(120 + 60)/7305 - 20*] \\ &= \$166.67 \times [21.34 - 20] \\ &= \$166.67 \times 1.34(\text{fraction disregarded} - \text{subsection 26AD(3A)}) \\ &= \$167 \end{aligned}$$

[*F is the lesser of the number of days of leave used (20) and the amount calculated in the formula $C(B + D)/E$ (21.34)]

Eligible assessable income

| | |
|--|----------|
| Amount taxable under subsection 26AD(3): | \$16000 |
| Less post 1993 Budget component: | \$167 |
| Eligible assessable income: | \$15833. |

Summary

\$15833 of Amy's unused long service leave payment will be included in her assessable income and subject to tax at a rate not exceeding 30% plus medicare levy; and

\$367 (ie, \$200 + \$167) will be included in her assessable income and taxed at marginal rates.

CHAPTER THREE *Credit Unions*

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Summary of proposed amendments

3.1 Purpose of amendments: To phase out the current exemption from tax provided by section 23G of the *Income Tax Assessment Act* (the Principal Act) for income in the nature of interest paid to credit unions by their non-corporate members in respect of loans made to those members and to allow credit unions to be taxed as co-operatives.

3.2 Date of effect: The amendments will come into effect from the date upon which the Bill receives Royal Assent. They will remove the exemption for large credit unions (those with total gross assets in excess of \$30 million as at 30 June 1993) and allow them to be taxed as co-operatives or companies, with effect from the 1994-95 year of income, subject to a concessional tax rate of 20% for the 1994-95, 1995-96 and 1996-97 years of income.

3.3 The amendments will remove the exemption for all other credit unions and allow them to be taxed as co-operatives or companies, with effect from the 1995-96 year of income, subject to a concessional tax rate of 20% for the 1995-96 and 1996-97 years of income.

Background to the legislation

3.4 Section 23G of the Principal Act currently provides that income in the nature of interest received by an approved credit union from its non-corporate members in respect of loans made to those members is exempt from income tax.

3.5 Section 23G was enacted to overcome the decision in *Sydney Water Board Employees Credit Union Ltd v. FC of T 73* ATC 4129 where the High Court held that the principle of mutuality did not apply to interest paid to the credit union by its members in respect of loans made to them by the credit union, and that the interest was assessable income in the hands of the credit union.

3.6 This statutory exemption was justified on the basis that credit unions satisfied a social need for finance not provided at that time by other financial institutions. However, since financial deregulation, this justification is no longer valid. The range of personal financial services provided by credit unions is provided also by a wide range of other bodies which receive no tax concessions.

3.7 In order to ensure equity and consistency of tax treatment with other financial institutions, the law will be amended to remove the exemption. In addition, the law will be amended to allow credit unions to be taxed as co-operatives if they satisfy the requirements of section 117 of the Principal Act.

3.8 The proposed amendments initially will reduce the competitive advantage enjoyed by credit unions by taxing them as co-operatives or companies at a concessional rate of 20% until and including the 1996-97 year of income, after which they will be taxed at the full corporate rate.

3.9 Large credit unions (those with total gross assets greater than \$30 million as at 30 June 1993) will be liable to pay tax at the concessional rate of 20% with effect from the 1994-95 year of income. All other credit unions will be liable to pay tax at the concessional rate of 20% with effect from the 1995-96 year of income. This will allow smaller credit unions an additional year to prepare for the introduction of taxation. All credit unions then will be liable for the full corporate tax rate for the 1997-98 year of income and all later years of income.

Explanation of proposed amendments

3.10 Division 7 of Part 3 the Bill will amend section 6 [*Clause 39*], section 23G [*Clause 41*], section 117 [*Clause 42*] and section 119 [*Clause 43*] of the Principal Act and will introduce new section 6H [*Clause 40*] into the Principal Act.

Object of Division

3.11 The object of the proposed amendments is to phase out the special tax treatment of credit unions. [*Clause 38*]

Interpretation

3.12 Subsection 6(1) of the Principal Act is amended by inserting a definition for 'transitional credit union' [Clause 39]. That term is defined as having the meaning given by new section 6H of the Principal Act, and it is used in amended sections 23G and 117 of the Principal Act and in amended section 23 of the *Income Tax Rates Act 1986*.

What is a 'transitional credit union'?

3.13 For the purposes of the Principal Act, a credit union is a transitional credit union in relation to a year of income if the year of income is the 1994-95 year of income, the 1995-96 year of income or the 1996-97 year of income and it is a designated large credit union. [New paragraph 6H(1)(a)] [Clause 40]

3.14 This means that credit unions with total gross balance sheet assets of more than \$30 million as at 30 June 1993 will be liable to pay tax at the concessional tax rate of 20% for the 1994-95, 1995-96 and 1996-97 years of income and will be liable to pay the full corporate rate of tax for the 1997-98 year of income and all later years of income.

3.15 A credit union is also a transitional credit union in relation to a year of income if the year of income is the 1995-96 or the 1996-97 year of income and it is not a designated large credit union. [New paragraph 6H(1)(b)] [Clause 40]

3.16 This means that a credit union with total gross balance sheet assets of \$30 million or less as at 30 June 1993, or a credit union that was not in existence as at 30 June 1993, will be liable to pay tax at the concessional rate of 20% for the 1995-96 and 1996-97 years of income, and will be liable to pay the full corporate rate of tax for the 1997-98 year of income and all later years of income.

What is a 'designated large credit union'?

3.17 A designated large credit union is a credit union with total gross balance sheet assets as at 30 June 1993 of more than \$30 million. Total gross assets are to be determined on the basis of the amount of total gross assets that would have been disclosed in the audited balance sheet of a credit union for the last ordinary accounting period that ended before 1 July 1993 if its accounts had been prepared in accordance with generally accepted accounting principles. [New subsection 6H(2)] [Clause 40]

3.18 In other words, if the unaudited accounts of a credit union disclose total gross assets of \$30 million or less and the audited accounts indicate that total gross assets actually exceed \$30 million, the credit union will be a designated large credit union for the purposes of the Principal Act.

Definitions

3.19 Proposed new section 6H uses the terms 'accounts', 'accounting period' and 'credit union'. A definition of each of these terms for the purposes of the new section is included in the proposed amendments [*New subsection 6H(3)*] [*Clause 40*].

3.20 The term 'accounts', in relation to a credit union referred to in new section 6H, is defined to mean accounts prepared by or on behalf of a credit union for the purpose of providing an annual report to the shareholders of the credit union.

3.21 The term 'accounting period', in relation to a credit union referred to in new section 6H, is defined to mean the end of its ordinary accounting period when the balance of its accounts is struck.

3.22 The term 'credit union' is defined to have the same meaning given to it in section 23G of the Principal Act.

Removal of exemption of interest received by credit unions

3.23 Section 23G of the Principal Act is amended to provide that subsection 23G(2) does not apply to a credit union in relation to a year of income if the credit union is a transitional credit union in relation to that year of income, or if the year of income is later than the 1996-97 year of income. [*New subsection 23G(2A)*] [*Clause 41*]

3.24 This means that if a credit union is a transitional credit union in relation to a year of income, it will no longer be entitled to the exemption provided under section 23G of the Principal Act.

Credit unions to be allowed to be taxed as co-operatives or companies

3.25 Section 117 of the Principal Act is amended to provide that subsection 117(2) will not apply to a credit union in relation to a year of income if the company is a transitional credit union in relation to that year of income or if the year of income is later than the 1996-97 year of income. [*New subsection 117(3)*] [*Clause 42*]

3.26 Subsection 117(2) of the Principal Act currently provides that credit unions which enjoy the exemption provided for by section 23G of the Principal Act are not eligible to be taxed as co-operative companies. However, when the exemption no longer applies to a credit union, it will be allowed to be taxed as a co-operative if it satisfies the requirements specified in subsection 117(1).

Application of the mutuality principle to interest received by credit unions in respect of loans to members

3.27 Section 119 of the Principal Act will be amended to provide that if a credit union receives a payment of, or in the nature of interest, the payment is taken to be for the rendering of services *[New subsection 119(2)] [Clause 43]*. New subsection 119(2) is not intended to limit the generality of subsection 119(1). *[New subsection 119(3)] [Clause 43]*

3.28 It is clear from the High Court's decision in the *Sydney Water Board Employees Credit Union* case that interest received by a credit union from its members in respect of loans made to those members is not mutual income and is assessable income of the credit union. Nevertheless, the proposed amendment to section 119 of the Principal Act is intended to put beyond doubt that any payments of, or in the nature of interest, received by any credit union in respect of loans to its members is assessable income.

Application of the amendment to section 119

3.29 Proposed new subsection 119(2) is expressed to apply only to assessments in respect of the 1994-95 year of income and later years of income *[Clause 44]*. This is to ensure that the provision cannot be construed as having effect in relation to any year of income prior to the enactment of subsection 117(2).

Amendments to Income Tax Rates Act 1986

Summary of proposed amendments

3.30 *Purpose of amendments:* To provide a concessional tax rate of 20% for a credit union in the years of income in which it is a transitional credit union.

3.31 *Date of effect:* The amendments will come into effect from the date upon which the Bill receives Royal Assent and will apply to a credit union which is a transitional credit union in respect of the 1994-95, 1995-96 or 1996-97 years of income.

Explanation of proposed amendments

3.32 Division 2 of Part 4 of the Bill will amend section 23 of the *Income Tax Rates Act 1986* (the Principal Act).

Object of the Division

3.33 The object of this Division is to provide a concessional rate of tax for credit unions during the transitional period after which they become liable to pay tax at the full corporate rate. *[Clause 46]*

Rates of tax payable by companies

3.34 Section 23 of the Principal Act will be amended to include a reference to a 'transitional credit union'. *[New paragraph 23(2)(e)]*
[Clause 47]

3.35 Section 23 of the Principal Act will be amended also to provide that the rate of tax payable by a company (other than a registered organization or a life assurance company) that is a transitional credit union in relation to the year of income is 20%. *[New subsection 23(4E)]**[Clause 47]*

3.36 This means that during the relevant transitional period, a credit union will be liable to tax at the concessional rate of 20%.

CHAPTER FOUR *Medicare Levy Low Income Thresholds*

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Summary of amendments

4.1 **Purpose of the amendment:** To amend the *Medicare Levy Act 1986* (the Act) to raise the low income thresholds for individuals, married couples and sole parents [Clause 48]. Persons with a taxable income below the Medicare levy low income thresholds are not required to pay the levy.

4.2 **Date of effect:** 1 July 1993. [Clause 52]

Background to the legislation

4.3 Medicare levy applies to a person's taxable income at a rate prescribed in the Act (section 6). Since 1 July 1993 the rate has been 1.4%.

4.4 Each year the Government reviews the low income thresholds and decides whether it is appropriate to vary them.

4.5 The levy is not payable if a person's taxable income does not exceed the amount prescribed in the Act (subsection 7(1)). The present amount (that is, the low income threshold for individuals) is \$11,884. However, if a person's income is greater than the low income threshold, but does not exceed \$12,680, the amount of levy payable is 20% of the excess (subsection 7(2)).

Example

4.6 A taxpayer's taxable income in 1992-93 was \$12,433. The amount of levy payable is \$109.20 [20% of (\$12,433 - \$11,887)].

4.7 At the "shading-in point" of \$12,680, the amount of levy calculated at 20% of the excess is the same as if the Medicare levy had been applied at the then normal rate of 1.25% to the person's taxable income.

4.8 Additionally, the levy is payable if a person's family income exceeds the "family income threshold" and:

the person is married (or in a *de facto* relationship) on the last day of the income year; or

the person is entitled to a rebate for a child-housekeeper, a sole parent rebate or a housekeeper rebate.

4.9 The relevant "family income" is the sum of the taxable incomes of the person and of the person's partner. In other cases, it is the taxable income of the person.

4.10 The family income threshold is prescribed as \$20,070 plus \$2,100 for each dependent child or student (subsection 8(5)).

Explanation of the amendments

4.11 The low income threshold for individuals is to be increased to \$12,688 (up from \$11,887). *[Clause 50]*

4.12 The range of taxable income over which the levy is shaded in will be raised. The new range will be income exceeding \$12,688 but not exceeding \$13,643 (up from \$11,887 and \$12,680 respectively). *[Clause 50]*

4.13 The family income threshold will be changed by increasing the base amount to \$21,366 (up from \$20,070) *[Clause 51]*. There will be no change to the amount for each dependent child or student.

4.14 The 1993-94 low income thresholds and shading-in ranges will therefore be as shown in the following table:

Table Medicare levy low income thresholds and shading-in ranges

| Category of taxpayer | No levy if taxable (or family) income does not exceed | Reduced levy if taxable (or family) income is within the range | Ordinary rate of levy where taxable (or family) income exceeds |
|---|---|--|--|
| Individual taxpayer | \$12,688 | \$12,689-\$13,643 | \$13,643 |
| Married taxpayer with no child/students | \$21,366 | \$21,367-\$22,974 | \$22,974 |
| Married taxpayer with: | | | |
| 1 child/student | \$23,466 | \$23,467-\$25,232 | \$25,232 |
| 2 children/students | \$25,566 | \$25,567-\$27,490 | \$27,490 |
| 3 children/students | \$27,666 | \$27,667-\$29,748 | \$29,748 |
| 4 children/students | \$29,766* | \$29,767*-\$32,006# | \$32,006 |

For each additional child or student add:

\$2,100*

\$2,258#

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* References to Principal Act or minor technical consequential amendments only; not specifically mentioned in the Explanatory Memorandum.



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