1985

THE PARLIAMENT OF THE COMMONWEALTH
OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAXATION LAWS AMENDMENT BILL (NO. 4) 1985

INCOME TAX (COMPANIES, CORPORATE UNIT TRUSTS AND SUPERANNUATION FUNDS) AMENDMENT BILL 1985

EXPLANATORY MEMORANDUM

(Circulated by authority of the Treasurer
the Hon P.J. Keating M.P.)

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GENERAL OUTLINE

Taxation Laws Amendment Bill (No. 4) 1985

This Bill will amend -

the Income Tax Assessment Act 1936 -

- to deny income tax deductions for entertainment expenses incurred after 19 September 1985 (September 1985 Tax Reform announcement);

- to introduce rules to require, with effect from 1 July 1985, substantiation of employment-related expenses and car and travel expense claims (September 1985 Tax Reform announcement);

- to deny deductions for the travel costs of a spouse who accompanies an employee or self-employed person on a business trip (September 1985 Tax Reform announcement);

- as an alternative to substantiating claims in full, to introduce arbitrary deduction rules for car expenses (September 1985 Tax Reform announcement);

- to extend the company tax system to public unit trusts which carry on a trade or business, but not to public unit trusts whose business consists of investing in real estate for rental purposes or in equities or securities; the changes to apply to income of the 1985-86 and subsequent income years for such trusts established after 19 September 1985, and of the 1988-89 and subsequent income years for trusts created on or before that date (September 1985 Tax Reform announcement);

- to provide that capital expenditure by primary producers incurred after 19 September 1985 on water conservation or conveyance of a kind presently qualifying for immediate income tax deduction be deductible in equal instalments over 5 years (September 1985 Tax Reform announcement);

- to continue the immediate deductibility of capital expenditure on soil conservation and extend it to expenditure in respect of land degradation generally;

- to counter arrangements designed to exploit the concessional income tax treatment of lump sum superannuation payments and other retirement or employment termination payments by the commutation of immediate annuities purchased wholly or partly with moneys other than moneys paid on retirement or termination of employment (proposal announced on 22 August 1985);

- to extend the income tax rebate available in respect of taxable amounts received under life assurance policies to similar amounts paid under policies issued by certain State government insurance offices, and to correct a technical deficiency in the rebate provisions (proposal announced on 9 October 1985);

- to revise references to, and make other changes consequential upon the repeal of, certain Repatriation statutes as part of an exercise to rationalise and simplify the Repatriation legislation;

- to ensure that the carer's pension, introduced from 1 November 1985, payable to a person who provides constant care and attention to a severely handicapped pensioner spouse or close relative, and the corresponding carer's service pension, are taxed on a similar basis to the former spouse carer's pension (1985-86 Budget announcement); and

- to incorporate technical changes consequential on amendments of the Social Security Act 1947.

This Bill will also amend -

the Income Tax (Individuals) Act 1985 -

- to exclude from the scope of the Act the trustee of a public trading trust to whom company tax arrangements are to apply;

the Income Tax (International Agreements) Act 1953 -

- to deny to a public trading trust proposed to be taxed as a company credit for foreign tax paid on dividends in respect of which a rebate is to be allowed; and

- to ensure that reduced rates of withholding tax applicable to dividends paid by a company to a resident of an agreement country also apply to distributions made by a public trading trust to such a resident; and

the Income Tax (Rates) Act 1982 -

- to exclude from the scope of the Act the trustee of a public trading trust, who is to be subject to company tax arrangements.

Income Tax (Companies, Corporate Unit Trusts and Superannuation Funds) Amendment Bill 1985

This Bill will amend the Income Tax (Companies, Corporate Unit Trusts and Superannuation Funds) Act 1985 to formally declare and impose the rate of tax payable by trustees of public trading trusts within the meaning of the proposed Division 6C of Part III of the Income Tax Assessment Act 1936.

FINANCIAL IMPACT

The estimated revenue gain from denying income tax deductions for entertainment expenses is $20m in 1985-86, $310m in 1986-87 and $330m in 1987-88.

Revenue gains of $105m are expected in 1987-88 from the measure to require substantiation of employment-related expenses and car and travel expenses, increasing to $200m after about 4 years.

The measure to tax, as companies, those public unit trusts which operate a trade or business is expected to result in revenue savings of $5m in each of the 1986-87 and 1987-88 financial years.

The potential revenue saving arising from the move to a 5 year write-off of water conservation or conveyance expenditure by primary producers is estimated at $25m in 1986-87 and $20m in 1987-88. An accurate estimate cannot be made of the revenue cost of extending the soil conservation immediate write-off to expenditure in respect of land degradation but is likely to be less than $1m in a full year.

The revenue gain from taxing the carer's pension will be less than $50,000 in each of the 1986-87 and subsequent years.

The amendments being made to counter the exploitation of the eligible termination payment provisions of the income tax law will prevent future losses of revenue. The impact on revenue of any prior exploitation cannot yet be determined.

The revenue forgone by allowing the income tax rebate in respect of certain life assurance policies issued by State government insurance offices will be offset by amounts which the respective State Governments have agreed to reimburse to the Commonwealth.

The measures to amend the income tax law as a result of changes to the Repatriation legislation will have no effect on revenue.

MAIN FEATURES

The main features of the Bills are as follows:

Taxation Laws Amendment Bill (No. 4) 1985

Entertainment Expenses
(Clauses 6, 9, 10 and 23)

The Bill will implement the proposal, announced in the 19 September 1985 Statement on Reform of the Australian Taxation System, to deny income tax deductions for entertainment expenses.

Under the existing law, deductions are allowable for losses or outgoings incurred in entertaining existing or prospective clients, business associates, employees and others, provided the expenditure is incurred in the course of gaining or producing assessable income or is necessarily incurred in carrying on a business for the purpose of gaining or producing such income.

With certain exceptions, entertainment expenses incurred after 19 September 1985 will no longer be tax deductible. Typical of the kinds of entertainment expenses that will no longer attract deductibility include those on business lunches and drinks, dinners, cocktail parties, staff social functions, sightseeing tours, sporting or theatrical events, and hospitality to selected guests at product launches or film premieres. Hostess allowances paid by employers to spouses of employees will not be deductible.

The following expenses will not fall within the general entertainment deduction prohibition :

- expenditure in the ordinary course of a business carried on for the purpose of providing entertainment (e.g., expenditure incurred in the operation of a theatre);

- entertainment made available to the general public for the purpose of business advertising or promotion (e.g., shows put on in a retail shopping mall);

- meals that are an ordinary incident of a business seminar;

- the cost of a person's meal while travelling on business away from home, otherwise than in the course of entertaining a client, etc.;

- the cost of overtime meals of an employee provided pursuant to an award or collective industrial agreement;

- expenditure in providing entertainment to the sick, disabled, poor or otherwise disadvantaged persons;

- in-house recreational facilities for employees;

- meals provided to employees (including directors) in an in-house dining facility or provided on-the-job to staff of restaurants, hotels and motels.

Special rules will apply with effect from the date of introduction of the Bill to deny deductions for the cost of meals provided to clients and other guests in in-house dining facilities.

Where an entertainment allowance is paid by an employer to an employee, deductions will continue to be available to the employer for payment of the allowance, but the employee will not be allowed a deduction for entertainment expenditure paid for from the allowance.

There will be a number of safeguarding provisions.

One will ensure that taxpayers cannot misuse the exceptions that relate to expenses incurred by persons who are in the entertainment business or who provide public entertainment for the purpose of promotion or advertising.

Those exclusions will not apply if, through re-arrangement of supply contracts, taxpayers purport to charge for entertainments of the kind that were previously provided gratuitously to customers or clients.

Another will make sure that, where a hostess allowance for entertainment is given to the spouse of an employee, the exception for employee allowances cannot be availed of by the device of making the spouse an "employee".

The cost of entertainment that is paid for as part of a "package deal", e.g., for advertising services, will not be deductible. An example would be where a private viewing box is provided to a firm sponsoring a particular sporting event. In such cases, if the relevant contract does not separately specify the cost of the entertainment component or where the entertainment is provided under a collateral arrangement, the Commissioner of Taxation will be authorised to make a reasonable estimate of that component.

The general rule of non-deductibility of entertainment expenses will also extend to plant and equipment that is used in, or in connection with, the provision of entertainment. Depreciation allowances will not be available in respect of plant used after 19 September 1985 to the extent to which it is used for the purpose of providing entertainment of a "non-deductible" kind.

The rule will also apply to entertainment expenses incurred in being elected as a member, or in contesting an election for membership, of the parliament of the Commonwealth or a State or of a territory or local government body. To the extent that any such expenditure is incurred after 19 September 1985 in entertaining others - except where the entertainment is generally extended to the public - it will not be deductible. Deductions will not be denied, however, for the cost of a candidate's own meals whilst travelling away from home (unless in the course of entertaining someone).

Substantiation Requirements
(Clauses 9, 14 and 23)

Subject to specific exemptions outlined below, the amendments proposed by the Bill will make it a requirement for deduction that documentary evidence be maintained to substantiate relevant employment-related expenses, and car and travel expense claims. Expenses in contesting an election for membership of a State or Commonwealth Parliament or territory or local government body will be subject to the substantiation requirements. The documentary evidence will need to be available on official request but it will not be necessary - nor is it intended -

that such evidence be attached as a matter of course to income tax returns.

Substantiation requirements are to apply to most employment-related expenses. Examples include expenses incurred in deriving salary and wage income including such items as protective clothing, trade journals and subscriptions to trade, business or professional associations.

The general rule is that an expense will be regarded as substantiated only if a taxpayer is able to produce a receipt, invoice or other documentary evidence that shows the amount, date and essential character of the expense. For individual items of expenditure of less than $10 which total less than $200 in a year of income, a taxpayer will be entitled to maintain a contemporaneous record of the expenditure instead of individual receipts. A relieving provision will also apply where a person is able to demonstrate that records have been lost through circumstances beyond his or her control or where it would be impractical to obtain receipts.

More detailed substantiation requirements are to apply in relation to car expenses; although as explained below, there will also be alternative standard claims available in certain cases.

The requirements will extend to claims relating to the use of passenger cars, station wagons, mini buses, panel vans, utilities or other small capacity commercial vehicles; although taxis, panel vans, utilities and non-passenger commercial vehicles, the private use of which is restricted to from home to work travel are to be excluded from the new requirements.

In addition to the need to be able to verify actual expenditure on, for example, registration, insurance, petrol and service charges, taxpayers seeking to deduct the business proportion of those expenditures are to be required to maintain daily log books or similar records in which details of business trips are recorded.

Alternative arbitrary bases for deduction without full substantiation are to be available for car expenses.

Where annual business use exceeds 5,000 kilometres the taxpayer will be entitled to claim a deduction equal to 1/3rd of relevant expenses and costs or, alternatively, a deduction equal to 12% of the purchase price of the motor vehicle. Where the vehicle is acquired under a lease, the 12% deduction will be based on the market value of the vehicle on entry into the lease. The value on which the 12% deduction is to be based will be subject to the limit under the existing law on the cost price of cars for depreciation purposes. The current limit for these purposes is $26,660.

Where the 1/3rd of annual vehicle costs option for deduction is adopted, the taxpayer will be required to meet the basic substantiation requirements as to documentation of expenditure but will be relieved of the requirement to maintain log books as to the business proportion of kilometres travelled. Where the 12% of cost basis of deduction is adopted, the taxpayer will only be required to substantiate the purchase price.

For cars with an estimated business use in a year of less than 5,000 kilometres, the taxpayer will be entitled to a deduction determined by applying a standard rate per kilometre. For these purposes the standard rates are to be prescribed by Regulation. Under this option, a taxpayer will not be required to maintain documentation relating to expenses; nor will full substantiation of business kilometres be required. Rather the deduction is to be allowable on the basis of detailed and reasonable estimates of business use.

More stringent rules are also to apply to substantiate the business purpose of overseas travel and extended domestic travel. In addition to the basic substantiation requirements evidencing expenditure, it will also be necessary to maintain a diary of business activities conducted during the trip.

In addition, the amendments proposed by the Bill will deny deductions for travelling expenses in respect of a spouse who accompanies an employee or self-employed person on a business trip. This exclusion will not apply where there is a genuine and substantial business purpose for the spouse's presence, independent of the fact of being the spouse of the person. These rules will extend to de facto partners and other relatives.

Two general exclusions from the substantiation requirements are to apply to employment-related expenses of employees. Under the first of these, substantiation will not apply to claims within the limits of reasonable domestic travel and meal allowances paid under the terms of an award relating to the provision of overtime meals. Claims which exceed the amount of reasonable travel or overtime meal allowances or which are made in respect of allowances that are excessive in amount, will be subject to the substantiation requirements.

The other general exclusion from the substantiation requirements is for employment-related expenses (including employees' car and travel expenses) where aggregate claims in the particular income year do not exceed $300.

The substantiation requirements are to apply with effect for the income year commencing 1 July 1986, so that documentary evidence of expenditure incurred on or after that date will be required. Log books (in relation to car expenses) and diaries (in relation to travel expenses) will similarly be required from that date. As a general principle, employees will be required to maintain records for a period of 3 years and 6 months from the date of lodgment of the return in respect of which the claims are made. To the extent that the documentary evidence relates to expenses incurred in carrying on a business - which may be the case for car or travel expenses - the basic retention period will be 7 years.

Taxation of public trading trusts
(Clauses 15 and 16)

The Bill will give effect to the proposal, announced in the 19 September 1985 Statement on Reform of the Australian Taxation System, to extend the corporate unit tax arrangements of Division 6B of Part III of the Income Tax Assessment Act 1936 ("the Assessment Act") to public unit trusts which operate a trade or business.

The taxable income of a public unit trust operating a trade or business will be taxed at the rate applicable to companies - presently 46 per cent. Distributions to unitholders of trust income or other profits derived by the trustee will be taxed on the basis applicable to dividends paid by a company. The measure will be given effect by inserting in the Assessment Act a new Division 6C modelled on the corporate unit trust provisions of Division 6B.

A unit trust will come within the scope of the proposed amendments if, at any time during a year of income, it operates a trade or business and is also a "public unit trust". Public unit trusts of the more traditional kind the business of which is to invest in land or an interest in land for rental purposes, in equities or securities or a combination of these, will not be affected.

Reflecting the basic tests that apply in the existing corporate unit trust provisions, a trust will be a public unit trust in relation to a year of income where its units are listed on a stock exchange, are held by 50 or more persons or are available for investment by the public. With one exception, a unit trust will not be regarded as a public unit trust if 20 or fewer persons hold 75% or more of the beneficial interests in the income or property of the trust. (For this purpose, a person and his or her relatives or nominees will be regarded as one person).

The exception is where one or more persons or bodies exempt from income tax (including governments) hold units in a trust carrying entitlement to 20 per cent or more of the beneficial interest in the income or property of the trust. In such event a unit trust will be taken to be a public unit trust taxable as a company, even though it would not otherwise be one, e.g., because the number of unitholders is less than 50.

The income of a unit trust which, in relation to a year of income, meets the tests specified will be subject to tax at the general company tax rate. Distributions (referred to as "unit trust dividends") made to unitholders out of income or other profits derived by the trustee during a year of income for which the trust has been or will be taxed as a company will constitute assessable income in the hands of the unitholders as if they were dividends paid by a company.

To the extent that the income of a taxable unit trust consists of dividends paid by a company or unit trust dividends paid to it by another unit trust (including a corporate unit trust taxed as a company by Division 6B), the trustee will be entitled to a rebate of tax in the same way as dividend income derived by a public company is rebatable. Unit trust dividends received by a company will also qualify for rebate in the company's hands. The anti-avoidance provisions of the Assessment Act relating to dividend-stripping operations are also to be made applicable to cases where stripping operations are carried out in connection with unit trust dividends paid by a trustee.

The proposed amendments will apply in relation to the 1985-86 year of income and subsequent years for public unit trusts established after 19 September 1985. For trusts established on or before that date, the amendments will first apply to income of the 1988-89 year of income.

A number of related safeguarding measures will support the intended operation of these provisions.

The amendments in relation to public unit trusts are contained in clauses 15 and 16 of Part II of the Bill. Parts III, IV and V of the Bill contain consequential amendments of the <u>Income Tax (Individuals) Act 1985</u>, the <u>Income Tax (International Agreements) Act 1953</u> and the <u>Income Tax (Rates) Act 1982</u> respectively.

The Income Tax (Companies, Corporate Unit Trusts and Superannuation Funds) Amendment Bill 1985 will declare and impose tax at the rate of 46% on the net income of those public trading trusts to be subject to the new basis of taxation.

Rates of tax imposed on individuals and trustees generally (Clauses 25 to 28)

The Bill will ensure that rates of tax imposed on individuals and trustees generally will not apply to determine the tax payable by trustees of certain public unit trusts operating a trade or business that, by clauses 15 and 16, are proposed to be taxed as companies.

Taxation agreements with overseas countries (Clauses 29 to 32)

This Bill will amend the Income Tax (International Agreements) Act 1953 as a consequence of the proposal to tax certain public unit trusts operating a trade or business as companies, and to treat distributions to their unitholders as dividends.

Broadly, an effect of the agreements with other countries where foreign tax is paid on income derived by an Australian resident is that a credit is available to the taxpayer for the Australian tax or the foreign tax on the income, whichever is the lesser. Such a credit is not available, however, to companies for foreign tax on dividends that are effectively freed from Australian tax because of the rebate of tax allowable under section 46 or 46A of the Income Tax Assessment Act.

As public unit trusts operating a trade or business and taxed as companies will be entitled to the rebate of tax for dividends from companies and distributions from other unit trusts taxed as companies an amendment proposed by this Bill will ensure that a credit for foreign tax is not available on rebatable dividends derived by those public unit trusts.

Another matter is the rate of dividend withholding tax imposed on Australian dividends paid to a resident of a country with which Australia has a double taxation agreement. The normal rate of dividend withholding tax of 30% is reduced, generally to 15%, for dividends paid to a resident of an agreement country. By these amendments, it is proposed that the same reduced rate be applicable to unit trust dividends paid to a resident of an agreement country.

Rates of tax payable upon incomes other than incomes of companies, etc. (Clauses 33 to 35)

The Bill will amend the Income Tax (Rates) Act 1982 to ensure that the rates of tax declared by that Act for individuals and trustees generally do not apply to determine the income tax payable by a person in the capacity of trustee of a public unit trust operating a trade or business and to be subject to tax as a company.

Water conservation or conveyance expenditure
(Clause 11)

The Bill will implement the proposal, announced on 19 September 1985 as part of the Statement on Reform of the Australian Taxation System, to replace the immediate income tax deduction for capital expenditure incurred by a primary producer on conserving or conveying water with write-off over 5 years. Such expenditure, where incurred under a contract entered into after 19 September 1985 and incurred primarily and principally for the purpose of conserving or conveying water, will be deductible by way of 5 equal annual instalments - that is, a 20% deduction will be allowable in the year in which the expenditure is incurred and in each of the subsequent 4 years.

Soil conservation expenditure
(Clause 12)

Consequential on the proposed amendments of the water conservation or conveyance expenditure provisions (see notes above),the Bill will also amend the soil conservation expenditure provisions so that, to be deductible, such expenditure must be incurred primarily and principally for the purpose of soil conservation. This "primarily and principally" test, which is to have a counterpart in the water conservation expenditure provisions, ensures that the two categories of deduction are mutually exclusive in their application to particular expenditure.

The soil conservation write-off is being extended to apply, where relevant, not only to expenditure in respect of soil erosion or salinity but more generally to expenditure in respect of land degradation. The concession will therefore apply, inter alia, to expenditure incurred in -

- an operation primarily and principally for the purpose of preventing or combating land degradation, otherwise than by the erection of fences; or
- an operation consisting of the erection of fences (including any extension, alteration or addition) primarily and principally for the purpose of excluding livestock or vermin from areas affected by land degradation in order to prevent or limit any extension or aggravation of that degradation and to assist in reclaiming those areas.

These amendments are to apply to expenditure incurred after 19 September 1985.

<u>Taxation of carer's pension</u>
(Clause 5)

The Bill will give effect to the 1985-86 Budget announcement to introduce, from 1 November 1985, a carer's pension for people who provide constant care and attention to a severely handicapped age or invalid pensioner spouse or close relative. The carer's pension replaces, and by an amendment proposed in the Bill will be taxed on the same basis as, the former more limited spouse carer's pension paid under the Social Security Act. It will therefore be taxed -

- when paid to a male carer -
  - if he is 65 years or older; or
  - if the handicapped pensioner for whom he is caring, being a man, is 65 years or older or, being a woman, is 60 years or older; and
- when paid to a female carer -
  - if she is 65 years or older; or
  - if the handicapped pensioner for whom she is caring, being a man, is 65 years or older or, being a woman, is 60 years or older.

The service pension formerly paid under Repatriation legislation to a male caring for his severely handicapped service pensioner wife has also been extended to cover persons caring for close relatives, and will be taxed on a similar basis to the former service pension that was payable only to a male carer. The rules outlined above for the social security carer's pension will apply where the handicapped person's service pension is paid because he or she is permanently unemployable. In other service pension cases, the carer's service pension will be taxable irrespective of age.

It has also been necessary to make a number of technical changes consequential on recent amendments of the <u>Social Security Act 1947</u>.

<u>Commutations of immediate annuities</u>
(Clauses 7 and 8)

The Bill will also give effect to the proposal, announced on 22 August 1985, to counter a tax avoidance arrangement under which moneys other than retirement or employment termination payments are used to purchase an annuity payable immediately over a specified number of years, but with the intention that the annuity will be commuted in the short term. Under the arrangement, the greater part of the earnings on the principal sum are paid out on commutation so that they become payments subject to concessional treatment under the eligible termination payment provisions of the income tax law that apply to lump sum superannuation payments and similar payments made on retirement or termination of employment. The result is that, instead of the earnings being subject to full marginal rates of tax - as they would be if paid out over the purported life of the annuity or if the moneys were invested elsewhere - they are subject to tax at a rate of no more than 30%, or 15% on the first $55,000 if the recipient is aged 55 or more. Moneys that have no relationship whatever with retirement or employment termination could, by this device, be used to generate earnings subject to concessional tax treatment.

Under amendments proposed by the Bill, earnings paid out on commutation after 22 August 1985 of an immediate annuity purchased on or after 1 July 1983 (the date from which the eligible termination payment provisions of the law first applied) will, to the extent that those earnings relate to moneys other than lump sum retirement or termination payments used to fund the purchase of the annuity, be subject to normal marginal rates of tax. The ability to "roll over" (i.e., preserve for future concessional tax treatment with tax-free accumulations) such annuity earnings by paying them into, for example, an approved deposit fund will also be denied. The amendments will not apply to alter the current concessional tax treatment of earnings related to any component of annuity principal funded by lump sum retirement or termination payments.

<u>Rebate of tax on amounts paid under certain life assurance policies</u>
(Clause 18)

Under the existing law bonuses, and other amounts in the nature of bonuses, received by a taxpayer during the first 10 years of policies of life assurance issued after 7 December 1983 (or during the first 4 years of policies issued after 27 August 1982 and before 8 December 1983) are, by section 26AH of the Income Tax Assessment Act, generally included in the taxpayer's assessable income. If the amount so included in assessable income is in respect of a policy issued by a life assurance company the investment income of which is subject to tax, or by a friendly society, the taxpayer is entitled in his or her assessment for the year of income to a rebate of tax equal to 30% of that amount. The rebate of tax allowed is designed to broadly compensate for the tax paid by the life assurance company in respect of its investment income or paid by the friendly society in respect of its life assurance business.

State government insurance offices are, because of their status as public authorities for income tax purposes, exempt from Commonwealth income tax. Amounts paid on policies issued by those offices and to which section 26AH applies do not therefore presently attract the rebate of tax.

Amendments proposed by this Bill will extend the operation of the existing rebate provisions to assessable amounts received under life assurance policies issued after 27 August 1982 by the Government Insurance Office of New South Wales, the State Government Insurance Office (Queensland) and the South Australian State Government Insurance Commission. Entitlement to the rebate will be available from the commencement date of the existing rebate provisions. In return, the New South Wales, Queensland and South Australian Governments have agreed to reimburse the Commonwealth for the estimated Commonwealth revenue forgone by allowing the rebate.

Amendments contained in the Bill will also remedy a technical deficiency in the rebate provisions by ensuring that the rebate of 30% is available to trustees of taxable superannuation funds and ineligible (taxable) approved deposit funds where, by the operation of section 26AH, the funds' assessable incomes include bonuses, and other amounts in the nature of bonuses, received in respect of life assurance policies. Under the amendments the rebate of tax will apply to trustees of these funds from the year in which the rebate provisions first applied - generally the 1982-83 income year.

<u>Repatriation legislation consequential amendments</u>
<u>(Clauses 4, 5, 13, 17, 20, 21 and 22)</u>

The <u>Repatriation Act 1920</u>, which was introduced immediately after World War 1, was the main statute that provided for the payment of pensions and for medical treatment of veterans and their dependants. That Act was subsequently extended to include within its scope World War 2 veterans.

The Repatriation legislation has, however, been characterised by increasing diversification and complexity with separate enactments to cover other conflicts in which Australia has been involved. Moreover, yet further Acts have been passed to deal with particular groups of servicemen and women not otherwise covered by existing laws.

The Veterans' Entitlements Bill 1985, which was introduced into the Parliament on 16 October 1985, is designed to rationalise and simplify the burgeoning body of Repatriation legislation in this area by replacing various Repatriation statutes with one consolidated Act - the <u>Veterans' Entitlements Act 1985</u> - which is intended to come into operation on 5 December 1985.

As a consequence of those changes, this Bill will amend several provisions of the <u>Income Tax Assessment Act</u>

1936 (the 'Assessment Act') to ensure that references to repealed Repatriation statutes are replaced by references to the Veterans' Entitlements Act 1985. These amendments, which will operate on and from 5 December 1985, are not substantive in nature and will not affect the operation of the relevant provisions of the income tax law.

The Bill will also make a number of technical amendments of the Assessment Act as a consequence of the enactment of the Repatriation Legislation Amendment Act 1985 - Act No. 90 of 1985 - on 6 June 1985. Broadly stated, that Act overcame the effects of a recent High Court decision and implemented other changes to the repatriation system announced by the Treasurer in the Statement of Government Expenditure Saving delivered on 14 May 1985.

One particular change made at that time was to abolish future eligibility for certain pensions then payable under the Repatriation Acts to relatives of ex-servicemen. Such pensions then being paid were continued in force by the amending legislation. Amendment of the Assessment Act, to include appropriate references to the Repatriation Legislation Amendment Act 1985, was overlooked at that time, and this Bill will rectify that situation, with effect from 6 June 1985. These amendments are also of a purely technical kind, and will not disturb the practical effect of the income tax law in this area.

Income Tax (Companies, Corporate Unit Trusts and Superannuation Funds) Amendment Bill 1985

This Bill will amend the Income Tax (Companies, Corporate Unit Trusts and Superannuation Funds) Act 1985 to take account of the extension of company tax arrangements to certain public unit trusts operating a trade or business under proposals contained in Part II of the Taxation Laws Amendment Bill (No. 4) 1985. The purpose of the amendments proposed by this Bill is to formally declare and impose at a rate of 46% the tax payable by trustees of the relevant public trading trusts.

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

NOTES ON CLAUSES

TAXATION LAWS AMENDMENT BILL (No. 4) 1985
PART I - PRELIMINARY

Clause 1 : Short Title

This clause provides for the amending Act to be cited as the Taxation Laws Amendment Act (No. 4) 1985.

Clause 2 : Commencement

Under sub-clause 2(1), the amending Act, except as provided in sub-clauses 2(2), 2(3) and 2(4), is to come into operation on the day on which it receives the Royal Assent.

By sub-clause 2(2), sub-clause 5(1) which will amend section 23AD of the Income Tax Assessment Act 1936, will be deemed to have come into operation on 6 June 1985. The relevant amendments to Section 23AD are of a technical nature arising as a consequence of amendments to Repatriation legislation by the Repatriation Legislation Amendment Act 1985 which came into operation on that date.

Sub-clause 2(3) will deem the amendments proposed by sub-clause 5(2) to have come into operation on 1 November 1985. Those amendments - also to section 23AD of the Income Tax Assessment Act - deal with the taxing of the new carer's pension payable under the Social Security Act 1947 and certain Repatriation legislation from 1 November 1985.

By sub-clause 2(4), the amendments proposed by clause 4, sub-clause 5(3) and clauses 13, 17, 20, 21 and 22 of the amending Act are to come into operation simultaneously with the Veterans' Entitlements Act 1985. These amendments to the Income Tax Assessment Act are as a consequence of the proposal to enact a new Veterans' Entitlements Bill to rationalise and simplify the existing body of Repatriation legislation.

The amending Act would, but for clause 2, come into operation on the twenty-eighth day after Royal Assent, by virtue of sub-section 5(1A) of the Acts Interpretation Act 1901.

PART II - AMENDMENTS OF THE INCOME
TAX ASSESSMENT ACT 1936

Clause 3 : Principal Act

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

Clause 4 : Income of certain persons serving with an armed force under the control of the United Nations

Section 23AB of the Principal Act provides special taxation concessions for certain Australian civilian personnel serving with an armed force of the United Nations overseas.

By that section, any compensation paid under the Compensation (Commonwealth Government Employees) Act 1971 in respect of the incapacity or death of a civilian on such service is exempt from income tax, provided the Australian Government would have had a liability to pay a pension under that Act in respect of that person's incapacity or death if he or she had been a member of the Defence Force serving on special service within the meaning of the Repatriation (Special Overseas Service) Act 1962.

The Repatriation (Special Overseas Service) Act is to be repealed on 5 December 1985 and its provisions subsumed in the Veterans' Entitlements Act 1985 which is to come into effect on that day. This clause will therefore omit references to that former Act from paragraphs 23AB(5)(a) and 23AB(10)(c) of the Principal Act, and substitute relevant references to the appropriate Schedule to the Veterans' Entitlements Act. This amendment will not alter the basis of the present exemption from income tax of the compensation payments concerned.

Clause 5: Exemption of certain pensions

This clause will make a number of amendments of section 23AD of the Principal Act which sets out the circumstances in which pensions, benefits and allowances paid under social security, repatriation and other welfare legislation are subject to, or exempt from, tax.

The legislative scheme of section 23AD is that sub-section (3) exempts from tax all pensions, allowances or benefits paid under the relevant legislation other than those included within the term "excepted payment", which is defined in sub-section (1). The term includes pensions, allowances and benefits that are assessable irrespective of the age of the recipient, and other payments, specified in the definition of "excepted pension" in sub-section (1), that are assessable only when the recipient is a "prescribed person" as defined in sub-section (1), i.e., a man or woman of age pension age, a woman in receipt of a "wife's pension" as defined in sub-section (1) whose husband is aged 65 or more, or a man in receipt of a "spouse carer's pension" as defined in sub-section (1) whose wife is aged 60 years or more.

As mentioned earlier in these notes, the Repatriation Legislation Amendment Act 1985 amended several of the Repatriation statutes with effect on and from 6 June

1985. One particular change made by that Act was to withdraw, in respect of future applications, entitlement to certain small additional payments made to the wife and children of incapacitated veterans.

To the extent that such amounts were previously payable under the Repatriation statutes, sub-section 66(2) of the Repatriation Legislation Amendment Act provided legislative authority for the continued payment of those amounts under that Act.

Paragraphs (a) to (c) of sub-clause (1) of this clause propose a number of amendments to section 23AD of the Principal Act to ensure that payments that, on and after 6 June 1985, are technically made under sub-section 66(2) of the Repatriation Legislation Amendment Act, are within the scope of the existing definitions of "excepted payment", "excepted pension", and the operation of section 23AD generally.

By virtue of sub-clause 2(2) of the Bill, these amendments are deemed to have come into operation on 6 June 1985 - the date on which the Repatriation Legislation Amendment Act came into force. These amendments, however, will technically apply only until 4 December 1985. This is because the relevant provisions of the Repatriation Legislation Amendment Act will themselves be subsumed as part of the rationalisation of the various Repatriation laws in the proposed Veterans' Entitlements Act 1985 and associated legislation which is to come into operation on 5 December 1985. Technical amendments of the Principal Act to reflect the commencement of that Act are proposed by sub-clause (3) of this clause.

The amendments proposed by sub-clause (2) are needed to provide for the taxation treatment to be given to the new carer's pension payable under the Social Security Act 1947 and the carer's service pension payable under relevant Repatriation legislation. Certain technical changes that are consequential on recent amendments of the Social Security Act are also proposed by this sub-clause.

The social security carer's pension is payable from 1 November 1985 to a person providing constant care and attention to a spouse or close relative who is severely handicapped and who is an age or invalid pensioner. This pension replaces, and will be given much the same taxation treatment as, the former spouse carer's pension paid to a male carer. The carer's pension therefore will be exempt from tax only where both the carer and the handicapped pensioner spouse or close relative, as the case may be, are below age pension age. When either the carer or the handicapped pensioner is of age pension age, the carer's pension will be taxable. The same rules will apply to the pension paid to a person caring for a service pensioner who is permanently unemployable (i.e. the handicapped person is receiving the equivalent of an invalid pension by virtue of sub-section 85(2) of the Repatriation Act or, from 5 December 1985, proposed section 39 of the Veterans' Entitlements Act 1985). In any other case, the service pension paid to a carer will be taxable irrespective of age.

Paragraph (a) of sub-section 5(2) proposes to insert a definition of "carer's pension" in sub-section 23AD(1) of the Principal Act. "Carer's pension" is to be defined to mean a pension payable under Division 6 of Part III of the Social Security Act 1947, or under section 85AA of the Repatriation Act 1920 (including that section as applying by virtue of other provisions of that Act or by virtue of the Repatriation (Special Overseas Service) Act 1962), to a person who provides constant care and attention to a relative who, being a man, has attained the age of 65 years or, being a woman, has attained the age of 60 years. The purpose of the definition is to ensure that a person receiving a carer's pension, as defined, in respect of the care of a man 65 years or older, or of a woman 60 years or older, as the case may be, is taxed on the pension. Such a person will come within proposed new paragraph (d) of the definition of a "prescribed person" in sub-section 23AD(1) - refer to the notes on the amendment proposed by paragraph 5(2)(k) of the Bill. A person in receipt of a carer's pension, being a man 65 years or older, or being a woman 60 years or older, as the case may be, will fall within the ambit of the definition of "prescribed person" because of the operation of existing paragraphs (a) or (b) of the definition, and will be taxable on the pension, notwithstanding that the person's spouse or close relative, being a man, is less than 65 years of age or, being a woman, is less than 60 years of age.

Reflecting the proposed repeal of various Repatriation Acts and their replacement by the Veterans' Entitlements Act, paragraph (b) of the definition of "carer's pension" will be amended by paragraphs (a) and (b) of sub-clause (3) of this clause to substitute a reference to that Act from the date it comes into operation.

Paragraph (b) of sub-clause 5(2) proposes to insert a definition of "dependent child" in sub-section 23AD(1) by reference to a definition of the term in section 6 of the Social Security Act. The definition is relevant to the operation of paragraphs (e) and (f) of the definition of "excepted payment" in sub-section 23AD(1) that operate to exempt from tax additional payments to pensioners and beneficiaries in respect of dependent children. Paragraphs (e) and (f) of the definition of "excepted payment" are proposed to be amended by paragraphs 5(2)(g) and (h) of this Bill to take account of the insertion of the new definition. Paragraph (e) of the definition will be replaced by the amendment proposed by paragraph 5(3)(e) of the Bill as a consequence of the operation of the proposed Veterans' Entitlements Act from 5 December 1985.

By paragraph (c) of sub-clause 5(2), a reference to the carer's pension, as defined, is to be included in sub-paragraph (a)(i) of the definition of "excepted payment" in sub-section 23AD(1) of the Principal Act. This amendment will ensure that a woman under 60 years of age in receipt of a pension defined as a "carer's pension" will only be exempt from tax on it if the relevant handicapped male relative is under 65 years of age, or in the case of a female relative, is under 60 years.

Paragraph (d) of sub-clause 5(2) proposes to substitute a reference to a relative - in lieu of "the spouse" - in sub-paragraph (b)(ii) of the definition of "excepted payment" in sub-section 23AD(1). This amendment will ensure that pension payments to a person caring for any service pensioner relative receiving a pension otherwise than because he or she is permanently unemployable (i.e. the handicapped person is not receiving the equivalent of an invalid pension by virtue of sub-section 85(2) of the Repatriation Act (or, from 5 December, proposed section 39 of the Veterans' Entitlement Act) - in lieu of the earlier pension payable only to a male caring for his spouse - will be taxed, irrespective of the age of the carer. An amendment proposed by paragraph 5(3)(c) of the Bill will replace this sub-paragraph of the definition of "excepted payment" from 5 December 1985 as a consequence of the commencement of the Veterans' Entitlements Act on that date.

The amendment proposed by paragraph (e) of sub-clause 5(2) is consequential upon the change in title of the Director-General of Social Security to the Secretary to the Department of Social Security.

The amendment to be made by paragraph (f) of sub-clause 5(2) is consequential upon the proposed inclusion of a definition of "rent" in sub-section 23AD(1) of the Principal Act by paragraph 5(2)(m) of the Bill. Because of the inclusion of the definition of rent, an amendment is necessary to paragraph (d) of the definition of "excepted payment" in sub-section 23AD(1) to omit the words "lodging or board and lodging" that are encompassed by the definition. A payment under the Social Security Act or the Repatriation laws to a pensioner or beneficiary because he or she pays rent is exempt from income tax.

Paragraphs (g) and (h) of sub-clause 5(2) are technical amendments and will omit references to a person having the custody, care and control of a child from paragraphs (e) and (f) respectively of the definition of "excepted payment" in sub-section 23AD(1), as a consequence of the proposed inclusion, by paragraph 5(2)(b) of the Bill, of a definition of "dependent child" in that sub-section - see earlier notes on that paragraph.

By paragraph (j) of sub-clause 5(2), a reference to a relative is to be included in paragraph (c) of the definition of "excepted pension" in sub-section 23AD(1) in lieu of the present reference to "the spouse". This amendment is related to the amendment proposed by paragraph 5(2)(d) - see notes on that paragraph - and will ensure that pension payments to a person caring for a service pensioner relative who is permanently unemployable (i.e. the handicapped person is receiving the equivalent of an invalid pension by virtue of sub-section 85(2) of the Repatriation Act (or, from 5 December 1985, proposed section 39 of the Veterans' Entitlements Act) are included within the definition of "excepted pension". Accordingly, these pension payments will only be taxable when paid to or in respect of a prescribed person.

Paragraph (k) of sub-clause 5(2) proposes to amend the definition of "prescribed person" in sub-section 23AD(1) to substitute a new paragraph (d) that will include a reference to a person to or in respect of whom a "carer's pension", as defined, (in lieu of a spouse carer's pension), is payable. The term "prescribed person" is used for the purposes of the operation of the expression "excepted payment" and ensures that pensions, allowances or benefits that are an "excepted pension" paid to a prescribed person - that is, a person of age pension age or to a wife of, or a person receiving a carer's pension in respect of, someone of that age - are taxable.

Paragraph (m) of sub-clause 5(2) proposes to amend sub-section 23AD(1) to omit the definition of "spouse carer's pension" that has in effect been replaced by the definition of "carer's pension" inserted by paragraph 5(2)(a) of the Bill, and to insert a definition of "rent". "Rent" is to be defined to have the same meaning as in section 6 of the Social Security Act 1947, and basically means rent in respect of premises occupied by a person as his or her home. The term includes amounts paid for lodging or for board and lodging, for the use of a site for a caravan or other vehicle, or a structure occupied by the person as his or her home, or for the right to moor a vessel that is occupied by the person as his or her home. As already explained in the discussion on paragraph 5(2)(f) of the Bill, the term is relevant to the operation of paragraph (d) of the definition of "excepted payment" in sub-section 23AD(1).

Paragraph (n) of sub-clause 5(2) will amend sub-section 23AD(2) which specifies the time at which a person is deemed to have ceased to receive a wife's or spouse carer's pension in circumstances where the spouse dies but payment of the relevant pension continues. Reflecting the introduction of the carer's pension from 1 November 1985, paragraph (n) will omit the reference to "spouse" in the existing provision.

This amendment will ensure that payments of a pension made to a person on or after the pension pay-day prior to the date of death of the handicapped spouse or close relative or, if the spouse or relative died on a pension pay-day, on or after that pension pay-day, will not fall within the definition of "carer's pension". Accordingly, these payments of pension will not be taxable until the person, if a man, attains the age of 65 years or, if a woman, attains the age of 60 years, unless the payments are made under the Repatriation laws otherwise than because the handicapped relative was permanently unemployable in which case they will continue to be taxed.

Paragraph (o) of sub-clause 5(2) will amend paragraph 23AD(4)(h) of the Principal Act to substitute the citation Parliamentary Contributory Superannuation Act 1948 for Parliamentary Retiring Allowances Act 1948.

By sub-clause 2(3) of the Bill, the amendments proposed by sub-clause 5(2) are to come into operation from 1 November 1985.

Sub-clause (3) of this clause will make a number of technical changes to section 23AD of the Principal Act as a consequence of the proposed repeal of various Repatriation statutes and the consolidation of their provisions in the Veterans' Entitlements Act 1985 and associated transitional and consequential legislation that is to come into operation on 5 December 1985. These ammendments fall into three broad categories.

The first group of amendments to be made by paragraphs (a), (b) and (h) of sub-clause (3) merely replaces references to Repatriation Acts that are to be repealed with references to provisions of the Veterans' Entitlements Act which provide corresponding payments, viz., a carer's pension and a wife's service pension.

The second category of changes - to be made by paragraphs (c), (e) and (f) - is to the same general effect as those described above, except that they will amend provisions proposed to be amended by paragraphs (d), (g) and (j) respectively of sub-clause (2) of this clause. The amendment by paragraph (e) in substituting a new paragraph (e) in the definition of "excepted payment" reflects a change in the manner of referring to a dependant in Repatriation legislation, on the introduction of the Veterans' Entitlements Act. The operation of the provisions being amended is explained in the earlier notes on the changes proposed by those paragraphs of sub-clause (2).

The last group - proposed by paragraphs (d), (g) and (j) - will continue in force the income tax treatment of the payments subject to the amendments proposed by paragraphs (a) to (c) of sub-clause (1) of this clause - see earlier notes on that sub-clause. The relevant payments are to continue in force by operation of the Veterans' Entitlements (Transitional Provisions and Consequential Amendments) Act 1985 which is also proposed to operate from 5 December 1985.

All of these amendments are of a technical nature, and do not alter the present operation of section 23AD of the Principal Act. The amendments will, by virtue of sub-clause 2(4) of the Bill, came into operation on the same day as the Veterans' Entitlements Act 1985.

Clause 6 : Meals provided to clients in in-house dining facilities

Clause 6 will insert new section 26AAAC in the Principal Act. The section complements the operation of new section 51AE, which is to be inserted in the Principal Act by clause 9.

As explained in the notes on that clause, section 51AE will operate to deny deductions for losses or outgoings to the extent to which they are incurred in respect of the provision of entertainment. An exception to that rule is to apply in relation to expenses incurred in the provision of food and drink in an in-house dining facility (broadly, a dining facility on the premises of a taxpayer which is used principally for the provision of food and drink to employees).

Where meals are provided to non-employees (e.g., clients) in a taxpayer's in-house dining room, the assessable income of the taxpayer is to include, by virtue of sub-section 26AAAC(1), an amount equal to $30 per meal provided. This amount is designed to offset the cost of the provision of such meals and, accordingly, where section 26AAAC applies in relation to a dining room, new sub-paragraph 51AE(5)(f)(i) ensures that the costs of providing meals in the dining room will remain fully deductible.

A taxpayer is, however, to be entitled to elect that section 26AAAC not apply in relation to a particular dining room during a year of income, with the result that section 51AE will apply to disallow the cost of providing meals to non-employees in the dining room.

Sub-section 26AAAC(2) is a drafting measure that ensures that expressions used in section 26AAAC have the same meanings as are ascribed to them for the purposes of section 51AE.

By virtue of sub-clause 21(3), section 26AAAC will apply in relation to meals provided to non-employees after the date of introduction of the Bill.

Clause 7 : Interpretation

Clause 7 of the Bill proposes the amendment of section 27A of the Principal Act, which contains a number of definitions and interpretational provisions necessary for the operation of Subdivision AA of Division 2 of Part III of the Act. Subdivision AA deals with the taxation of retirement and kindred payments made on or after 1 July 1983. It defines the payments affected (called eligible termination payments) and provides the rules to determine the extent to which they are to be included in assessable income.

The amendments being made by this clause and by clause 8 will counter the tax avoidance arrangement described in earlier notes under the Main Features section of this memorandum. As noted, that arrangement is designed to exploit, through the purchase and commutation of an immediate annuity not purchased wholly with retirement moneys, the concessional income tax treatment, under Subdivision AA, of eligible termination payments.

In terms of sub-clause 23(2), these amendments are to apply where such an annuity purchased on or after 1 July 1983 (the date from which Subdivision AA first applied) is commuted, or its residual capital value becomes payable, after 22 August 1985 (the date on which the proposal to amend the law was announced).

Under the amendments, a part of the earnings on a relevant annuity paid out on commutation - the earnings constituting an eligible termination payment - will not qualify for the concessional tax treatment and other benefits presently available in respect of eligible termination payments. That non-qualifying part of the earnings is to be the part attributable to moneys used to fund the purchase of the annuity that did not consist of eligible termination payments. The benefits to be denied are -

- the ability to defer income tax liability by rolling over the amount into, for example, an approved deposit fund - as provided by sub-section 27A(12);

- the benefit of the rebate available under section 160AA of the Principal Act, which limits the tax on the fully assessable component of an eligible termination payment to no more than 30%; and

- the benefit of the "before and after rules" incorporated in sections 27B and 27C of the Principal Act, under which an eligible termination payment is apportioned, according to the period to which it relates, into a pre-July 1983 component (no more than 5% of which is included in assessable income) and a post-June 1983 component (which is included in full in assessable income). These rules would be relevant where the annuity commuted was purchased partly with an earlier eligible termination payment carrying with it a period that commenced before July 1983.

Paragraphs (a) and (b) of clause 7 propose the insertion in sub-section 27A(1) of the Principal Act of the following three new definitions.

"immediate annuity eligible termination payment" is the particular kind of eligible termination payment that is to be subject to the proposed change in treatment. It must be an eligible termination payment by virtue of the application, in respect of an immediate annuity, of paragraph (g), (h) or (j) of the existing definition of an eligible termination payment - that is, it must be a payment in relation to the commutation of, or of the residual capital value of, an immediate annuity. Also the immediate annuity in question must be one that was not purchased wholly with a "rolled-over amount" - that is, by an existing definition, an amount consisting of an earlier eligible termination payment, liability to tax on which was deferred by the purchase of the annuity. This latter requirement ensures that the amendments being made will not affect a commuted annuity that was purchased wholly with an earlier eligible termination payment. They will apply only where the purchase moneys consist wholly or partly of moneys other than eligible termination payments (i.e., retirement related moneys).

"income component" is the term used to identify the part of the amount paid out (in the definition called the "capital annuity payment") on commutation of an immediate annuity that represents the earnings on that annuity. Paragraph (b) of the definition deals with the more simple case where no annuity payments have been made to the annuitant prior to commutation. In that case, the "income component" is the "capital annuity payment" less the purchase price of the annuity. Where the annuity is commuted in full, the whole of the purchase price is deducted. Where the annuity is only partially commuted, the relevant proportion of the purchase price is deducted.

<u>Paragraph (a)</u> of the definition deals with the case where one or more annuity payments have been made prior to commutation. In such cases, some part of the purchase price of the annuity will be, or will have been, excluded from assessable income - as a deductible amount or deductible amounts under section 27H in subjecting the annuity payment to tax. A deductible amount is an annual amount excluded from an annuity on assessment, on the basis that the amount represents the return of an appropriate portion of the "undeducted purchase price" of the annuity (a term defined in the existing provisions to mean, in broad terms, purchase price for which no income tax deduction or rebate has been allowed).

To calculate the "income component" of the capital annuity payment in these cases, there is deducted from the capital annuity payment the actual purchase price of the annuity as reduced by the portion of the purchase price already taken into account for section 27H purposes. If the whole of the purchase price qualifies as undeducted purchase price, the amount of the purchase price so taken into account would simply be the sum of the deductible amounts. However, in some cases, a part of the purchase price does not qualify as undeducted purchase price - for instance, where part of the purchase price consists of the fully assessable component of a rolled-over eligible termination payment. For that reason, component C in the formula in the definition of "income component" specifies the amount to be deducted from the actual purchase price of the annuity as being the aggregate of the amounts that would have been deductible amounts for the purposes of section 27H, if the section 27H calculation was based on the purchase price of the annuity rather than the undeducted purchase price.

In those circumstances the "income component" is to be ascertained in accordance with the formula A-(B-C), where -

A is the capital annuity payment - that is the amount of the commutation payment;

B is the purchase price of the annuity (or in partial commutation cases, of that part of the annuity commuted) to which the eligible termination payment relates; and

C is the aggregate of the amounts that would have been deductible amounts if the component representing the undeducted purchase price of the annuity in the formula in sub-section 27H(2) were replaced by a component representing the purchase price of the annuity.

"non-qualifying component" is the term used to identify the proportion of the "income component" that is not attributable to a rolled-over amount - that is, to an earlier eligible termination payment. Paragraph (a) of the definition applies where the commuted immediate annuity was purchased partly from a rolled-over amount and partly from non-retirement moneys. In that case, the "non-qualifying component" is to be ascertained in accordance with the formula $\frac{AB}{C}$, where -

A is the "income component" (see earlier definition);

B is the proportion of the actual purchase price of the annuity that consists of non-retirement moneys; and

C is the actual purchase price of the annuity.

Paragraph (b) of the definition applies where the annuity was purchased entirely with non-retirement moneys. In that case, the whole amount of the income component is the non-qualifying component.

New sub-section 27A(12A) of the Principal Act, to be inserted by paragraph (c) of clause 7, ensures that income tax liability in respect of the non-qualifying component of an eligible termination payment cannot be deferred by rolling over that amount as provided by sub-section 27A(12) of the Principal Act. An eligible termination payment rolled-over (referred to in sub-section 27A(12) as a qualifying eligible termination payment) is to be taken, by new subsection (12A), not to be a qualifying eligible termination payment to the extent that the amount consists of a non-qualifying component.

Clause 8 : Assessable income to include certain superannuation and kindred payments

Section 27B of the Principal Act determines the proportion of an eligible termination payment that is to be included in assessable income in full - that is, the post-June 1983 component. The post-June 1983 component is calculated in accordance with the formula $A - \frac{AB}{C} - D$ in sub-section 27B(1). The present component A in that formula is the amount of the eligible termination payment, less the concessional component of the payment - that is, any part of the payment that is a bona fide redundancy payment, an approved early retirement scheme payment or an invalidity payment. The effect is that any such payment is separated from the eligible termination payment subject to the general taxing arrangements. Concessional components are included in assessable income under a separate provision in section 27C of the Principal Act, whereby only 5% of such payments is included in assessable income.

Paragraph (a) of clause 8 proposes the insertion of a new definition of component A into sub-section 27B(1) so that the non-qualifying component (relevant only to the commutation of an immediate annuity purchased wholly or partly with non-retirement moneys - see notes on clause 7) of an eligible termination payment is also dealt with separately. The non-qualifying component is to be assessed under a separate provision - proposed new sub-section 27B(3) (see notes below).

The new definition of component A is made up of two paragraphs, each of which reduces the amount or value of an eligible termination payment for the purposes of sub-section 27B(1). Paragraph (a) of the definition effectively restates existing component A by dealing with the concessional component, while paragraph (b) reduces an eligible termination payment arising from the commutation of an immediate annuity by any non-qualifying component. The non-qualifying component is excluded from the general taxing treatment of eligible termination payments so that it does not attract the benefit of the "before and after rules" described earlier in these notes. This could occur where the annuity commuted was purchased partly with an earlier eligible termination payment carrying with it a service period commencing before 1 July 1983 and partly with other moneys.

By paragraph (b) of clause 8, a new sub-section (3) is to be inserted into section 27B of the Principal Act. The new sub-section includes in assessable income the full amount of any non-qualifying component of an eligible termination payment arising from the commutation of an immediate annuity. A further consequence of excluding the non-qualifying component from assessment under the ordinary application of sub-section 27B(1) is that the component becomes ineligible for the benefit of the rebate available under section 160AA of the Principal Act, which would otherwise limit the rate of tax on the fully assessable component of the eligible termination payment to no more than 30%. Because, under the terms of section 160AA, the rebate is only available in respect of amounts of eligible termination payments included in assessable income under sub-section 27B(1), that rebate will not apply to any non-qualifying component - assessable under new sub-section 27B(3) - of an eligible termination payment. Any such component will therefore be taxed at the taxpayer's full marginal rate of tax.

Clause 9 : Deductions not allowable for entertainment expenses

Introductory Note

Clause 9 proposes to insert new section 51AE in the Principal Act to introduce a general prohibition on the deduction of entertainment expenses.

Under the existing law, losses or outgoings incurred in entertaining existing or prospective clients, business associates, employees, etc., may qualify for deduction provided the expenditure in question is incurred in the course of gaining or producing assessable income or is necessarily incurred in carrying on a business for the purpose of gaining or producing such income.

The effect of the amendments proposed by Clause 9 will be that, apart from the exceptions outlined below, entertainment expenses incurred after 19 September 1985 will no longer be deductible for income tax purposes. Typical kinds of entertainment that will no longer attract deductibility include business lunches and drinks, dinners, cocktail parties, and staff social functions. Similarly, expenditure incurred in entertainment of staff, business associates, clients, etc., by way of sightseeing tours, access to sporting or theatrical events and hospitality provided to invited guests at such events as product launches or film premieres will not be deductible. In addition, deductions will be denied for hostess allowances paid by employers to the spouses of employees such as senior executives to offset the cost of attending or assisting with company-sponsored functions.

The broad effect of section 51AE will be that activities of the type that would generally be considered to constitute entertainment will be treated that way irrespective of any actual or claimed connection with business activities, discussions, etc.

Certain expenses that might otherwise fall within the general entertainment expense prohibition are to be specifically excluded so that deductions will, as appropriate, continue to be available.

Under the first of these, deductions will continue to be available for expenditure incurred in the ordinary course of a business carried on for the purpose of providing entertainment for payment (e.g., expenditure incurred in the operation of a theatre or restaurant). Similarly, expenditure incurred by employees in the course of their employment in an entertainment business will continue to be deductible.

Certain expenditure on entertainment for promotional or advertising purposes will continue to be deductible. Under this exception, the cost of providing the products of a business free of charge for promotional purposes will, where that would otherwise constitute entertainment, continue to be deductible where they are provided for the purpose of promoting the business to the public. An example would be the cost of providing free drinks in a restaurant or hotel. In addition, general promotional entertainment will continue to qualify for deduction provided it is undertaken for public promotional purposes and that its enjoyment is open to the public generally (e.g., a show put on in a shopping mall). Finally, promotional "give-aways" provided under a contract for the supply of goods or services entered into in the ordinary course of business activities will be outside the scope of the entertainment expense prohibition where those give-aways are provided for the purpose of promoting or advertising the business to the public.

The cost of overtime meals of an employee provided pursuant to an industrial award will not be affected by the proposed amendments. Similarly, the cost of a person's meals while travelling on business away from home will be unaffected unless they are incurred in the course of entertaining someone else.

Special rules will apply in relation to the cost of in-house dining and recreational facilities for employees. Broadly, the cost of providing meals to employees in an in-house cafeteria or other dining facility that is operated principally for the provision of food or drink to employees on working days will continue to be deductible; as will the cost of providing in-house recreational facilities for employees. Expenditure incurred after the date of introduction of the Bill in entertaining non-employees in an in-house dining facility will no longer be deductible.

Consistent with the treatment of meals provided to employees in in-house dining facilities, the cost of providing on-the-job meals to staff of restaurants, hotels and motels will also continue to be deductible.

A further exclusion from the general entertainment expense prohibition will apply in relation to entertainment (e.g., meals) provided in association with business seminars. Under these, meals, etc., that are reasonably incidental to the person's attendance at a seminar will continue to be deductible; although the cost of any recreational activities (e.g., associated sightseeing tours) will not.

A final exception will ensure that expenditure incurred in providing entertainment to members of the public who are sick, disabled, poor or otherwise disadvantaged will continue to be deductible.

Where an allowance is paid by an employer to an employee for the purpose of providing entertainment, the allowance will continue to be a deductible outgoing to the employer provided that the allowance is otherwise included in the assessable income of the employee. In these circumstances, section 51AE will apply to deny deductions for any entertainment expenses incurred by the employee.

The general entertainment expense prohibition will also apply to plant and equipment that is used for the provision of non-deductible entertainment. So much of any use of plant for that purpose will be taken in determining any depreciation allowance deductions to be used otherwise than in producing assessable income; with the result that depreciation deductions will be denied or reduced accordingly.

A number of safeguarding provisions will apply. Under the first of these the Commissioner of Taxation is to be authorised to look past the specific terms of an agreement under which expenditure is incurred or to collateral agreements entered into in relation to the incurring of particular expenditure so as to determine what part, if any, of that expenditure can appropriately be treated as expenditure on the provision of non-deductible entertainment.

A further safeguarding provision will apply in relation to hostess allowances to ensure that the intended non-deductibility of such allowances is not circumvented by the device of making the spouse an employee in an attempt to take advantage of the general exclusion from the entertainment expense prohibition of outgoings incurred by way of allowances to employees.

A final safeguard will apply against any attempted restructuring of business arrangements to bring entertainment of the kind previously provided without charge to clients within the ambit of the exceptions outlined above in relation to expenses of an entertainment business or promotional give-aways supplied with the sale of goods.

Notes on the individual provisions of proposed new section 51AE follow.

Sub-section 51AE(1) defines certain terms used throughout the section -

"agreement" is given an extended meaning, common to other provisions of the Principal Act, so as to include any agreement, arrangement or understanding, either express or implied, whether or not intended to be enforceable under the law.

"business" is defined to include a prospective business and is relevant to the definition of eligible seminar (see below).

"eligible dining facility" is defined to mean a canteen, dining room, cafe, restaurant or similar facility on the premises of a taxpayer or, if the taxpayer is a company, a related company. The definition is relevant for the purposes of proposed sub-paragraph 51AE(5)(f)(iii), which, as explained in the notes on that sub-paragraph, will ensure that the cost of on-the-job meals provided on such premises to employees is not treated as non-deductible entertainment expenses.

"eligible relative" means, in relation to a person, a relative of the person (as defined in sub-section 6(1) of the Principal Act) and another person who, although not legally married to the person, lives with the person on a bona fide domestic basis as husband and wife. The definition applies for the purposes of proposed sub-section 51AE(6) the operation of which is described later in these notes but which, broadly, protects the policy of non-deductibility of hostess allowances against potential avoidance arrangements.

"eligible seminar" is defined by means of exclusions of what are otherwise seminars by virtue of the definition of that term. As explained in the notes on that definition, a seminar is defined broadly to include all conferences, meetings, etc. By virtue of paragraph (a) of the definition of eligible seminar, a seminar that relates to the operations of a particular business (or prospective business) will not be considered an eligible seminar. The practical effect of paragraph (a) will be to exclude from the definition of eligible seminar any business discussions undertaken in the ordinary course of a business. This general exclusion is subject to the operation of the definition of "exempt training session" which will bring within the meaning of eligible seminar a seminar which is organised by an employer solely for the purpose of training employees or to enable employees (including employers, directors in a company, partners in a partnership) to discuss broad management issues where the seminar is held in conference facilities operated by an unrelated business operation.

By paragraph (b), a seminar that is conducted with the dominant purpose of advertising or promoting a particular business or its products is excluded from being an eligible seminar. The purpose of this exclusion is to ensure that new paragraphs 51AE(5)(c) and (d) have their intended operation of providing a code for the treatment of entertainment expenses in connection with promotion or advertising activities.

Paragraph (c) of the definition ensures that a seminar that, looked at objectively, is one that is designed primarily for the provision of entertainment will not qualify as an eligible seminar.

To qualify as an eligible seminar a seminar must also be of a continuous duration of not less than 4 hours, after allowing for any meal or recreation breaks (see notes on new sub-section 51AE(2)).

The definition of eligible seminar is significant for the purposes of new paragraph 51AE(5)(iv) which, broadly, will ensure the continued deductibility of entertainment that is reasonably incidental to a person's attendance at an eligible seminar (see notes on that sub-paragraph). Entertainment provided in connection with a seminar which is not an eligible seminar will, unless it falls within the terms of one of the other exclusions embodied in sub-section (5), be subject to disallowance under new sub-section 51AE(4).

"employee" is defined to include a director of a company.

"exempt training session" is defined for the purposes of the definition of eligible seminar. Its operation is explained in the notes on that definition.

"industrial instrument" is defined to mean a Commonwealth State or Territory law or an award, order, determination or industrial agreement in force under such a law. The definition is relevant for the purposes of the operation of new paragraphs 51AE(5)(f)(vi) and (5)(k) which apply to exclude from the operation of the entertainment expense prohibition the cost of meals attributable to a provision of an industrial instrument relating to overtime.

"in-house dining facility" means, in short, a staff canteen or dining room on an employer's premises (or those of a related company - see below) that is not open to the public. For this purpose the definition requires that the facility be operated principally for providing food and drink on working days to employees or, if the employer is a company, employees of a company that is part of a group subject to 100 per cent common ownership (see notes on the concept of related company embodied in proposed new sub-sections 51AE(15) to (18)). The definition of in-house dining facility is relevant for the operation of new sub-paragraphs 51AE(5)(f)(i) and (ii) which apply, broadly, to permit continued deductibility of the costs of providing meals to employees in an in-house dining facility.

"in-house recreational facility" is defined, like in-house dining facility, to ensure that losses or outgoings in providing such a facility for employees on work premises are not treated as non-deductible entertainment expenses (see notes on paragraph 51AE(5)(f)(v)). To qualify for this exclusion, the facility will need to be located on the employer's premises (or those of a related company) and operated principally for use on working days by employees or, if the employer is a company, employees of a related company.

"participants" defines persons that could be expected to partake in the ordinary business discussions of a business for the purposes of paragraph (a) of the definition of eligible seminar, the broad effect of which is to exclude a seminar consisting of discussions relating to the business between participants or between participants and other people (see earlier notes on the definition of eligible seminar). For this purpose a participant is defined broadly to include any person involved in, or associated with, the carrying on of a business. It brings within its scope persons acting in the capacity of an agent, employee, director, partner, shareholder, financier, advisors, etc.

"premises" is defined to include a vessel or floating structure (e.g., an oil drilling platform).

"recreation" is defined both for the purpose of clarifying the defined term "recreational facility" and the meaning of entertainment as defined by sub-section 51AE(3). It also relates to proposed sub-paragraph 51AE(5)(f)(iv), the broad effect of which is that the cost of entertainment associated with a person's attendance at an eligible seminar (e.g., lunches) will not be treated as non-deductible expenditure unless it is for the recreation of the person. For these purposes, "recreation" is defined to include amusement, sport or similar leisure-time pursuits, and recreation or amusement provided on, or by means of, vehicles, vessels or aircraft, e.g., joy flights or sightseeing tours.

"recreational facility" means a facility for recreation (as defined), but does not include accommodation or dining and drinking facilities (other than vending machines). The definition relates to that of "in-house recreation facility", the meaning of which is explained above.

"seminar" is defined broadly to include a conference, convention, lecture, meeting, speech, question and answer session, training session or educational course. The definition is relevant to the definition of eligible seminar, as explained above.

New sub-section 51AE(2) is relevant to the operation of the definition of the term eligible seminar in new sub-section 51AE(1). Sub-section (2) will ensure that any meals or any breaks for rest or recreation will not be taken to affect the requirement, explained in the notes on that definition, that an eligible seminar be one of a continuous duration of not less than 4 hours (paragraph 51AE(2)(a)). Equally, meals or rest or recreation breaks will not be taken to form part of the seminar in determining whether the particular seminar satisfies the 4 hours duration requirement.

Proposed sub-section 51AE(3) defines entertainment for the purposes of the operation of the entertainment expense prohibition. By paragraph (3)(a) entertainment is defined to be the provision of entertainment by way of food, drink or recreation. As explained in the notes on the definition of that term in sub-section 51AE(1), "recreation" includes amusement, sport and leisure-time pursuits generally.

By paragraph (3)(b) accommodation or travel is to be treated as entertainment to the extent to which it is incidental to the provision of entertainment. As such the cost of travel and accommodation associated with, for example, entertaining a client over a weekend at a tourist resort would be subject to the operation of the entertainment expense prohibition. Costs associated with the use of aircraft, boats or vehicles directly in providing entertainment (e.g., by way of joy flights or sightseeing tours) are brought within the meaning of entertainment through the definition of recreation.

By virtue of sub-section (3), section 51AE will apply both to expenditure on entertaining another person or on oneself. An example of the latter could arise where an employee expends money out of an overtime meal allowance on dining at a restaurant. As explained in the notes on paragraph (5)(j), expenditure by an employee on overtime meals will qualify for exclusion from the general prohibition only where it is funded by an allowance under an industrial award, etc.

Sub-section (3) will also make it clear that the prohibition can apply in cases where the entertainment is provided pursuant to an agreement as well as where it is provided gratuitously. This will ensure that, for example, entertainment provided to an employee pursuant to an employment contract will be within the scope of the section.

Paragraphs (3)(c) to (3)(f) will ensure that, in determining whether a particular function or event is within the definition of entertainment, the fact that business discussions took place or that it occurred in connection with the working of overtime is to be disregarded. Similarly the fact that it is in connection with advertising or attendance at a seminar will not detract from the essential entertainment nature of the particular event or function.

In effect, paragraphs (3)(c) to (f) will ensure that activities of a type that would generally be considered to constitute entertainment will be treated that way irrespective of any actual or claimed connection with business activities, etc.

Sub-section 51AE(4) is the operative provision which will deny deductions otherwise allowable under section 51 of the Principal Act for losses or outgoings incurred after 19 September 1985 for the provision of entertainment. The sub-section also authorises an apportionment of expenses incurred only partly in respect of the provision of entertainment, to disallow that part.

In being expressed to apply to losses or outgoings incurred in respect of the provision of entertainment, sub-section (4) is designed to apply widely so as to include incidental expenses (e.g., taxi fares incurred in taking guests to a luncheon) and to the expenses of the host in participating in the particular function. As a further example, it would also embrace allowances paid to spouses of executives to offset their costs in having to attend company sponsored functions and the like.

As explained in the notes on proposed sub-section 51AE(14), the disallowance of entertainment expenses extends, by virtue of that sub-section, to the denial of depreciation allowances on plant used for non-deductible entertainment purposes.

Sub-section 51AE(5) excludes from the general entertainment expense prohibition certain losses or outgoings which would otherwise be, or which in certain circumstances might otherwise be taken to be, in respect of the provision of entertainment.

By paragraph (5)(a), losses or outgoings incurred in respect of the provision of entertainment for payment in the ordinary course of a business carried on for that purpose will not be precluded from deduction. This paragraph would apply, for example, to expenses incurred in operating a theatre or restaurant.

Paragraph (a) will also ensure that the ordinary expenses of a business that, while not being solely an entertainment business, includes providing entertainment for payment, will continue to be deductible. This would be relevant, for example, where, by paying for accommodation in a motel, a traveller becomes entitled to view movies on a video provided in the room. The cost of meals provided by airlines to passengers would similarly fall within the operation of paragraph (a) and, as such, continue to be deductible.

Paragraph (5)(b) applies with respect to promotional "give-aways" provided under a contract for the supply of goods or services entered into in the ordinary course of business activities. Paragraph (b) ensures that where such "give-aways" constitute entertainment (e.g., a holiday given with the purchase of certain goods) their cost will continue to be deductible to the business where they are provided for the purpose of promoting or advertising the business or its products to the public.

As explained in relation to paragraph (4)(a), the cost of providing entertainment for payment in the ordinary course of a business carried on for that purpose will continue to be deductible. By paragraph (5)(c), the cost of providing free a business's goods or services will continue to be deductible where that is done for public promotional or advertising purposes. This exclusion could extend, for example, to free drinks provided in a restaurant or to free passes to movies. Paragraph (c) also permits deductions for the cost of exhibiting goods for public promotional purposes where that might otherwise be seen to constitute entertainment, e.g., a fashion parade.

Paragraph (c) does not extend generally to the cost of entertainment provided in association with the supply or exhibition of a business's products (for example, drinks provided at a fashion show or a film premiere). Expenses in providing associated entertainment would, therefore, be subject to the general entertainment expense prohibition unless they fall within the exclusion provided by paragraph (d).

Paragraph (5)(d) excludes from the general entertainment deduction prohibition entertainment provided in promoting or advertising a person's business or products to the public where that entertainment is publicly available. Paragraph (d) would apply, for example, to shows put on in a shopping mall. Unlike paragraph (c), the exclusion under paragraph (d) is not limited to the cost of supplying a business's own products but would extend, for example, to expenditure on drinks provided in connection with a fashion parade in a department store where the show is open to the public generally.

By virtue of paragraph (5)(e) an allowance paid to an employee for the purpose of providing entertainment to, for example, existing or prospective clients, will continue to be deductible to the employer, where the allowance is included in the assessable income of the employee.

In these cases the disallowance of entertainment expenses will apply to expenditure incurred by the employee in entertaining the clients, etc.

Paragraph (5)(f) deals with the treatment of entertainment provided in in-house dining and recreational facilities or by way of the provision of overtime meals to employees.

Sub-paragraph (5)(f)(i) applies where meals are supplied exclusively to employees in an in-house dining facility to exclude from the general ban on entertainment expense deductions the costs of providing those meals. The sub-paragraph means that deductions will be allowed for the full costs of providing meals in such facilities where proposed new section 26AAAC (see notes on clause 6) applies to include an amount in the assessable income of the taxpayer in respect of the cost of supplying meals to non-employees (e.g., clients) in an in-house dining facility. The cost of providing food or drink in an in-house dining facility for the purposes of a party, reception or other social function (e.g., a staff Christmas party) will continue to be subject to disallowance under sub-section (3).

Under sub-paragraph (5)(f)(ii) a taxpayer may elect that the cost of meals supplied to non-employees in an in-house dining facility not be offset by the inclusion of an amount as assessable income under section 26AAAC. This right of election is available in respect of each in-house dining facility operated by the taxpayer.

Where such an election is made, the effect of sub-paragraph (f)(ii) is to exclude from the entertainment expense prohibition so much of the cost of operating the in-house dining facility as is attributable to the supply of meals to employees (including employees of a related company being one that shares 100% common ownership - see notes on new sub-sections (15) to (18)). The consequence of this is that the cost of providing any meals to non-employees in an in-house dining facility will be precluded from deduction by the operation of sub-section (4).

As with sub-paragraph (f)(i), the cost of providing food or drink in an in-house dining facility for the purposes of a party, etc., will continue to be subject to disallowance under sub-section (3).

Sub-paragraph (5)(f)(iii) applies in relation to restaurants, hotels and similar establishments to exclude from the entertainment expense prohibition the cost of meals provided to employees of the restaurant, etc. Where a restaurant forms part of a motel or resort, the exclusion will not be confined to restaurant staff but will apply to meals of all employees engaged in the establishment. However, as with in-house dining rooms, costs associated with parties, receptions or other social functions will not be deductible.

Sub-paragraph (5)(f)(iv) will permit, by sub-sub-paragraph (A) of that sub-paragraph, deductions for entertainment that form an ordinary incident of a person's attendance at an "eligible seminar" (see notes on that term in proposed new sub-section 51AE(1)). Food and drink supplied between, or as an incident of, working sessions would generally qualify for deduction on that basis. By virtue of sub-sub paragraph (B), the cost of recreation in connection with an eligible seminar (e.g., a trip to a local tourist attraction) will not, however, qualify for deduction.

Where the seminar is one conducted by an employer for participation by employees, the employer would also be denied a deduction for so much of the cost of the seminar as relates to ineligible recreation. Where the cost of ineligible recreation is built into a seminar registration fee, an appropriate part of that fee would be denied deductibility.

The cost of entertainment provided in connection with a seminar that does not qualify as an eligible seminar will not qualify for deduction, unless the costs fall for consideration under another paragraph of sub-section (4), (e.g., a lunch in connection with a board meeting where the lunch is taken in an in-house dining facility).

By virtue of sub-paragraph (5)(f)(v), costs associated with providing an in-house recreational facility will not be subject to the entertainment expense prohibition. Broadly, as explained in the notes on proposed new sub-section 51AE(1), an in-house recreation facility is a recreational facility located on premises of an employer and provided for the benefit of employees (or employees of a related company).

Proposed new sub-paragraph (5)(f)(vi) ensures that the cost to an employer of providing food or drink to an employee in connection with overtime worked by the employee will continue to be deductible where that cost is borne pursuant to an industrial award (see notes on the definition of industrial instrument contained in proposed new sub-section 51AE(1)).

New paragraph (5)(g) is designed to ensure that expenditure on entertainment that does not involve the entertainment of another person and which would otherwise be deductible to the person benefiting from it will continue to be deductible. Paragraph (g) would apply to ensure that the cost of a person's meals while travelling in the course of performing his or her duties as an employee or in the course of a business activity will continue to be deductible - unless the expenditure was incurred in the course of entertaining another person (e.g., dining a prospective client).

Paragraph (g) will also ensure that expenses borne by, for example, a restaurant reviewer or theatre critic in attending particular establishments or events in the course of his work will continue to be deductible.

The exclusion under paragraph (g) will apply whether the expenses are borne by the person participating in the entertainment or, in the case where that person is acting in the capacity of an employee, by an employer.

Proposed new paragraph (5)(h) complements the operation of paragraph (5)(a) and ensures that costs borne by an employee in the course of his or her duties in connection with a business operated for the provision of entertainment will continue to be deductible. The exclusion provided by paragraph (h) would apply, for example, to uniform laundry expenses of an employee in a restaurant or theatre.

Paragraph (5)(j) is complementary to the operation of new sub-paragraph (5)(f)(vi). It ensures that where an employee is provided with an allowance paid by his employer pursuant to an industrial award for the purpose of meeting the costs of overtime meals, payments by the employee for those meals will continue to be deductible.

Paragraph (5)(k) ensures that the deductibility of expenditure incurred on a gratuitous basis in providing entertainment to members of the public who are sick, disabled, poor or otherwise disadvantaged will not be affected by the entertainment expense prohibition. An example of this type of expenditure might be that of a company-sponsored Christmas party put on in a children's hospital.

Proposed new sub-section 51AE(6) contains safeguards to prevent the exploitation of the exceptions to the entertainment expense prohibition conceded by paragraphs (5)(a) and (b). Under those paragraphs, expenses incurred in connection with a business operated for the provision of entertainment or in respect of entertainment for public promotional purposes under a contract for the sale of goods or services (e.g., promotional give-aways supplied with the sale of goods) will continue to be deductible.

Sub-section (6) will permit the Commissioner of Taxation to ignore any attempts prompted by the introduction of the entertainment expense prohibition to restructure business arrangements to bring entertainment of the kind previously provided without charge to their clients within the ambit of the paragraph (5)(a) or (b) exclusions. Sub-section (6) would apply, for example, where a professional firm attempted to rearrange its contracts for the supply of professional services to purport to give away free business lunches with each service contract executed.

New sub-section 51AE(12) would also impact on any such attempted rearrangements. As explained in the notes on that sub-section, the Commissioner is to be empowered to deny a deduction for such part of any loss or outgoing as results from the provision of entertainment. In these circumstances it could be expected that deductions otherwise allowable for any outlay by a client for goods or services that resulted in the provision of entertainment by or on behalf of the supplier would be appropriately reduced.

New sub-section 51AE(7) is a further safeguard which will apply in relation to the provision of hostess allowances to relatives of employees such as senior executives. By virtue of sub-section 51AE(3), an allowance paid to the spouse or other relative (see notes on the definition of "eligible relative" contained in proposed new sub-section 51AE(1)) of such an executive to offset the costs of attending company-sponsored functions will not be deductible. Sub-section (7) ensures that this intention is not defeated by such arrangements as taking on an executive's spouse as an employee with the view to taking advantage of the exclusion under paragraph (5)(e) of allowances paid to employees. By new sub-section 51AE(8) the safeguarding provisions of sub-section (7) will apply equally to relatives of partners in a partnership. Subsection (8) is also relevant to the definition of eligible seminar in new sub-section 51AE(7) in that it ensures a reference in that definition to the participation of employees includes participation of partners in a partnership.

New sub-section 51AE(9) sets down the procedures for making an election in relation to the treatment of meals provided to non-employees in an in-house dining facility (see notes on new sub-paragraph (5)(f)(ii)). By sub-section (9), an election for that purpose is to be exercised by notice in writing and is to be lodged with the Commissioner on or before the date of lodgment of the relevant return of income (or by such later date as the Commissioner permits).

As explained in the notes on the definitions of "seminar" and "eligible seminar" in proposed new sub-section 51AE(1), the tax treatment of entertainment provided in connection with a seminar is to be determined by the operation of those definitions and the exclusion under new sub-paragraph (5)(f)(iv). Sub-section 51AE(10) ensures that any such expenses that might otherwise fall for consideration under new paragraphs (5)(g) (otherwise deductible entertainment expenses) and (5)(j) (employee expenses in entertainment business) will have their deductibility determined in accordance with the rules for seminars.

New sub-section 51AE(11) is a drafting measure that is designed to ensure that the exclusion provisions of sub-section (5) are not taken to imply that expenses that fall within the exclusions are necessarily deductible under section 51. Sub-section (11) is necessary because paragraph (5) extends to expenses that might or might not - depending on the particular circumstances under which the expenditure is incurred - be otherwise deductible under section 51.

New sub-section 51AE(12) is a general safeguarding provision that will enable the Commissioner of Taxation to look past the specific terms of an agreement under which expenditure is incurred or to collateral agreements entered into in relation to the incurring of particular expenditure so as to determine what part, if any, of that expenditure can appropriately be treated as expenditure on the provision of non-deductible entertainment (see notes on new sub-section 51AE(13)). The safeguard would apply, for example, where in connection with the incurring of what is, on the face of it, a deductible expense not related to the provision of entertainment, a collateral agreement is entered into under which entertainment is provided for or on behalf of the taxpayer. An example would be where under arrangements associated with expenditure by a taxpayer in sponsoring a particular sporting event, the taxpayer is provided with a hospitality tent or viewing box. In these circumstances, the Commissioner of Taxation is to be authorised to estimate an entertainment component of the sponsorship package. Sub-section (12) is also capable of operating in cases where the amount ascribed to the entertainment component of the contract under which other goods or services are supplied is less than a reasonable amount or no amount is ascribed to that component.

New sub-section 51AE(13) extends the general entertainment expense prohibition to plant and equipment that is used for the provision of non-deductible entertainment. So much of any use of plant for that purpose will be taken for the purpose of determining any depreciation allowance deductions to be for use otherwise than for the purpose of producing assessable income; with the result that depreciation deductions will be denied or reduced accordingly. Sub-section (13) also ensures that deductions for repairs to property used for non-deductible entertainment purposes are denied (or appropriately reduced).

Sub-section 51AE(14) operates for the purposes of sub-sections (12) and (13) to define "non-deductible entertainment". For these purposes non-deductible entertainment is entertainment, the cost of which to the taxpayer, had it been incurred directly rather than through another person, would not be deductible.

Sub-sections 51AE(15) to (16) prescribe the conditions under which one company will be treated as being related to another. The concept of related companies is relevant for the purposes of the treatment of expenditure incurred in respect of the provision of in-house dining facilities, in-house recreational facilities and eligible dining facilities (see notes on the definitions of those terms in new sub-section 51AE(1) and on the operation of paragraph 51AE(5)(f)).

Sub-section 51AE(15) specifies two tests, either of which must be satisfied if a company is to be taken to be related to another company. These are that one of the companies was a subsidiary of the other company (paragraph (a)) or both of the companies were subsidiaries of the same parent (paragraph (b)).

Sub-section 51AE(16) specifies the circumstances in which a company is to be taken to be a subsidiary of another company (termed the "holding company"). Under sub-paragraph (2)(a)(i) this relationship is established if all the shares in the subsidiary company are beneficially owned by the holding company. Sub-paragraph (a)(ii) establishes the relationship if all the shares in the subsidiary company are beneficially owned by a company that is, or two or more companies each of which is, a subsidiary of the holding company. By sub-paragraph (a)(iii) the necessary relationship will also exist if all the shares in the subsidiary company are owned by the holding company and by a company that is, or two or more companies each of which is, a subsidiary of the holding company.

Paragraph (16)(b) imposes a further requirement that there was no agreement, arrangement or understanding in force by virtue of which any person was in the position to affect rights of the holding company or of another subsidiary of the holding company in relation to the particular subsidiary company.

Sub-section 51AE(17) extends the operation of sub-sections (15) and (16) by establishing a qualifying group relationship between companies which are part of a wholly-owned chain of subsidiaries of a holding company. Thus, in a corporate structure under which all of the shares in the subsidiary are owned by one or more wholly-owned companies that are interposed between a holding company and the end subsidiary company, the qualifying group relationship will be found between each of those companies.

Sub-section 51AE (18) qualifies the operation of sub-section (16). It specifies for the purposes of paragraph (b) of that sub-section the circumstances in which a person is to be regarded as being in a position at a particular time to affect the rights of one company in relation to another company. A person will be in that position if he or she has at the particular time a right, power, or option to acquire any of the rights of the first company in its subsidiary or to prevent that company from exercising rights in the subsidiary for its own benefit.

Car expenses incurred by employee

New section 51AF will apply to deny a deduction for car expenses incurred by an employee in respect of a car that is provided by an employer for the exclusive use of the employee or relatives (including a de facto spouse) of the employee if the employee or the employee's relatives are entitled to use the car for private purposes.

The section is being inserted in conjunction with the proposed enactment, by clause 14, of new Subdivision F of Division 3 of Part III relating to substantiation requirements for, inter alia, car expenses for which deductions are claimed. Consistent with the exclusion from the substantiation requirements of car expenses relating to cars provided by employers exclusively for the use of employees, it will deny deductions for car expenses incurred by employees on the view that such expenses have the true character of a reimbursement by the employee to the employer for the right to private use of the car.

Expressions used in section 51AF - car, car expense, employee, employer and eligible relative - have the same meanings as in new Subdivision F in which each is separately defined.

Sub-section 23(4) specifies that section 51AF will apply to deny deductions for car expenses to which it applies, where such expenses are incurred on or after 1 July 1986.

Deductions for travel expenses where person accompanied by eligible relative

Section 51AG will deny a deduction, except in certain limited cases, in respect of expenses of travel that relate to an accompanying spouse, de facto spouse or other relative of a person undertaking travel either as an employee or otherwise in the course of business.

The deduction will not be available where the accompanying person is neither an employee of the traveller nor of the traveller's employer or, if such an employee, performs no substantial duties as an employee during the travel. Where the accompanying person is an employee either of the traveller or the traveller's employer, the deduction will be denied if the duties performed by the accompanying person are incidental to those of the traveller, and it can be reasonably concluded that the accompanying person would not have accompanied the traveller but for their personal relationship.

The terms "eligible relative", "employee" and "employer" as used in section 51AG each have the same meaning as in new Subdivision F (see notes on clause 14) wherein they are individually defined.

Sub-section 23(5) ensures that section 51AG will apply to deny deductions for travel expenses attributable to an accompanying person where such expenses are incurred on or after 1 July 1986.

Clause 10 : Certain election expenses not deductible

Clause 10 will insert new section 74B in the Principal Act. The section complements the operation of new section 51AE which is to be inserted in the Principal Act by clause 9. As explained in the notes on that clause, section 51AE will operate to deny deductions for losses or outgoings to the extent to which they are incurred in respect of the provision of entertainment.

New section 74B will apply similarly to deny deductions for entertainment expenses otherwise allowable under section 74 or 74A of the Principal Act. Broadly, sections 74 and 74A authorise deductions for expenses incurred in contesting an election for membership of the Federal or a State Parliament, or a Territory or Local Government body.

By sub-section 74B(1) election expenses incurred after 19 September 1985 will no longer qualify for deduction to the extent to which they are incurred in the provision of entertainment; although, entertainment that is available to the public generally will, consistent with an exclusion operating for the purposes of section 51AE, continue to be deductible.

Sub-section 74B(2) also mirrors an exclusion contained in section 51AE and ensures that sub-section (1) does not apply to deny a deduction otherwise allowable in respect of meals while travelling in the course of a campaign - unless the expenditure was incurred in the course of entertaining another person.

Sub-section 74B(3) is a drafting measure that ensures that a reference in new section 74B to the provision of entertainment has the same meaning as in section 51AE.

Clause 11 : Deduction of expenditure on conserving or conveying water

Section 75B of the Principal Act authorises a full deduction, in the year of income in which the expenditure is incurred, for capital expenditure by a taxpayer carrying on a business of primary production on plant or structural improvements for the purpose of conserving or conveying water for use in the taxpayer's business. Clause 11 will amend section 75B to withdraw the immediate deductibility of such expenditure incurred under a contract entered into after 19 September 1985 and replace it with deductions in equal instalments over 5 years commencing with the year in which the expenditure is incurred - a 20% deduction being allowed in that year and in each of the next 4 years of income.

By paragraph (a) of clause 11, existing sub-section 75B(2) of the Principal Act, which sets out the kinds of expenditure that, subject to the other provisions of section 75B, qualify for deduction under that section, is to be omitted and a new sub-section 75B(2) substituted. The new sub-section restates the existing sub-section, but is limited in its application to expenditure incurred before 20 September 1985.

The operative provision of section 75B, sub-section 75B(3), allows an immediate deduction for relevant expenditure (that is, expenditure described in sub-section 75B(2)) in the year in which it is incurred. Paragraph (b) of clause 11 will amend sub-section 75B(3) to specifically provide that an immediate deduction is allowed in respect of expenditure to which section 75B applies by virtue of new sub-section 75B(2), being inserted by paragraph (a) of this clause. The combined operation of new sub-section 75B(2), sub-section 75B(3) as amended and proposed new sub-section 75B(3C) (see following notes) will ensure that relevant expenditure incurred under a contract entered into on or after 14 April 1980 (as provided for in existing sub-section 75B(2)) and before 20 September 1985, or on construction or an alteration that commenced in that period, continues to qualify for full deduction in the year in which it is incurred.

Paragraph (c) of clause 11 proposes the insertion of new sub-section 75B(3A) in the Principal Act to specify the kinds of expenditure that are to qualify for deduction in equal instalments over five years. New sub-section 75B(3A) essentially restates existing sub-section 75B(2), except that in association with proposed new sub-section 75B(3C) (see following notes) it applies only to expenditure incurred under a contract entered into on or after 20 September 1985, or on construction or an alteration that commenced on or after that date. By the incorporation of a primarily and principally test, sub-section 75B(3A) will only apply to expenditure on plant or structural improvements that is incurred by a taxpayer primarily and principally for the purpose of conserving or conveying water for use in the taxpayer's business of primary production.

The terms of new sub-section 75B(3A) will, for example, ensure that expenditure incurred on constructing a dam primarily and principally for the purpose of holding water for irrigation, but which also serves to some degree as a retention dam to prevent excessive water run-off that could lead to soil erosion, is properly deductible over 5 years under section 75B and is ineligible, as a soil conservation measure, for immediate deduction under section 75D of the Principal Act in the year in which it is incurred.

Paragraph (c) of the clause will also insert a new operative provision, sub-section (3B), into section 75B of the Principal Act. The sub-section will apply only in respect of expenditure referred to in new sub-section (3A). Such expenditure is, subject to the succeeding provisions of section 75B, to be deductible in 5 equal annual instalments, the first in the year in which the expenditure is incurred and a further instalment in each of the next 4 years.

New sub-section 75B(3C), also to be inserted by paragraph (c) of clause 11, will apply where expenditure to which section 75B applies is incurred on or after 20 September 1985 -

- under a contract that the taxpayer entered into on or after 14 April 1980 and before 20 September 1985 (new paragraph 75B(3C)(a)); or

- on the construction or installation by a taxpayer (or another person on the taxpayer's behalf) of plant or a structural improvement, or of an extension thereto, where that construction or installation commenced on or after 14 April 1980 and before 20 September 1985 (paragraph 75B(3C)(b)),

to treat the expenditure, for the purposes of section 75B, on the same basis as if it had been incurred on or after 14 April 1980 and before 20 September 1985. Such expenditure will therefore continue to be eligible for immediate deduction in the year in which it is actually incurred.

Existing sub-section 75B(10) of the Principal Act applies, where expenditure to which section 75B applies is incurred by a partnership, so that the expenditure is not taken into account in calculating the net income of the partnership or the partnership loss. Rather, each partner is deemed to have incurred so much of the expenditure actually incurred by the partnership as, by agreement between the partners, is borne by each partner. Where no such agreement has been reached between the partners, the expenditure is deemed to have been incurred by each partner in proportion to his or her individual interest in the net income or loss of the partnership for the relevant year of income. Subject to the other provisions of section 75B, each partner's proportion of the expenditure is deductible in the partner's own assessment of the year of income in which the expenditure was incurred by the partnership.

Paragraph (d) of clause 11 will amend sub-section 75B(10) to include a reference to new sub-section 75B(3B), which, as explained above, will authorise the write-off over 5 income years of eligible capital expenditure incurred under a contract entered into after 19 September 1985. The effect of this amendment will be to ensure that, where the relevant expenditure is incurred by a partnership under a contract entered into after 19 September 1985, an amount representing 20% of that expenditure will be apportioned, in accordance with the terms of sub-section 75B(10), and the portions will be eligible for deduction in each partner's assessment. The initial deduction will be allowed in the year the expenditure was incurred by the partnership and subsequent deductions in each of the next 4 income years.

By sub-clause 23(7) of the Bill, the foregoing amendments of section 75B are to apply to expenditure incurred on or after 20 September 1985.

Clause 12 : Deduction of expenditure on prevention of land degradation

Section 75D of the Principal Act provides immediate deductibility for capital expenditure incurred by a taxpayer on a range of soil conservation operations on land in Australia that is being used in the taxpayer's business of primary production. Those operations are specified in sub-section 75D(1).

Clause 12 proposes a number of amendments of sub-section 75D(1). These will ensure that expenditure incurred on the operations specified in the sub-section will only qualify for immediate deduction where those operations are primarily and principally for the stated purpose. The insertion in section 75B by clause 11 and in section 75D by this clause of a primarily and principally test is designed to ensure that those two provisions have a mutually exclusive operation in relation to particular expenditure, thus making it clear whether it is deductible over 5 years (section 75B) or in full (section 75D) in the year in which it is incurred.

The amendments will also expand the application of the sub-section by providing that qualifying expenditure on certain operations may be in respect of land degradation more generally and not only in respect of soil erosion or salinity.

By sub-clause 23(7) of the Bill, the amendments are to apply to expenditure incurred on or after 20 September 1985.

Paragraph (a) of clause 12 will insert the primarily and principally test into paragraphs 75D(1)(a), (b) and (c). This will mean that expenditure for the purpose of eradicating or exterminating animal or vegetable pests (existing paragraph 75D(1)(a)) or for the purpose of destroying detrimental weed or plant growth (existing paragraph 75D(1)(b)) must be primarily and principally for that purpose before the expenditure qualifies for deduction under section 75D. The effect of the amendment of existing paragraph 75D(1)(c) is described in the following notes.

Under paragraph 75D(1)(c) of the Principal Act, expenditure incurred by a primary producer on preventing or combating soil erosion (other than by the erection of fences) qualifies for immediate deduction. Paragraph (b) of clause 12 will amend paragraph 75D(1)(c) to extend its scope to expenditure incurred to prevent or combat land degradation generally, subject to the primarily and principally test being inserted in paragraph 75D(1)(c) by paragraph (a) of this clause. The expression "land degradation" is intended to be broader than "soil erosion" and includes not only soil erosion but other effects detrimental to the land such as decline of soil fertility or structure, degradation of natural vegetation, the effects of deposits of eroded material and salinisation. Amended paragraph 75D(1)(c) will provide that capital expenditure on, for example, contour banking primarily and principally for the purpose of preventing, or combating the effects of, land degradation in the form of, say, soil erosion qualifies for immediate deduction in the year in which that expenditure is incurred, even though the contour banking might also serve another (minor) purpose such as conveying water.

Existing paragraph 75D(1)(d) specifies expenditure on the erection of control fences, to exclude livestock or vermin from areas affected by soil erosion or excessive salinity, as being expenditure to which section 75D applies so that it qualifies for immediate deduction. Paragraphs (c), (d) and (e) of clause 12 will amend paragraph 75D(1)(d) to incorporate the primarily and principally test (paragraph (c)) and to replace existing references to "soil erosion or excessive salinity" and "soil erosion or salinity" with references to the wider term "land degradation" (paragraphs (d) and (e)). (For the meaning of this term, see the preceding notes on the amendment being made by paragraph (b) of this clause to paragraph 75D(1)(c)). As a consequence, where expenditure is incurred on the erection of fences primarily and principally to exclude livestock or vermin from parts of land affected by land degradation, in order to prevent or limit any extension or aggravation of that degradation and to assist in reclaiming the degraded areas, that expenditure will qualify for immediate write-off under section 75D.

Paragraph (f) of clause 12 proposes the insertion of the primarily and principally test into paragraph 75D(1)(f), which provides immediate deductibility for expenditure on certain drainage works, other than those that drain swamp or low-lying land. This amendment will ensure that where, for example, expenditure is incurred on the construction of drainage works as part of an irrigation system, and not primarily and principally for the purpose of controlling salinity or assisting in drainage control, that expenditure will not be eligible for immediate deduction under sub-section 75D. Such expenditure could be expected to qualify for write-off over 5 years under section 75B of the Principal Act, as proposed to be amended by clause 11 of this Bill (see notes on that clause).

Clause 13 : Rebates for residents of isolated areas

Section 79A of the Principal Act authorises rebates of tax for individual taxpayers who are residents of certain areas that are isolated, subject to uncongenial climatic conditions or high costs of living. The amount of any rebate allowable under this section in a taxpayer's assessment is reduced by the amount of any "prescribed allowance" paid to the taxpayer.

The term "prescribed allowance", defined in sub-section 79A(4), refers to remote area allowances payable to certain welfare recipients under either Social Security or Repatriation legislation.

The Veterans' Entitlements Bill 1985 will repeal the Repatriation Acts presently referred to in that definition, and the remote area allowances will be payable, on and after 5 December 1985, under proposed section 57 of the Veterans' Entitlements Act 1985.

This clause will omit the present definition of "prescribed allowance" and insert a new definition that is to the same effect as the former definition, except in so far as it refers to remote area allowances paid under the proposed Veterans' Entitlements Act.

By virtue of sub-clause 2(4) of the Bill, this amendment will apply from the date on which the Veterans' Entitlements Act comes into operation.

Clause 14 : Substantiation of certain expenses

This clause will insert new Subdivision F in Division 3 of Part III of the Principal Act to introduce rules requiring substantiation of employment-related expenses of employees and car and travel expense claims by employees and self-employed persons. Alternative arbitrary deduction rules for car expenses are also to be introduced by the Subdivision.

Background

Presently the income tax law specifies the type of expenses which qualify for deduction in determining a taxation liability. Primary among these is the general deduction provision of the Principal Act (section 51) which authorises deductions for losses or outgoings to the extent to which they are incurred in gaining or producing assessable income or are necessarily incurred in carrying on a business for that purpose. The law does not, however, specify what proof is required to substantiate those claims.

Subject to the specific exemptions outlined below, the proposed amendments will make it a requirement for deduction that appropriate documentary evidence be maintained to substantiate relevant employment-related, car and travel expense claims. Under the proposal, the documentary evidence will need to be available on request by the Commissioner of Taxation but it will not be necessary - nor is it intended - that such evidence be attached as a matter of course to income tax returns.

Employment-related expenses

The substantiation requirement is to apply with limited exceptions to expenses incurred in deriving salary and wage income.

General examples of the type of expenses covered include tools of trade, protective clothing and trade journals, all of which would fall for deduction under section 51. Deductions claimed for repairs (section 53), borrowing expenses (sections 67 and 67A) and election expenses (section 74) may also be involved. In addition, expenditure on subscription to trade, business or professional associations (deductible under section 73) and, in some cases, expenditure in acquiring depreciable plant will be subject to substantiation. Car expenses, and travel expenses incurred in deriving salary or wage income, will be subject to the separate substantiation requirements outlined below.

Form of substantiation

The general rule is to be that an expense will be regarded as substantiated only where a taxpayer is able to produce a receipt, invoice or other documentary evidence that evidences the amount, date and essential character of the expense. For individual items of expenditure of less than $10 which total less than $200 in a year of income, a taxpayer may maintain a contemporaneous record of the expenditure detailing the amount, date and description rather than obtain individual receipts. A relieving provision will be available where a person is able to demonstrate that records have been lost through circumstances beyond his or her control or where it would be impractical to obtain receipts.

Car expenses

More detailed substantiation requirements are to apply in relation to car expenses; although alternative arbitrary deduction rules are also to be introduced. The substantiation requirements as they apply to car expenses will extend beyond claims by employees to include those by self-employed persons.

The requirements will apply to the use of passenger cars, station wagons, mini buses, panel vans, utilities or other small-capacity commercial vehicles; but not the use of taxis, panel vans, utilities and non-passenger commercial vehicles, the private use of which is restricted to from home to work travel and travel incidental to business use.

The substantiation rules will not apply to car expenses incurred in relation to cars included in the trading stock of a car sales business or in a business of letting cars out on lease or on hire. Nor will they apply to an employer who provides a car to an employee in circumstances where the employee is entitled to use the car for private use.

The types of car expenses to which substantiation is to apply include running costs such as registration, insurance, petrol, oil and service charges, lease charges and interest on borrowings used to finance the car, repairs and depreciation deductions. In the case of depreciation the substantiation rules will be relevant for establishing the cost of the vehicle.

In addition to the basic substantiation rules which will apply to verify actual expenditure, taxpayers seeking to deduct the whole or any part of those expenditures are to be required to maintain daily log books or similar records in which details of business trips are recorded. Details required would include the date of the trip, the odometer reading at the beginning and end of the trip, the number of kilometres travelled on the trip and the purpose of the trip. Where, over a period during a day, a car is in continuous use for business purposes, a combined entry will be sufficient for these purposes.

Alternative deduction rules which either reduce or eliminate the substantiation requirements for car expense claims are to apply according to whether or not the business use during a year of income can be expected to exceed 5,000 kilometres.

Annual business mileage in excess of 5,000 kilometres

A taxpayer is to be entitled to adopt one of two alternative methods of deduction in circumstances where, having regard to the occupation or business of the taxpayer the annual business distances in relation to the vehicle can reasonably be expected to be in excess of 5,000 kilometres. Where these rules apply there will be no need for the taxpayer to maintain distance records.

Under the first of these methods, the taxpayer will be entitled to a deduction equal to one-third of the annual vehicle costs incurred by the taxpayer. While the taxpayer will not be required to maintain trip details he or she will, under this basis of deduction be required to meet the basic substantiation requirements as to documentation of expenditure.

Under the second alternative, a taxpayer will be entitled to a deduction equal to 12% of the purchase price of the motor vehicle. For these purposes, where a car is subject to a cost ceiling for depreciation purposes under section 57AF of the Principal Act, the 12% deduction will be similarly limited. Proportionate deductions will apply where a car is acquired or disposed of during the year.

In circumstances where the vehicle is financed by a lease arrangement, the deduction is to be based on the market value of the car at the time the lease commenced. The purchase price ceiling will be taken into account for this purpose.

Annual business mileage less than 5000 kilometres

A further alternative basis of deduction is to be available where estimated business use or other income-related use in a year is less than 5000 kilometres. Where this basis is used, the deduction is to be determined by applying a standard rate per kilometre.

Under this method, a taxpayer will not be required to maintain documentation relating to expenses; nor will full substantiation of business kilometres be required. Rather, the deduction is to become available on the basis of detailed and reasonable estimates of business use.

For the purposes of this deduction method it is proposed that standard rates per kilometre, which will vary according to engine capacity, be prescribed by Regulation.

Changes in basis of deduction

As a general rule a taxpayer will not be entitled to change the basis of deduction once adopted in relation to a particular car, although changes in arbitrary deduction bases will be available in circumstances where the annual business mileage of a car varies from more than 5000 kilometres to less than 5000 kilometres (or vice versa).

Travel expenses

More stringent rules are also to apply to substantiate the business purpose of overseas travel and extended domestic travel. Thus, in addition to the basic substantiation requirements evidencing expenses, a taxpayer is to be required to maintain a contemporaneous documented record (e.g., a diary) of business activities conducted during the trip. Details required would include the date, duration and nature of any business activity. These requirements are to apply to expenditure incurred by a taxpayer in respect of his or her own travel, whether as an employee, employer or a self-employed person.

For the purposes of this rule, travel within Australia that involves the person being away from his or her normal place of abode for a continuous period of more than 5 nights will be taken to be extended domestic travel.

Maintenance and production of substantiation documents

Under the substantiation requirements a taxpayer will be required to maintain relevant documents (including log books and travel diaries) for a period of 3 1/2 years from the date of lodgment of the relevant return of income. However, to the extent that the documentary evidence relates to expenses incurred in carrying on a business - which may be relevant for car or travel expenses - the basic retention period will be 7 years.

The amendments will authorise the Commissioner of Taxation to require a taxpayer to produce relevant substantiation documents. When producing those documents the taxpayer will be required to also provide a schedule detailing the items of expenditure and identifying them to relevant receipts. Where a taxpayer fails to respond to such a request the amendments will authorise the disallowance of deductions claimed. Similar production requirements are to apply in respect of car log books and travel diaries.

General exclusions : travel and meal allowances

Two general exclusions from the substantiation requirements are to apply to the employment-related expenses of employees. Under the first of these, the general substantiation requirements will not apply to claims within the limits of reasonable domestic travel and overtime meal allowances.

Claims which exceed the amount of a reasonable travel or meal allowance or that are made in respect of allowances that are not reasonable in amount, will be subject to the substantiation requirements.

General exclusions : threshold exclusion

Employment-related expense claims which in aggregate do not exceed $300 in the particular income year will not be subject to the substantiation requirements. For these purposes claims made in respect of domestic travelling allowances and overtime meal allowances will not be taken into account; such expenditure being subject to the arrangements outlined above.

Claims for car and travel expenses by employees will not be subject to the specific substantiation requirements outlined above where the aggregate employment-related expenses claimed, including any car or travel expenses, do not exceed $300.

Operative date

The substantiation requirements are to apply with effect from 1 July 1986 so that documentary evidence of expenditure incurred on or after that date will be required. Log books (in relation to car expenses) and diaries (in relation to travel expenses) will similarly be required from that date. The new arbitrary deduction rules for car expenses will first apply for the income year commencing on 1 July 1986.

Against that background, detailed notes on the operation of the proposed new rules, to be contained in sections 82KT to 82KZB, i.e. new Subdivision F of Division 3 of Part III of the Principal Act, follow.

Interpretation

Sub-section 82KT(1) defines certain terms used throughout new Subdivision F.

"car" means a motor car, station wagon, panel van, utility truck or similar vehicle and any other road vehicle that has a designed load-carrying capacity of less than 1 tonne or fewer than 9 passengers. Expenditure in respect of these kinds of vehicles, including those that have four wheel drive will be subject to the substantiation rules unless it falls within the category of vehicles excluded from those rules by the operation of new sub-sections 82KV(3) and (4).

"car expense" is defined to make clear the various outgoings in respect of a car that will be subject to the substantiation rules. For that purpose, a car expense is any outgoing incurred in connection with a car, including -

- expenditure in operating the car, e.g. the cost of petrol, oil, servicing, insurance,registration and cleaning;
- costs of borrowing money to acquire a car;
- costs (other than principal or interest payments) of discharging a mortgage given as security for repayment of money borrowed to acquire the car, or the payment of the whole or a part of the cost of the car;
- lease payments and costs of preparing, registering and stamping a lease or for assigning or surrendering a lease of a car;
- interest on money borrowed to acquire the car or on the outstanding balance of its cost;
- repairs;
- depreciation.

Car expense does not include taxi fares or expenses of travelling in a car outside Australia. Such expenses are subject to the specific substantiation requirements relating to overseas travel expenses.

"depreciation" means depreciation that is allowable under the Principal Act or would be allowable but for the operation of new Subdivision F. The definition makes clear what is meant by depreciation in the definitions of 'car expense' and 'employment-related expense' (see notes on those definitions) and is relevant to proposed provisions (e.g. under sub-section 82KW(3) or section 82KX) which will operate to deny deductions for car expenses where a taxpayer makes an election that gives rise to one of the alternative arbitrary bases of deduction in relation to a car.

"elect" means elect in accordance with new Subdivision F. The manner in which elections giving rise to one of the alternative arbitrary bases of deduction in relation to a car under section 82KW and 82KX are to be made is set out in section 82KY.

"eligible expense" is defined as an outgoing incurred by a taxpayer for the purchase of food and drink for which a meal allowance was paid to the taxpayer, or on food, drink, accommodation, or incidentals, for which a travel allowance was paid. By the operation of proposed section 82KZ, such eligible expenses will not be deductible unless they can be substantiated by specific documentary evidence and, in the case of a travel allowance, the activities engaged in are properly recorded in a diary or like document. Relief from those requirements is available, however, in respect of travel expenses and costs of overtime meals that do not exceed reasonable allowances.

"eligible relative" means, in relation to a person, a relative of the person (as defined in sub-section 6(1) of the Principal Act) and another person who, although not legally married to the person, lives with the person on a bona fide domestic basis as husband and wife.

"employee" and "employer" are defined to have the same meanings as those terms are given for the purposes of the PAYE provisions of the

Principal Act - under section 221A - except that a State and an authority of a State,and persons they employ, will be treated as employers and employees whether or not an agreement has been entered into as provided for by section 221B relating to the PAYE obligations of States and their authorities.

"employment-related expense", like 'car expense', is defined to delineate the various outgoings relating to employment income that will be subject to substantiation. For that purpose, an employment-related expense is an outgoing incurred in producing salary and wages income, specifically including -

- periodical subscriptions to trade, business or professional associations;
- costs of borrowing money used to produce salary and wages income;
- costs (other than principal or interest payments) of discharging a mortgage given as security for repayment of money borrowed to produce salary and wages income, or the payment of the whole or a part of the cost of property used to produce salary and wages income;
- lease payments and costs of preparing, registering and stamping a lease or for assigning or surrendering a lease of property used to produce salary and wages income;
- interest on borrowed money used to produce salary and wages income;
- repairs to property, plant or articles used to produce salary and wages income;
- depreciation of plant or articles used to produce salary and wages income; and
- election expenses that would otherwise be deductible under section 74 or 74A of the Principal Act.

Employment-related expense does not include a car expense, or an eligible expense in relation to a meal allowance or travel allowance. As explained elsewhere in these notes, there are to be separate substantiation rules for those expenses.

The definition of "expense" is a drafting device the effect of which is that, wherever the word "expense" appears in Subdivision F, it will mean one of the kinds of expense to which the substantiation rules apply i.e. a car expense, an employment-related expense or a travel expense, or an eligible expense in relation to a meal allowance or travel allowance.

"industrial instrument" is defined in connection with the exclusion from substantiation requirements of expenditure on overtime meals that does not exceed a reasonable 'overtime meal allowance' (see later notes). It means a law of the Commonwealth or of a State or Territory or an award, order, determination or industrial agreement in force under any such law. Its effect, in conjunction with the definition of 'overtime meal allowance' is that the exclusion will apply only to allowances paid under such an instrument and not to overtime meal allowances negotiated privately between an employer and an employee.

"meal allowance", as defined, means an allowance paid or payable to an employee to purchase food and drink, but excludes any part of a travel allowance (see later notes). The definition relates to the definition of 'overtime meal allowance'.

"outgoing" is defined to include a loss. The defined term is a drafting device so that, wherever it appears in Subdivision F, it is to be taken as meaning a loss or outgoing.

"overtime meal allowance" means a meal allowance, as defined (see earlier notes), but is limited to one paid under an industrial instrument as defined (see earlier notes) for the purpose of enabling an employee to purchase food and drink at meal or rest breaks whilst working overtime.

"person" is defined to include a partnership. The definition has particular effect in relation to proposed section 82KU, which defines the documentary evidence that is required to comply with the substantiation rules. References in that section to the name of the person who supplied the goods or services to which an expense relates are, if the supplier was a partnership, to be taken as references to the partnership.

"relevant car documents" is an expression that covers the two basic records which, in order to satisfy the substantiation requirements as to business or employment related mileage in relation to car expenses incurred by a taxpayer during a year of income, must be completed in the manner described. The first is a log book or similar document that records the following details of every "business trip" undertaken in the car -

- odometer readings at the start and finish of the trip;

- kilometres travelled;
- purpose of the journey;
- the identity of the driver;
- the date of the entry; and
- the name of the person making the entry.

The second document records -

- the odometer reading at the start of the income year or, if first 'business use' of the car occurs during that year, the reading at that time;
- the odometer reading at the end of the income year or, if the last use of the car by the taxpayer occurs during the year, the reading at that time;
- the date of each entry; and
- the name of the person who made the entries.

Both documents must be in English, and entries made either at the end of each journey or at the time of the odometer readings, or as soon as reasonably practicable thereafter. Each log book entry must be signed at the time of entry.

"<u>retention period</u>" specifies the period for which a taxpayer must retain documentary evidence of an expense that is subject to substantiation requirements. The general rule for documentary evidence of car expenses and travel expenses relating to income other than salary and wages is that it must be retained from the time it is obtained until the end of a 7 year period that commences from the date of lodgement of the return.

Similar rules apply for documentary evidence relating to salary and wages income, but the equivalent retention period is 3 1/2 years from the date of lodgment of the returns. If, at the end of the relevant 7 or 3 1/2 year period, there is an objection or request for amendment that has not been determined or otherwise finally disposed of - including any review or appeal arising therefrom - the 7 or 3 1/2 year retention period, as the case may be, is extended until the matter has been so determined or disposed of.

"<u>salary and wages</u>" is defined to mean assessable income that is salary and wages for purposes of the relevant PAYE provisions of the Principal Act, i.e. section 221A.

"<u>taxpayer</u>" in new Subdivision F, does not include a company or a person in the capacity of a trustee and, as a result, companies and trust estates are not required to comply with substantiation rules that might otherwise apply to car and travel expenses they incur.

"travel allowance" is an allowance paid by an employer to an employee to meet costs of accommodation, food and drink, and incidental expenses, whilst travelling away from home in the course of performing duties as an employee. The definition relates to that of 'eligible expense' in relation to a travel allowance (see earlier notes) and the substantiation rules that apply to expenditure of a kind that the allowance is intended to cover.

"travel diary" means a diary or similar document in which the taxpayer has recorded particulars, as specified in sub-section 82KZ(2), of activities undertaken whilst travelling in the course of producing assessable income or as an employee in receipt of a travel allowance. The particulars must be so recorded in order that relevant travel expenses qualify for deduction.

"travel expense" is defined to mean an outgoing in respect of travel outside Australia, or travel within Australia where the traveller is away from his or her ordinary place of residence for 5 nights or more continuously. Travel expense does not include a car expense (other than car expenses incurred in respect of overseas travel) or an eligible expense in relation to a travel allowance (see earlier definitions), which are subject to their own substantiation requirements.

The purpose of sub-section 82KT(2) is to reduce the number of times that log book entries must be made to substantiate car expenses. It does so by treating any consecutive series of journeys undertaken during a day in a car in the course of producing a taxpayer's assessable income as a single journey. Thus, if the car is used only for business purposes during a day, only one log book entry, as specified in paragraph (a) of the definition of "relevant car documents", need be made for that day's journeys.

Sub-section 82KT(3) specifies that depreciation that qualifies as a car expense or an employment-related expense of a year of income shall be deemed to have been an expense incurred on the last day of that year, thereby facilitating reference to later provisions (e.g. sub-section 82KV(1)) which require substantiation in respect of particular expenses "incurred" by a taxpayer.

Sub-section 82KT(4) is also a drafting measure so that, wherever the expression "producing assessable income" is used in Subdivision F, it may also be taken as meaning, where appropriate, gaining assessable income or carrying on a business for the purpose of gaining or producing assessable income.

Sub-section 82KT(5) makes clear that any reference in Subdivision F to a particular kind of business carried on by a person (e.g., in sub-section 82KV(3) or (5)) includes a case where that kind of business is carried on as part of, or in conjunction with, another business.

Sub-section 82KT(6) is a declaratory provision which stipulates that Subdivision F is not intended to affect the general interpretation or application of the Act (paragraph (a)), nor to extend existing entitlements to deductions except where arbitrary bases of deduction are provided as an alternative to deductions for car expenses in specified circumstances (paragraph (b)).

Documentary evidence

Section 82KU specifies the documentary evidence that is required, as a condition of deduction, to substantiate an expense to which Subdivision F applies.

By sub-section 82KU(1), documentary evidence of an expense other than depreciation is a receipt, invoice or similar document - obtained by or on behalf of the taxpayer at the time the expense was incurred or as soon as practicable thereafter - that contains the following:

- the date the expense was incurred;
- the name of the person who supplied the relevant goods or services or, if supplied by a person conducting a business, the name of that person or the business name of the business;
- the amount expressed in the currency in which it was incurred;
- the date of the document.

The document must also be in English, or in the language of the country where the expense was incurred, and signed and supplied by the person or business that supplied the relevant goods and services.

The documentary evidence that is required in respect of depreciation is specified in sub-section 82KU(2). It is a receipt, invoice or similar document obtained by or on behalf of the taxpayer by the time the depreciable property is first used for income-producing purposes, or as soon as reasonably practicable thereafter. The following must be set out in the document:

- the date the property was acquired;
- the name of the person who supplied the property or, if supplied by a person conducting a business, the name of that person or the business name of the business;
- the cost of the property; and
- the date of the document.

The document must be in English, or in the language of the country from which it was imported by the taxpayer, and signed and supplied by the person or business from whom the property was acquired.

Sub-section 82KU(3) is a relieving provision which enables a taxpayer to obtain a statement or certificate as documentary evidence instead of a receipt, invoice or similar document as required by sub-sections (1) and (2). It applies only if the supplier does not in the ordinary course of business issue receipts, invoices or like documents.

Sub-section 82KU(4) is similar in effect to sub-section (3), but applies only where the supplier is not operating a business e.g. where a car is purchased on the private market.

Sub-section 82KU(5) operates in relation to lease payments and interest payments that qualify as car expenses or employment-related expenses. It enables a periodic statement, certificate or similar document provided to a taxpayer by a leasing company, bank, financier etc. to qualify as documentary evidence of lease or interest payments made in a year of income, without the necessity of having to obtain a separate receipt for each payment.

Sub-section 82KU(6) applies to what, for the reasons set out in sub-sections (7) and (8), are expenses that cannot be documented. It stipulates that if, at the time such an expense is incurred, or as soon as practicable thereafter, specified details are made in English by or on behalf of the taxpayer in a diary or similar document, and the diary is signed by the person who makes the entry, the entry will serve as documentary evidence of the expense. The details to be entered are those that would be required if documentary evidence of the expense could be obtained in the ordinary way. Each entry must be dated.

For the purposes of sub-section (6), sub-section 82KU(7) classifies, as "undocumentable", expenses each of which do not exceed $10 and which, in total, do not exceed $200. There is thus no requirement to substantiate, otherwise than in accordance with sub-section (6), a series of small expenses the total claim for which in a year of income is not more than $200.

Relief from substantiation is likewise provided, by sub-section 82KU(8) if the Commissioner of Taxation is satisfied that the nature of an otherwise deductible expense incurred by a taxpayer is such as to make it unreasonable to expect a receipt etc. to have been obtained.

Sub-section 82KU(9) is a relieving provision that enables a taxpayer to obtain a statement or certificate instead of a receipt, invoice or similar document (as required by sub-section (2)) to document the purchase of depreciable property either where the taxpayer did not retain documentary evidence or did not obtain it in the first place. The sub-section will apply where the taxpayer did not intend to use the property for income-producing purposes at a time when documentary evidence that had been obtained was disposed of, or had no such intention at the time of purchase and hence failed to obtain documentary evidence.

Where those circumstances obtain, and the Commissioner of Taxation is satisfied (e.g. because the original supplier has gone out of business) that it is not practicable for documentary evidence of the purchase to be obtained when the property commences to be used for income producing purposes, sub-section 82KU(10) operates to relieve the taxpayer of the relevant substantiation requirements, conditional on a document being furnished that the Commissioner accepts as correctly reflecting the particulars that would have been set out in documentary evidence.

Car expenses

Section 82KV lays down the general rule that, subject to certain exceptions and qualifications, a car expense incurred by a taxpayer is not an allowable deduction unless documentary evidence of the expense is obtained and relevant car documents (e.g. log books etc) relating to the expense are maintained by or on behalf of the taxpayer - sub-section (1).

One of the qualifications is contained in sub-section 82KV(2) in relation to the general requirement that a car expense is to be substantiated, as well as by receipts, etc., by relevant car documents, including a log book entry of each "business" journey. Sub-section (2) operates so that if an entry is not properly made in relation to a particular journey, or the entry is not signed as required, the journey will be treated as not having been made in the course of producing assessable income. While that means that car expenses relating to that journey will not be deductible, it also has the effect of maintaining the efficacy of entries made in relation to other journeys.

Exceptions to the general requirement to substantiate car expenses in respect of a car are contained in sub-section 82KV(3). They are that -

(a) the car is not used by the taxpayer otherwise than in an "exempt manner" at any time during a year of income - the uses of a car that will be treated as use in an exempt manner are specified in sub-sections (4) and (5);

(b) the car is included in the trading stock of a business of selling cars and is not used by the taxpayer during the year; and

(c) the expenses in question are incurred in the course of a business of repairing cars or doing other work on cars (e.g., car resprayers, new seat installers, etc.).

Sub-section 82KV(4) specifies the circumstances in which, for the purposes of paragraph (3)(a), certain small commercial vehicles will be treated as being used in an exempt manner so as to remain free of the substantiation rules. The kinds of vehicles to which it applies are taxis, panel vans or utility trucks or other road vehicles (not being vehicles designed principally to carry passengers) having a designed load carrying capacity of less than one tonne. At any time when a taxpayer, or an employee of the taxpayer, uses such a vehicle in the course of providing assessable income of the taxpayer, in travelling between home and the workplace, or for travel that is incidental to the use of the car in producing assessable income, the car will be taken to be used in an exempt manner. If no other kinds of use are made of such a car in a year of income, the effect of sub-section (3) is that there is no requirement to substantiate car expenses that relate to it.

A similar exemption from substantiation is provided by sub-section 82KV(5) by stipulating that a car is used in an exempt manner when it is -

(a) included in the trading stock of a business of selling cars and used in the course of that business;

(b) used by letting it on hire in the course of a business of letting cars on lease or hire; or

(c) provided for the exclusive use of an employee or employees, or relatives of employees, where those persons are entitled to use it for private purposes.

Car expenses where business use exceeds 5000 kilometres

Section 82KW enables a taxpayer to elect, where more than 5000 kilometres are travelled in a car in a year of income in the course of producing the taxpayer's assessable income, that one of two arbitrary bases of deduction apply in relation to car expenses. Where less than 5000 "business" kilometres was travelled, but the car either was first used or ceased to be used part of the way through the year, the election will be available where it can be concluded that there would have been more than 5000 such kilometres if the car had been used for the whole year - sub-section (1). Where those conditions are satisfied, the taxpayer may elect for one or other of the bases of deduction provided by sub-sections 82KW(2) or (3).

Sub-section (2) allows, where an election is made, a deduction equal to one-third of the deduction that would have been allowable in respect of car expenses incurred in the year of income if the taxpayer had used the car exclusively in the course of producing assessable income. That deduction, being based on actual expenses, is subject to the requirement that documentary evidence, as specified in section 82KU is obtained, but the rules applicable to the completion and retention of "relevant car documents" - log books and records of odometer readings - do not apply.

Where an election under sub-section (1) is made that sub-section (3) applies, there is to be an entitlement to a deduction equal to 12% of the original cost of the car to the taxpayer. If the car is leased the 12% deduction is based on the market value of the car at the time the lease was entered into. The 12% deduction is proportionally reduced according to the formula contained in paragraph (3)(b) in relation to any period of a year when the car was neither owned nor leased by the taxpayer. Where sub-section (3) applies, no separate deduction is allowable for the car expenses themselves, and the taxpayer is, accordingly relieved from the requirement to maintain any substantiation documents.

Sub-section 82KW(4) operates to reduce the 12% of cost deduction where the cost of the car to the taxpayer exceed the motor vehicle depreciation limit under section 57AF. In such a case, the deduction will be 12% of the motor vehicle depreciation limit that would apply if depreciation was being allowed. A similar rule will apply to a leased car if its market value at the commencement of the lease exceeds the motor vehicle depreciation limit.

By the operation of sub-section 82KW(5), the special bases of deduction under sub-sections (2) and (3) are not available in respect of a leased car unless the lease is for a period of at least 12 months (e.g. where the vehicle is on short-term hire).

Car expenses where business use does not exceed 5000 kilometres

Section 82KX authorises a third arbitrary basis of deduction in relation to a car that is used by a taxpayer for the purpose of producing assessable income. The basis is available where the number of "business" kilometres travelled by a car that is owned or leased by a taxpayer for any part of a year of income is less than 5000. In that case, if the taxpayer makes an election under sub-section (1), there is an entitlement to a deduction calculated by multiplying the number of "business" kilometres, as established by reasonable estimates, by a rate of expenditure that is applicable to the engine size of the car. The rate will be prescribed in the Income Tax Regulations. Where a rate per kilometre basis of deduction applies, no separate deduction is allowable in respect of actual car expenses, and the taxpayer is not required to maintain substantiation documents.

By sub-section 82KX(2), the rate per kilometre basis of deduction is not available in respect of a leased car unless the lease is for a period of at least 12 months.

Elections

Sub-section 82KY(1) specifies that an election (e.g., under sub-sections 82KW(1) or 82KX(1)) under Subdivision F is to be made by notice in writing to the Commissioner of Taxation and lodged on or before the time of lodgment of the return of income of the year to which the election relates, or such later time as the Commissioner allows.

By sub-section 82KY(2), a taxpayer who would be entitled to elect that a particular provision apply in an income year, e.g., the 12% of cost basis of deduction in sub-section 82KW(3), and does not so elect, is not entitled to make an election in a later year. Such a person would continue to have to substantiate car expenses in respect of the particular car in subsequent years unless its annual "business" mileage fell below 5000 kilometres, in which case an entitlement to an election under sub-section 82KX(1) would arise. (A right of further election would similarly arise where annual business use moved from less than 5000 kilometres to in excess of that figure.) If that entitlement was not availed of, the taxpayer could not make the election in a later year. An election may be made in any year in which a car is first used for the purpose of producing assessable income, i.e., including where the car replaces another in respect of which no election had been made or a different basis had been elected.

Sub-section 82KY(3) reflects the principle of continuity expressed in sub-section (2). It deems a taxpayer to make similar successive annual elections in respect of a car if the taxpayer has in one year made an election that a particular provision apply (e.g., the 33-1/3% of expenses basis in sub-section 82KW(2)) and is entitled in the next year to make a similar election. In those circumstances, the taxpayer is not entitled to elect that another provision apply.

Sub-section 82KY(4) denies entitlement to an election under 82KW(3) or 82KX(1) (the 12% of cost basis or the standard rate per kilometre basis) unless the taxpayer has incurred the car expenses that relate to the taxpayer's use of the car. The sub-section is intended to prevent abuse of the elections by arrangements under which a person other than the taxpayer (e.g., an employee) would pay the running costs of the car - and thereby become entitled to a deduction - while the taxpayer remained entitled to a standard annual deduction of, say, 12% of the cost of the car. The operation of sub-section (4) is modified, however, to the extent that it does not apply to an expense that it would be unreasonable to expect the taxpayer to have incurred. That modification will ensure that sub-section (4) does not apply to preclude an election being made in circumstances where lease payments are made under a vehicle lease that provides for all maintenance and repairs etc., to be done at the expense of the lessor.

Sub-section 82KY(5) is also designed to prevent abuse of the arbitrary bases of deduction made available by sub-sections 82KW(3) and 82KX(1). It applies in circumstances where car expenses that would ordinarily be expected to be incurred in the 1986-87 year of income, or later, are brought forward to an earlier year, i.e., the 1985-86 year, in order to obtain a deduction for them in the earlier year as well as the standard deduction in the later year under an election made under sub-section 82KW(3) or 82KX(1). A typical example would be the prepayment, before 1 July 1986, of car lease payments that would otherwise have been made in the year of income commencing on 1 July 1986. If expenses are brought forward, and the taxpayer makes an election, the expenses are not deductible if the Commissioner of Taxation is of the opinion that the expenses would not have been brought forward but for the elections becoming available.

Sub-section 82KY(6) provides a basis for determining a balancing adjustment under section 59 in relation to a car that has been the subject of elections under sub-sections 82KW(3) and 82KX(1) (the 12% of cost basis and the standard rate per kilometre basis) and in respect of which a depreciation deduction has been allowed.

By way of background, section 59 applies on the sale or other disposal of depreciated property. If on disposal the depreciated value of the property exceeds the proceeds received, the excess is an allowable deduction. On the other hand, if the depreciated value is less than the proceeds, the difference is included in the taxpayer's assessable income as depreciation recovered.

Sub-section (6) will operate where depreciation in respect of a car has been allowed as a deduction, the taxpayer has elected to adopt one of the bases of deduction under sub-section 82KW(3) or 82KX(1) (expressed in paragraph (6)(b) as an election in a relevant manner), and the car is disposed of, lost or destroyed (paragraphs (a), (b) and (c)).

In those circumstances, the Commissioner of Taxation will be authorised to calculate a notional depreciated value of the car at the time of disposal as if the arbitrary basis of deduction had never applied (paragraph (d)). That notional calculation will be made by treating the taxpayer's use of the car during the year or years when the arbitrary basis of deduction applied as having been use for the purpose of producing assessable income (paragraph (e)) and by treating the car as having been used to the extent of 33 1/3% for business purposes during any year in which the 12% of cost basis applied, or to the extent of 20% where the standard rate per kilometre basis applied (paragraph (f)).

Paragraph (g) authorises an adjustment to be made to the amount of a section 59 balancing adjustment that is calculated by reference to the notional depreciated value by comparing the periods in respect of which depreciation was allowed with the aggregate of those periods and the income years in which the arbitrary basis of deduction applied with the effect that any balancing adjustment relates only to actual depreciation allowed.

Sub-section 82KY(7) is a drafting measure that makes clear that an election in a relevant manner, as mentioned in paragraph (6)(b), is an election that either the sub-section 82KW(3) or sub-section 82KX(1) basis of deduction applies.

Other expenses

Sub-section 82KZ(1) is a primary operative provision which denies a deduction in respect of an eligible expense in relation to a meal allowance or travel allowance, an employment-related expense or a travel expense (each of these terms is defined in sub-section 82KT(1)) unless documentary evidence is obtained by or on behalf of the taxpayer.

A further requirement for an eligible expense in relation to a travel allowance or a travel expense is, by the operation of sub-section 82KZ(2), the recording in a diary or similar document of specified particulars of each activity undertaken during the relevant travel. The entry, to be made at the time of the activity, or as soon as reasonably practicable thereafter, is to set out the following :

- the date the entry was made;
- the place of the activity;
- the date and approximate time the activity commenced;

- the duration of the activity;
- the nature of the activity.

Sub-section 82KZ(3) will operate, in a similar way to sub-section 82KV(2), to treat an activity that is not properly documented in a diary etc., as not having been engaged in in the course of producing assessable income of the taxpayer.

Sub-section 82KZ(4) will relieve from the substantiation requirements certain expenses incurred where an overtime meal allowance or a travel allowance is paid to a taxpayer. (See notes on the definitions of these allowances in new sub-section 82KT(1).) If, in the opinion of the Commissioner of Taxation, the amount of the allowance is reasonable having regard to outgoings that it would be reasonable for the taxpayer to incur for food and drink, accommodation or incidentals that the allowance is intended to cover, the substantiation rules do not apply provided the expense claimed as a deduction does not exceed the allowance.

Retention, and production, of documents

Section 82KZA contains the rules that require documentary evidence of expenses to be retained for specified periods and be produced when required in order to satisfy the substantiation requirements of Subdivision F.

Sub-section 82KZA(1) states the general rule that a deduction is not allowable, and is deemed never to have been allowable, for an expense if the taxpayer fails to retain for the retention period (as defined in sub-section 82KT(1)):

- documentary evidence of the expense
- relevant car documents (where applicable)
- travel diary (where applicable).

Sub-section 82KZA(2) authorises the Commissioner of Taxation to require, by written notice, a taxpayer to produce within a period of not less than 28 days documentary evidence relating to an expense incurred by the taxpayer.

Provided the retention period has not expired when the notice is served, sub-section 82KZA(3) operates to disallow a deduction (which may have been allowed at an earlier time) unless the taxpayer produces the following within the period specified in the notice or such longer period as the Commissioner allows:

- documentary evidence of the expense
- a schedule in English in a form approved by the Commissioner in which is included -

(a) a cross-reference to the documentary evidence; and
(b) a summary of the particulars in the documentary evidence. If the expense was incurred in foreign currency, details of the amount are to be expressed in Australian currency;

- relevant car documents in relation to car expenses (if applicable); and
- a travel diary relating to a travel expense or an eligible expense in relation to a travel allowance.

Sub-section 82KZA(4) makes clear that failure to comply with a notice of the Commissioner to produce documentary evidence is not an offence for which a taxpayer can be prosecuted. The "penalty", in effect, is loss of the deduction.

By operation of sub-section 82KZA(5), a taxpayer whose documentary evidence is lost or destroyed may have a copy of the original, or a document contemporary with the original that records all the matters set out in the original, treated for purposes of substantiation as the original. The operation of sub-section (5) in that way, however, is conditional on the loss or destruction being on account of circumstances beyond the taxpayer's control, and the Commissioner of Taxation being satisfied that reasonable steps had been taken to prevent such a loss.

Sub-section 82KZA(6) applies where documentary evidence of an expense is lost or destroyed but sub-section (5) does not apply because there is no copy of the original or "substitute document" that was in existence when the original was lost or destroyed. In that case, if the taxpayer has a document, e.g., a statement or certificate, that would constitute documentary evidence if it were a receipt, invoice or similar document, it may be treated as documentary evidence from when the taxpayer obtained it, and the rules relating to retention and production on request of the original will cease to apply. If it is not reasonably practicable for the taxpayer to obtain a substitute for the original documentary evidence, the retention and production requirements of section 82KZA that pertained to the original will also cease to apply. As with sub-section (5) the operation of sub-section (6) is conditional on the loss or destruction being on account of circumstances beyond the taxpayer's control and to the Commissioner of Taxation being satisfied that reasonable steps had been taken to prevent such a loss.

Sub-section 82KZA(7) applies in a similar way to sub-section (6) in relation to relevant car documents or a travel diary that became lost or was destroyed and sub-section (5) does not apply. That is, the retention and production the requirements cease to apply in relation to the original documents from the time they are lost or destroyed where the loss was due to circumstances beyond the control of the taxpayer and reasonable precautions against their loss had been taken.

Sub-section 82KZA(8) is a drafting measure that makes clear that each of the provisions of the section operates subject to the other provisions of Subdivision F.

Aggregate claims not exceeding a certain amount

Section 82KZB will obviate the requirement to substantiate employment-related expenses, or car expenses or travel expenses incurred by a taxpayer in producing salary and wages income, where the total amount of those expenses claimed as deductions in a year of income does not exceed $300 or such higher amount as may be prescribed from time to time.

Application

Sub-section 23(7) limits the application of new Subdivision F to expenses incurred in a year of income commencing on or after 1 July 1986. An exception is sub-section 82KY(6) which could have the effect of denying deductions for certain car expenses incurred during a year of income commencing before 1 July 1986.

Clause 15 : Modified application of Act in relation to certain unit trusts.

This clause will amend section 102L of the Principal Act to insert a new sub-section - sub-section (3A) - as an interpretative aid in applying certain terms used in sub-sections 102L(2) and (3).

Section 102L is part of Division 6B of Part III of the Principal Act which taxes as a company certain unit trusts (referred to as "corporate unit trusts") formed as part of a reorganisation of a company. The purpose of section 102L is to equate corporate unit trusts with companies in the application of certain provisions of the Principal Act.

Paragraph (2)(a) of section 102L entitles a trustee of a corporate unit trust to a rebate of tax in respect of amounts included in the net income of the trust by way of dividends paid by a company and unit trust dividends paid by another corporate unit trust. The amount of the rebate is equal to the amount that would be allowable as a rebate if the corporate unit trust was a resident public company and if the unit trust dividends were dividends paid by a company.

The amendment proposed by new paragraph 102L(3A)(a) will ensure that a trustee of a corporate unit trust is entitled to a rebate of tax in respect of unit trust dividends paid by a public trading trust that, by clause 16 of this Bill, is proposed to be taxed as a company under new Division 6C of Part III of the Principal Act.

Paragraph 2(b) of section 102L authorises the allowance of a rebate of tax to a resident company, not being the trustee of a corporate unit trust, in respect of unit trust dividends paid by a corporate unit trust included in its assessable income. New paragraph 102L 3A(b) will stipulate that the company also not be a trustee of a unit trust that is a public trading trust for the purposes of proposed new Division 6C of Part III of the Principal Act (clause 16 of the Bill).

New paragraph 102L(3A)(c) proposes that references in sub-sections 102L(2) and (3) to a unit trust dividend are to include references to unit trust dividends within the meaning of new Division 6C of Part III.

Clause 16 : Division 6C - Income of certain public trading trusts

Introductory Note

By this clause it is proposed to insert a new Division - "Division 6C - Income of certain public trading trusts" - in Part III of the Principal Act. The new Division, comprising sections 102M to 102T, will tax as a company the trustee of a public unit trust carrying on a trade or business (to be known as a "public trading trust"). The measures will also ensure that distributions of income or other profits to unitholders in such trusts will be taxed on the basis applying to dividends paid by a company.

The new provisions are modelled on those of Division 6B of Part III of the Principal Act that apply to a public unit trust established as a result of certain company reorganisations - called a "corporate unit trust". Such trusts are also taxed as companies and their distributions to unitholders taxed as dividends. New Division 6C will apply to unit trusts that are public unit trusts and operate a trade or business, other than a business that consists of investing in land or an interest in land for rental purposes, or of investing or trading in equities or securities, or a combination of these activities. The proposed amendments will apply to income of the 1985-86 and subsequent income years for public trading trusts established after 19 September 1985, and of the 1988-89 and subsequent income years for such trusts that were established on or before that date.

Tests are to apply to determine whether, in relation to a year of income, a unit trust is a public unit trust. Basically, a unit trust will meet these tests in relation to a year of income if its units are listed on a stock exchange, are held by 50 or more persons or are available for investment by the public. With one exception, a unit trust will not be regarded as a public unit trust if 20 or fewer persons hold 75% or more of the beneficial interests in the income or property of the trust. For this purpose, a person and his or her relatives or nominees will be regarded as one.

The exception is where persons or bodies who are exempt from income tax, including a government and its authorities, hold units in a trust that entitle them to 20 per cent or more of the beneficial interest in the income or property of the trust. In this event the unit trust will be taken to be a public unit trust, even though it would not otherwise be one, e.g., because the number of unitholders is less than 50.

Where, in relation to a year of income, a unit trust meets the tests specified, the trustee will be subject to tax on the net income of the trust at the general company tax rate. Distributions (referred to as "unit trust dividends") made to unitholders out of income or other profits derived by the trustee during a year of income for which the trust has been or will be taxed as a company will constitute assessable income in the hands of the unitholders as if they were dividends paid by a company.

Where the income of a public trading trust includes dividends paid by a company (or unit trust dividends paid by another unit trust, including a corporate unit trust taxed as a company by Division 6B), the trustee of the trust will be entitled to a rebate of tax in the same way as dividend income derived by a public company is rebatable. Unit trust dividends received by a company will also qualify for rebate in the company's hands.

A number of related safeguarding measures will support the intended operation of these provisions.

Parts III, IV and V of this Bill contain consequential amendments of the Income Tax (Individuals) Act 1985, the Income Tax (International Agreements) Act 1953 and the Income Tax (Rates) Act 1982 respectively.

Section 102M : Interpretation

Section 102M contains a number of definitions necessary for the operation of the proposed new Division 6C -

"eligible investment business" is a term used in the definition of "trading business" (also defined by section 102M) for the purpose of specifying the type of business that may be conducted by a trustee of a unit trust without causing the trust to be taken to be a trading trust for the purposes of Division 6C. For this purpose, an "eligible investment business" is to mean a business consisting of either or both of -

- investing in land or in an interest in land wholly or primarily for the purpose of deriving rent (paragraph (a)); or
- investing or trading in loans, bonds, securities, shares or units in a unit trust, or in a right or option in respect of any such investments (paragraph (b)).

Accordingly, a trustee of a unit trust developing, or trading in, real or leasehold property, dealing in commodity futures, or deriving income from royalties, franchises or other types of investment will not be carrying on an "eligible investment business" and will, for the purposes of Division 6C, be taken to be carrying on a trading business.

"eligible policy" is an expression used in the definition of "exempt life assurance fund" and thus, indirectly, in the definition of "exempt entity". It will have the same meaning as in section 110 of the Principal Act, i.e., a superannuation policy, a life assurance policy in relation to an immediate annuity or a life assurance policy in relation to a roll-over annuity.

"exempt entity" is defined for the purposes of sub-section (2) of section 102P, which sets out a number of tests for determining whether, in relation to a year of income, a unit trust that is not a public unit trust by the primary tests in sub-section 102P(1), will be taken to be a public unit trust because a substantial number of its units are beneficially owned by tax exempt bodies. The term is defined to mean -

- a body, association or fund the income of which is exempt from income tax by virtue of the application of paragraphs (d), (e), (ea), (eb), (ec), (f), (g), (h), (i) or (x) of section 23 of the Principal Act (paragraph (a));
- the trustee of a fund (itself defined as an "exempt life assurance fund")

maintained by a life assurance company solely in respect of life assurance business consisting of eligible policies, the income of which will be excluded from the life assurance company's assessable income; the trustee of a fund exempt from income tax under paragraph (j), of section 23, or of superannuation funds exempted by paragraphs (jaa) or (ja) of section 23, section 23F or 23FB; and the trustees of certain approved deposit funds exempt from income tax under section 23FA (paragraph (b));

- a person or body exempt from income tax by virtue of a provision of a Commonwealth Act other than the Principal Act (paragraph (c)); or

- a government, or an authority of a government, that for any reason is not liable to income tax (paragraph (d)).

"exempt life assurance fund" is a term used in paragraph (b) of the definition of "exempt entity" and means, in effect, a fund of a life assurance company consisting of eligible policies, the income of which, by virtue of sub-section 112A(1) of the Principal Act, is not subject to tax;

"land" is defined to include an interest in land; it will thus include real estate and leasehold estate.

"life assurance business" and "life assurance company" used in the definition of "exempt life assurance fund" are defined to give the terms the same meaning as they have in Section 110 of the Principal Act.

"net income" is defined, in relation to a unit trust to which Division 6C is to apply for a year of income, i.e., a "public trading trust", to mean the total assessable income of the public trading trust, calculated as if the trustee were a resident taxpayer, less all allowable deductions.

"prescribed trust estate" is a drafting measure used to identify a trust estate that is a public trading trust (as defined in section 102N) in relation to a year of income, or that has been treated as a public trading trust in relation to an earlier year of income. This will facilitate the treatment, in the hands of unitholders, of distributions of income or profits (termed "unit trust dividends") derived during a year of income in which a trust estate was a public trading trust, as if those distributions were dividends received from a company.

"<u>property</u>" is widely defined and includes choses in action, such as shares.

"<u>relevant year of income</u>" is defined as the 1985-86 year of income or a subsequent year of income. Subject to transitional arrangements discussed later, Division 6C may first apply to income of unit trusts for the 1985-86 year of income.

"<u>trading business</u>" is the phrase used in section 102N to refer to the activities carried on by a unit trust to establish whether it is a trading trust to which the new Division will apply if the particular trust is also a public unit trust. Where a trustee of a unit trust carries on a trading business, or is able to control, directly or indirectly, another person in the operation by that other person of a trading business, the unit trust will be regarded as a trading trust for the purposes of the operation of Division 6C. The phrase is defined to mean any business other than a business consisting wholly of an "eligible investment business" (as defined). The practical effect of those two definitions taken together is to expose to the new measures any public unit trust the business of which consists other than of investing in real estate for rental purposes or in shares and other securities.

"<u>trustee</u>" is a term used as a drafting measure to extend the ordinary meaning of that word to facilitate the reference in the definition of "exempt entity" to the holding of assets by a life assurance company in a statutory fund.

"<u>unit</u>" is the expression used to describe a beneficial interest in a prescribed trust estate, however that interest might be described formally.

"<u>unitholder</u>" is defined to include a person who is a beneficiary in a prescribed trust estate.

"<u>unit trust dividend</u>" is a term used in Division 6C to describe the distributions by the trustee of a prescribed trust estate that are to be taxable on the same basis as dividends paid by a company. It means, subject to the qualifications set out in paragraphs (c) or (d) -

- any distribution of money or property made by the trustee (paragraph (a)); and
- any amount credited by the trustee to a unitholder as a unitholder (paragraph (b)).

By paragraph (c), only distributions or amounts credited which are attributable to profits derived by the trustee of the trust during a year of income in which the trust was taxed as a public trading trust will be unit trust dividends. Paragraph (d) provides that any amount distributed or credited to a unitholder in connection with the cancellation, redemption or extinguishment of a unit, where the amount represents a return of capital contributed by the unitholder at the time of creation or issue of the unit, will not be a unit trust dividend.

Section 102N : Trading trusts

Section 102N is an interpretative provision that will operate to determine whether, in a year of income, a unit trust is a trading trust for the purposes of Division 6C.

A unit trust will be a trading trust in a year of income if, at any time during the year of income, the trustee -

- carried on a trading business (paragraph (a)); or
- controlled, or was able to control, directly or indirectly, the affairs or operations of another person, e.g. a trustee of another trust or a company, in respect of the carrying on by the other person of a trading business (paragraph (b)).

The term "trading business" is defined in section 102M to mean any business other than an "eligible investment business" which is also defined in that section. By the operation of this section, in conjunction with those definitions, a unit trust will be a trading trust in a year of income if it carries on any business other than the business of investing in land or in an interest in land for rental purposes, or of investing or trading in shares, bonds, securities and such like, or a business consisting of a combination of those activities.

A unit trust that generally satisfies the tests to be treated other than as a trading trust, because it is predominantly carrying on an eligible investment business, will not be taken to be a trading trust merely because it receives income from activities incidental to its main purpose that do not constitute the carrying on of a business.

Paragraph (b) of section 102N is a safeguarding provision against arrangements to circumvent the operation of Division 6C by having activities that would constitute a trading business of a public unit trust carried on by an associated entity. By taking income from the associate in the form of eligible investment income, the trustee could otherwise ensure that the relevant trust did not qualify as a trading business and so avoid the operation of Division 6C.

By paragraph (b), a unit trust will be a trading trust in a year of income if, at any time during the year, the trustee of the unit trust was in a position to control the affairs or operations of another person (i.e., the associated entity) in respect of the carrying on by that person of a trading business.

Section 102P : Public unit trusts

Section 102P sets down a number of tests to be considered in determining whether a unit trust will be a "public unit trust" for the purposes of Division 6C. It also contains safeguards against arrangements that might otherwise defeat the purpose of the amendments. These will ensure that a unit trust which may otherwise come within the scope of Division 6C does not escape its operation by arranging specially to be put beyond the tests for determining whether a unit trust is a public unit trust. Other safeguards will ensure that public unit trust status does not apply in relation to unit trusts that are not public in nature.

Sub-section 102P(1) lists three criteria for determining whether a unit trust is to be regarded as a public unit trust for a year of income. By this sub-section, a unit trust will be a public unit trust if, at any time during the year, units in the unit trust are -

(a) listed on a stock exchange in Australia or elsewhere (paragraph (a));

(b) offered for subscription to the public (paragraph (b)); or

(c) held beneficially by 50 or more persons (paragraph (c)).

Sub-section 102P(2) sets out an alternative test to those in sub-section (1) for determining whether a unit trust is to be regarded as a public unit trust. The basic purpose of this test is to ensure that the intended operation of the new provisions cannot be by-passed, e.g, by limiting the number of unitholders to less than 50. To that end, sub-section (2) will treat a trading trust as a public unit trust if, although its units are held by fewer than 50 persons, units carrying entitlement to 20% of the income or property of the trust are beneficially owned, directly or indirectly, by persons or bodies (including governments), that are exempt from income tax.

In specific terms the sub-section will operate to treat a unit trust as a public unit trust in relation to a year of income if, at any time during the year -

- an exempt entity (as defined in section 102M) or exempt entities had the right to acquire units in the trust entitling them to 20% or more of the beneficial interests in the income or property of the trust (paragraph (a));
- 20% or more of the total of moneys paid or credited by the trustee to unitholders was paid or credited to an exempt entity or exempt entities (paragraph (b)); or
- an exempt entity or exempt entities were in a position to require the rights attaching to any units to be varied to achieve the position in paragraphs (a) or (b) (paragraph (c)).

By sub-section 102P(3), a unit trust will not be regarded as a public unit trust because its units were offered to the public (paragraph 102P (1)(b)) if the Commissioner of Taxation is able to conclude that the offer to the public was made for the purpose of enabling the trust to be treated as a public unit trust. This provision will guard against a non-bona fide offer made merely to achieve public status, e.g., where assessment of a unit trust as a company could result in less tax being payable than if the ordinary provisions of Division 6 relating to trusts applied.

Sub-section 102P(4) sets out circumstances in which a unit trust that would otherwise be a public unit trust in relation to a year of income, because of the operation of sub-section (1) (but not sub-section 2) of this section, is not to be treated as a public unit trust for the purposes of Division 6C. Subject to the operation of sub-section (5), such a unit trust will not be a public unit trust if at any time during the year of income 20 or fewer persons held or had the right to acquire units in the trust entitling them to 75% or more of the beneficial interests in the income or property of the trust.

Sub-section 102P(5) bears on the operation of sub-section (4). It will over-ride the operation of that sub-section by allowing the Commissioner to treat a unit trust as a public unit trust in relation to a year of income if, for only a short time during the year of income, the unit trust is closely held in terms of sub-section (4). This will safeguard against any attempt to cloak a unit trust that has the real character of a public unit trust as other than public by fulfilling the test in sub-section (4) for a minimal period.

Sub-section 102P(6) relates to the operation of sub-sections (4) and (5). In applying the tests in those sub-sections in relation to a person who has a right to acquire or become the holder of a unit in a trust, the person shall be deemed not to have such a right if, having regard to the transferee's financial circumstances and to any other relevant matters, the Commissioner forms the opinion that it was not intended that the rights be exercised. This will ensure that a public unit trust is unable to avoid the operation of Division 6C by arranging that rights to acquire units be granted to persons who are not intended to exercise them.

Sub-section 102P(7) is complementary to sub-section (3) and will apply to deem a unit trust not to be a public unit trust where 75% or more of the income or property of the trust is paid to, or is capable of being required to be paid to, 20 or fewer persons, notwithstanding that those persons might not hold 75% or more of the units in the trust.

By sub-section 102P(8), which has a similar operation to sub-section (6), it is proposed that a public unit trust not be able to acquire non-public status by entering into arrangements to invoke the operation of sub-section (7).

By sub-section 102P(9), the phrase "offered to the public" is defined for the purposes of sub-sections (1) and (3) (see notes on those sub-sections). In relation to units in a trust the term is to mean -

- an offer to the public or a section of the public to subscribe for or purchase units in the trust (paragraph (a)); or

- an invitation to the public or a section of the public to make offers to subscribe for or purchase units in the trust (paragraph (b)).

Sub-section 102P(10) is designed to allow the beneficial ownership of units in a unit trust to be traced through any interposed trusts to the ultimate beneficiaries.

Under sub-section 102P(11) non-cash distributions of trust property to unitholders are to be taken into account as if they were cash distributions equal in amount to the value of the property distributed.

Sub-section 102P(12) is an interpretative measure and defines the term "person" as used in section 102P. A person, his or her relatives and any nominees who hold units in a unit trust for the person or his or her relatives will be taken as one person. This provision will have practical effect in determining whether a unit trust has 50 or more unitholders for the purposes of sub-section 102P(1), and whether 20 or fewer persons hold the units or other interests referred to in sub-sections 102P(4), (5) and (7).

Section 102Q : Resident unit trusts

A test that must be satisfied for the purposes of section 102R in considering whether a trading trust is to be subject to taxation as a company in a year of income is that, in the first year of application of section 102R to the trust, the unit trust is a resident unit trust.

Section 102Q specifies the conditions under which a unit trust is to be regarded as a resident unit trust in relation to a year of income. These are that, at any time during the year of income -

- either any property of the trust is situated in Australia or the trustee carried on business of the trust in Australia (paragraph (a)); and
- either the central management and control of the unit trust was in Australia or persons who held more than 50% of the beneficial interests in the trust were residents (paragraph (b)).

Section 102R : Public Trading Trusts

Section 102R will determine whether a unit trust is a public trading trust in relation to a relevant year of income, by considering together the various criteria contained in sections 102N, 102P and 102Q. The trustee of such a trust is to be assessed and liable to pay tax on the net income of the trust at a rate declared by Parliament for the purposes of proposed section 102S. (That rate is to be the company tax rate.)

Paragraph 102R(1)(a) applies to the years of income commencing on 1 July 1985, 1 July 1986 and 1 July

1987. A unit trust will be a public trading trust (and therefore subject to tax at the company tax rate) in relation to any of those years of income if it was established in the period after 19 September 1985 and before the commencement of the 1988-89 year of income, sub-paragraph (a)(i), and satisfies all of the tests set out in the paragraph in the relevant year of income. Those tests are that the unit trust -

- is a public unit trust in relation to the year of income (section 102P) (sub-paragraph (a)(ii));
- is a trading trust in relation to the year of income (section 102N) (sub-paragraph (a)(iii));
- is either a resident unit trust in relation to the year of income (section 102Q) - or was, in an earlier year, a public trading trust (sub-paragraph (a)(iv)); and
- is not a corporate unit trust in relation to the year of income within the meaning of, and thus taxed as a company in accordance with, Division 6B (sub-paragraph (a)(v)).

The application of this paragraph is subject to the operation of sub-sections 102R(2), (3) and (4) which contain tests for determining whether, in relation to a unit trust established on or before 19 September 1985, the trust was a trading trust and a public unit trust on that day. As indicated later in the notes on those sub-sections, their general purpose is to ensure that a unit trust established on or before 19 September 1985 will be treated as having been established after that day (and thus potentially subject to tax as a company prior to the 1988-89 income year) if the trust was not a public unit trust or was not carrying on a trading businesss on that day. It will not be necessary for a unit trust to have actually been a public unit trust and to have commenced trading activities on or before 19 September 1985. It will be enough if the trust was in existence and was in course of meeting those criteria by that date.

Paragraph 102R(1)(b) applies to the year of income commencing 1 July 1988 and subsequent income years. A unit trust established at any time, i.e., whether on or before, or after, 19 September 1985 will be a public trading trust in a year of income if it meets the tests set out in sub-paragraphs (i) to (iv) of that paragraph. Those tests correspond with the tests set out in sub-paragraphs 102R(1)(a)(ii) to (v) described above.

By sub-section 102R(2) a unit trust established on or before 19 September 1985, but which was not a trading trust on that date, will be taken for the purposes of section 102R to have been established after that date if it subsequently becomes a trading trust. This provision is relevant to the operation of paragraph (1)(a) if the unit trust satisfies the other criteria for the operation of that paragraph in any of the years commencing 1 July 1985, 1 July 1986 and 1 July 1987. By this safeguarding measure, a "shelf" unit trust established on or before 19 September 1985 may be taxed as a company prior to the commencement of the 1988-89 year of income if used as a vehicle to carry on a trade or business commencing after 19 September 1985.

Sub-section 102R(3) relates to the application of sub-section (2). It corresponds with the provisions of section 102N (see earlier notes), and is to the effect that a unit trust is a trading trust on a particular day if, on that day, the trustee -

- carries on a trading business (defined by section 102M) (paragraph (a)); or
- controls or is able to control, directly or indirectly, the affairs or operations of another person in respect of the carrying on by that person of a trading business (paragraph (b)).

For the purpose of the application of paragraph (3)(a), a unit trust will be regarded as carrying on a trading business on a particular day if, even though it had not commenced its trading activities on that day, it was at that time proceeding to do so, e.g., it was in the course of constructing or acquiring a building in which the business operations of the trust were proposed to be conducted.

Sub-section 102R(4) contains another test to be applied in determining whether, for the operation of paragraph (1)(a), a unit trust is to be taken to have been established after 19 September 1985. A unit trust that would otherwise be taken to have been established on or before 19 September 1985 (paragraph (a)), will be taken to have been established after that date -

- if the unit trust was not a public unit trust on that day (paragraph (b)); and
- the Commissioner of Taxation is satisfied that at no time on or before that date was it the intention of the trustee that the unit trust become a public unit trust (paragraph (c)).

A unit trust established on or before 19 September 1985, but not meeting the criteria of actually being a public unit trust on that day, will be regarded as meeting that test if there is evidence of an intention that the trust would become a public unit trust after 19 September. Such evidence could be found in relevant constituent documents, government permit and licensing approvals, and arrangements for listing units on a stock exchange, issue of prospectus, etc.

Section 102S : Taxation of net income of public trading trust

This section is the operative provision that requires the assessment of the net income of a public trading trust for a year of income and imposes liability to pay tax on that net income, at the rate declared by the Parliament, on the trustee.

Section 102T : Modified application of Act in relation to certain unit trusts

The purpose of this section, in broad terms, is to equate public trading trusts or, where appropriate, prescribed trust estates, with companies in the application of certain specified provisions of the Principal Act. In like manner, units in a prescribed trust estate, unitholders and unit trust dividends will be equated respectively with shares, shareholders and dividends paid by a company.

There are three main areas of the Principal Act affected. First, section 44 of the Principal Act will be modified so that unit trust dividends are included in the assessable incomes of unitholders on the same basis as company dividends are assessed to shareholders. Also, where a unitholder is not an Australian resident, the provisions requiring the payment of dividend withholding tax are to apply to the unit trust dividends paid to the non-resident.

The second change will modify the operation of sections 46, 46A and 46B of the Principal Act to entitle the trustee of a public trading trust to a rebate of tax in respect of dividends paid to the trustee by a company and in respect of unit trust dividends paid to the trustee by the trustee of a prescribed trust estate under either Division 6B or Division 6C. A rebate of tax will also be available in respect of unit trust dividends paid by a public trading trust that are included in the assessable income of a resident company. Rules contained in sections 46A and 46B relating to dividend-stripping arrangements will be made applicable to arrangements under which a unit trust dividend in terms of Division 6C is paid in circumstances similar to a company dividend-stripping operation.

Finally, the operation of Division 1A of Part VI of the Principal Act which requires companies to pay instalments of tax in advance of assessment, will be modified to require the payment of advance instalments of tax by trustees of public trading trusts.

Sub-section 102T(1) is a drafting measure to specify that the succeeding provisions of the section are to have effect for the purpose of the imposition, assessment and collection of tax in respect of the net income of a public trading trust, and in respect of unit trust dividends paid by a prescribed trust estate.

By sub-section 102T(2), sections 46, 46A and 46B of the Principal Act, which govern the eligibility of a resident company to a rebate of tax in respect of dividends included in its assessable income, are to be made applicable to unit trust dividends.

By paragraph (2)(a) the trustee of a public trading trust will be entitled to a rebate of tax in respect of amounts included in the net income of the trust by way of dividends paid by a company and unit trust dividends paid by a prescribed trust estate. By the operation of sub-section 102T(4), the reference in paragraph (2)(a) to unit trust dividends will include such dividends paid by a corporate unit trust for the purposes of Division 6B.

The amount of the rebate will be equal to the amount which would be allowable as a rebate if the public trading trust and the prescribed trust estate were both resident public companies and the unit trust dividends were dividends paid by a company.

Paragraph (2)(b) authorises the allowance of a rebate of tax to a resident company, not being the trustee of a public unit trust, in respect of unit trust dividends included in its assessable income. The rebate will be allowable on the same basis as applies when dividends are included in the assessable income of a resident company.

Sections 46A and 46B of the Principal Act operate to prevent a double benefit in the form of a full rebate of tax on dividends received in the course of a dividend stripping operation. By the operation of sub-section 102T(3), those sections will apply in relation to a unit trust dividend where the related arrangements have the same essential purpose as a dividend-stripping arrangement carried out in relation to a company.

Sub-section (3) will apply where the Commissioner of Taxation is satisfied that an arrangement in relation to a unit trust dividend would have been regarded as a dividend-stripping arrangement for the purposes of section 46A or 46B if the unit trust dividend had been a dividend paid by a company. The practical effect will be that those sections will apply in like manner in relation to the unit trust dividend so as to reduce or eliminate the amount of rebate available in respect of the unit trust dividend.

Sub-section 102T(4) is an interpretative provision relevant to the application of certain terms used in sub-sections 102T(2) and (3). By paragraph (4)(a) a reference in paragraph 102T(2)(a) to a prescribed trust estate is to include a reference to a trust estate that is a prescribed trust estate for the purposes of Division 6B. As a consequence the trustee of a public trading trust in receipt of unit trust dividends from a corporate unit trust will be entitled to a rebate of tax on those dividends.

Paragraph (4)(b) relates to the operation of paragraph 102T(2)(b) that applies to a resident company other than a company in the capacity of a trustee of a public trading trust. By paragraph (4)(b) a company that is a trustee of a corporate unit trust for the purposes of Division 6B will also be excluded from the operation of paragraph 102T(2)(b).

By paragraph (4)(c) references in sub-sections (2) and (3) to a unit trust dividend includes a unit trust dividend within the meaning of Division 6B.

The practical effect of these measures is explained in the earlier notes on sub-section 102T(2).

Sub-section 102T(5) has the purpose of modifying the operation of section 221AC of the Principal Act to require the payment of instalments of tax by trustees of public trading trusts in the same manner as companies and corporate unit trusts are required to pay instalments of tax. By this sub-section, a liability to pay three instalments of tax will be imposed on a trustee of a public trading trust for the year of income that commenced on 1 July 1985 and for each subsequent year of income. In practical terms, instalments of tax will not be payable by a trustee of a public trading trust before the 1987-88 financial year on income of the 1986-87 income year.

Sub-section 102T(6) ensures that the definition of "year of income" in sub-section 6(1) of the Principal Act, as it applies to companies, will also apply to public trading trusts and to trustees of public trading trusts. The year of income of a company and, by reason of this provision, the year of income of a public trading trust, is the financial year immediately prior to the financial year for which income tax is levied.

By sub-section 102T(7) a reference to a company in certain provisions of the Principal Act is to be read as including a public trading trust or, where appropriate, the trustee of a public trading trust. The provisions of the Principal Act to which sub-section (7) will apply are -

- the definition of "person" in sub-section 6(1) (in this definition a person is defined to include a company);

- section 160AF, which provides for a credit against Australian tax on income derived in Papua New Guinea if tax has been paid in Papua New Guinea in respect of that income. The credit is not available, however, where the income is derived by a company and consists of dividends in respect of which the company is entitled to a rebate of tax under section 46 or 46A. The operation of section 160AF is to be modified so that the credit for Papua New Guinea tax will also be unavailable in respect of rebatable dividends derived from Papua New Guinea by a public trading trust; and

- Division 1A of Part VI, which requires the payment of instalments of tax by companies - the operation of this Division is to be modified to require the payment of instalments of tax by trustees of public trading trusts (as explained in the earlier notes on sub-section 102T(5)).

A reference to "the taxable income of a company except income in respect of which it is assessable as trustee" in section 158 of the Principal Act is, by the operation of <u>sub-section 102T(8)</u>, to include a reference to the net income of a public trading trust. Section 158 applies to exclude companies from the scope of the primary producer income averaging provisions, and the modification proposed will similarly exclude public trading trusts from their scope.

By <u>sub-section 102T(9)</u> the reference to "income tax that a company is liable to pay in the capacity of a trustee" in sub-section 221AA(1) of the Principal Act is not to include income tax that a trustee of a public trading trust is liable to pay in respect of the net income of the public trading trust. The effect of sub-section 221AA(1) is to exclude from the requirement to pay instalments of company tax a company that derives income in the capacity of a trustee. The modification proposed by sub-section (9), in conjunction with other provisions in section 102T, will require the payment of instalments of tax by trustees of public trading trusts.

<u>Sub-section 102T(10)</u> is to the effect that a trustee of a public trading trust is to be taken, for the purposes of sub-section 221YB(1) of the Principal Act, to be a company not being a company in the capacity of a trustee. Section 221YB imposes a liability to pay provisional tax on persons other than companies and on

companies in the capcity of a trustee. As the trustee of a public trading trust is to become liable to pay company tax instalments this sub-section will have the effect of excluding such a trustee from the liability to pay provisional tax.

By sub-section 102T(11) a reference in certain provisions of the Principal Act to a company or to a company that is a resident is to be read as including a prescribed trust estate or, where appropriate, the trustee of a prescribed trust estate. The provisions of the Principal Act to which this sub-section will apply are -

- paragraph 23(jb) to the extent that the paragraph exempts the income of a foreign superannuation fund that consists of dividends paid by a resident company;

- sub-section 44(1), which requires that dividends paid by a company be included in the assessable income of a shareholder. If the shareholder is a resident of Australia, dividends paid out of profits derived by the company from any source are included in the shareholder's assessable income. If the shareholder is a non-resident, only dividends paid out of profits derived by the company from Australian sources are included in the shareholder's assessable income. By the modification proposed to be made to sub-section 44(1) by sub-section (11), unit trust dividends paid to a unitholder in a prescribed trust estate will be included in the unitholder's assessable income. If the unitholder is a non-resident, only unit trust dividends paid out of profits derived by the trustee from Australian sources will be included in assessable income; and

- section 128B and Division 4 of Part VI, which relate to the imposition of dividend withholding tax in respect of dividends paid by a resident company to a non-resident shareholder. The modified operation of these provisions will impose the same requirements for the payment of withholding tax in respect of unit trust dividends paid to a non-resident unitholder.

Sub-section 102T(12) will require a reference to a dividend in certain provisions of the Principal Act to be read as including a unit trust dividend. The provisions of the Principal Act to which this sub-section will apply are -

- the definition of "paid" in sub-section 6(1) - this definition refers to the payment of dividends;

- paragraph 23(jb) (see previous notes in relation to sub-section (11));

- sub-section 44(1), which requires the inclusion of dividends in the assessable income of a shareholder (see earlier notes in relation to sub-section (11));

- section 116AA which applies for the purpose of ascertaining the amount of a rebate of tax to which a life assurance company is entitled under sections 46 and 46A of the Principal Act in relation to dividends included in its assessable income. In its modified application, section 116AA will also apply for the purpose of ascertaining the amount of a rebate of tax to which a life assurance company is entitled under sections 46 and 46A in relation to unit trust dividends included in its assessable income; and

- sections 128A and 128B and Division 4 of Part VI. The operation of these provisions, which relate to dividend withholding tax, will be modified to impose the same requirements for the payment of withholding tax in respect of unit trust dividends paid to a non-resident unitholder.

Sub-section 102T(13) will require a reference to a share in a company in sections 116AA and 221YL to be read as including a unit in a prescribed trust estate. The purpose of the modification to the operation of section 116AA has been discussed in the earlier notes relating to sub-section (12). Section 221YL deals with the payment of dividend withholding tax and, in its modified operation, will also apply in relation to the payment of withholding tax on unit trust dividends.

By sub-section 102T(14), a reference to a shareholder in a company in sub-section 44(1) is to be read as including a unitholder in a prescribed trust estate.

By sub-section 102T(15), a reference to taxable income of a company in Division 1A of Part VI (instalments of company tax) is to be read as including a reference to the net income of a public trading trust.

Sub-section 102T(16) will require that a reference to a trust estate or to a trustee in certain provisions in the Principal Act is not to be read as including a public trading trust or the trustee of a public trading trust. The provisions of the Principal Act concerned are section 6B, Division 6 of Part III and sub-sections 128A(3) and 157(3) each of which is concerned with the normal liability to tax imposed on trustees and beneficiaries of trust estates.

Public trading trusts and unitholders in prescribed trust estates are to be subject to the new basis of taxation provided for in these amendments and, accordingly, it is to be provided by sub-section (16) that the existing trust provisions will not apply to those public trading trusts and their unitholders.

Sub-section 102T(17) will modify the operation of paragraph 26(b) of the Principal Act. That paragraph requires the inclusion in assessable income of beneficial interests in income derived under certain instruments, including an instrument of trust. In its modified operation, paragraph 26(b) will not apply to beneficial interests in the income of a public trading trust.

Sub-section 102T(18) will require a reference to the register of members of a company in sub-section 221YL(1) of the Principal Act to be read as including any record of names or addresses of unitholders in a prescribed trust estate. Section 221YL requires a company to make a deduction, on account of dividend withholding tax, from a dividend paid to a shareholder shown in the register of members as having an address outside Australia. By reason of the modification proposed by sub-section (18), a deduction for withholding tax will also be required to be made from unit trust dividends paid to unitholders at addresses outside Australia.

Sub-section 102T(19) relates to the assessment of unit trust dividends paid to a unitholder in a prescribed trust estate. The purpose of the sub-section is to ensure that, in the application of sub-section 44(1) of the Principal Act in relation to unit trust dividends paid out of profits derived by the trustee, profits derived by the trustee of a public trading trust will be characterised as profits notwithstanding that the profits are, or might become, part of the corpus of the trust estate.

Sub-section 102T(20) relates to the liability for withholding tax on unit trust dividends under section 128B of the Principal Act. In its present form, section 128B applies to income comprising dividends derived by a non-resident on or after 1 January 1968. By this sub-section, a unit trust dividend will be deemed, for the purposes of section 128B, to be income derived by a unitholder at the time at which the unit trust dividend is paid.

Clause 17 : Rebate in respect of certain pensions

Section 160AAA of the Principal Act provides for a rebate of tax for low income taxpayers who are in receipt of certain pensions, allowances or benefits under Social Security or Repatriation legislation. As mentioned in the notes on clause 5 of the Bill, the Veterans' Entitlements Bill 1985 will repeal certain Repatriation statutes and replace them with a consolidated Act - the Veterans' Entitlements Act 1985.

This clause will omit paragraphs (a) to (d) inclusive from sub-section 160AAA(1) that refer to Repatriation Acts that are to be repealed, and will insert a new paragraph - paragraph (a) - that refers to the proposed Veterans' Entitlements Act, which is to come into operation on 5 December 1985.

Reflecting this, the amendment proposed by this clause will, by sub-clause 2(4) of the Bill, commence on the same day.

Clause 18 : Rebate in respect of amounts assessable under section 26AH

Section 160AAB of the Principal Act authorises a rebate of tax in respect of bonuses, and other amounts in the nature of bonuses, received under life assurance policies and included in assessable income by virtue of section 26AH of the Principal Act. As explained in the Main Features part of this Explanatory Memorandum, section 26AH includes in assessable income bonuses and similar amounts paid on certain life assurance policies issued after 27 August 1982 and, depending on the date of commencement of a policy, applies to such amounts received either during the first 4 years or during the first 10 years of the policy. The section 160AAB rebate applies where the policy is one issued by a life assurance company, the investment income of which is subject to income tax, or by a friendly society. This rebate effectively compensates for income tax that has been paid to the Commonwealth by a life insurance company on its investment income or by a friendly society in respect of its life assurance business.

Clause 18 proposes two amendments of section 160AAB. First, it will amend section 160AAB to extend the application of that section to life assurance policies issued by certain State government insurance offices that are treated as public authorities under the income tax law and are exempt from income tax. Although so exempt, the insurance offices in question - those in New South Wales, Queensland and South Australia - are required to pay to their respective State Treasuries an amount equal to the Commonwealth income tax that would be payable if they were not exempt. This requirement, coupled with the non-availability of the rebate in respect of their policies, can have an adverse affect on the competitive position between those State insurance offices and private sector insurance companies. In return for extending the operation of section 160AAB as proposed, the relevant State Governments have agreed to re-imburse the Commonwealth for the revenue forgone by allowing the rebate.

The second of the proposed amendments will correct a technical deficiency in section 160AAB, which has the unintended effect of denying taxable superannuation funds and ineligible (taxable) approved deposit funds the benefit of the rebate.

Paragraph (a) of clause 18 is a drafting measure to accommodate the insertion, by paragraph (b) of the clause, of new paragraphs 160AAB (1)(c), (d) and (e).

New paragraphs 160AAB(1)(c), (d) and (e) extend the meaning of "eligible 26AH amount" (that is, an amount in respect of which the section 160AAB rebate is available) to include relevant amounts paid on policies issued by the Government Insurance Office of New South Wales, the State Government Insurance Office (Queensland) or the State Government Insurance Commission of South Australia. At present, these are the only State insurance offices that offer life assurance policies in respect of which amounts may be included in assessable income of a year of income under section 26AH.

Paragraph (c) of clause 18 proposes the insertion of new sub-section 160AAB(5A). Sub-section (5A) will extend availability of the rebate to the trustee of a taxable superannuation fund or an ineligible (taxable) approved deposit fund. The terms "superannuation fund" and "ineligible approved deposit fund" used in new sub-section (5A) have the same meaning as those terms have in Division 9B of the Principal Act. The new sub-section specifies the rebate allowable to be an amount equal to 30% of any "eligible 26AH amount" (see notes above on new paragraph 160AAB(1)(c), (d) and (e)) included in the assessable income of the superannuation fund or ineligible approved deposit fund.

By the operation of sub-clause 23(8), each of these amendments will first apply to income tax assessments for the year of income in which 28 August 1982 (the effective commencement date of section 160AAB) occurred. In respect of taxable amounts received by trustees of taxable superannuation funds and approved deposit funds from private sector life insurance companies, and by any taxpayer from the nominated State Government insurance offices, the rebate will generally be available in the 1982-83 and all subsequent income years. As 1 July 1983 was the earliest date from which the rebate was allowable in respect of taxable amounts received from friendly societies, the rebate will generally be available to trustees of taxable superannuation and approved deposit funds in respect of those amounts in the 1983-84 and all subsequent income years.

Clause 19: Amendment of Assessments

The general rules governing the amendment of income tax assessments are laid down in section 170 of the Principal Act, which contains certain limitations on the power of the Commissioner of Taxation to amend assessments. Sub-section (10) of the section authorises the re-opening of assessments at any time, without the limitations usually applying to the making of amended assessments and either to increase or reduce liability, where this is necessary to give effect to specified provisions of the Principal Act.

Clause 19 of the Bill will insert in sub-section 170(10) a reference to new Subdivision F of Division 3 of Part III - Substantiation of certain expenses - being inserted by clause 14, to ensure that the Commissioner has authority to re-open income tax assessments where that becomes necessary to give effect to its provisions.

Clause 20 : Interpretation

This clause will amend section 251R of the Principal Act, an interpretative provision which ascribes particular meanings to words and expressions used in Part VIIB of the Principal Act that relates to the Medicare levy.

The expression 'Repatriation Acts', which is defined in existing sub-section 251R(1) as meaning any one of several specified Repatriation Acts, including the Seamen's War Pensions and Allowances Act 1940, is used in Part VIIB - in paragraph 251U(1)(b) of the Principal Act. As the several Repatriation Acts presently referred to in that definition (other than the Seamen's War Pensions and Allowances Act) are to be replaced by a single Act - the Veterans' Entitlements Act 1985 - it is no longer necessary to define the expression 'Repatriation Acts'. It is proposed to simply refer to the Veterans' Entitlements Act and the Seamen's War Pensions and Allowances Act in paragraph 251U(1)(b) - see notes on the following clause.

This clause will therefore remove the present definition of 'Repatriation Acts' from sub-section 251R(1).

By sub-clause 2(4) of the Bill, this amendment will come into operation on the same day as the Veterans' Entitlements Act.

Clause 21 : Prescribed persons

By section 251U of the Principal Act, certain persons are exempt from payment of the Medicare levy if they are a "prescribed person" as defined in that section. For example, by virtue of paragraph 251U(1)(b), a repatriation beneficiary is a prescribed person if entitled to full free medical treatment under any of the "Repatriation Acts" - a term defined by sub-section 251R(1) of the Principal Act.

As indicated in the notes on clause 20 of the Bill, it is proposed to remove that definition as a consequence of the proposed repeal of several Repatriation Acts and the consolidation of their provisions into the Veterans' Entitlements Act 1985.

This clause will therefore remove the reference to the term 'Repatriation Acts' in paragraph 251U(1)(b), and replace it with a reference to the actual Acts which may give rise to an entitlement to full free medical treatment, i.e., the proposed Veterans' Entitlements Act and the Seamen's War Pensions and Allowances Act. This amendment will not disturb the practical operation of paragraph 251U(1)(b).

This amendment by virtue of sub-clause 2(4) of the Bill, will apply from the same day as the Veterans' Entitlements Act comes into operation.

Clause 22 : Release of liability of members of the Defence Force on death

Section 265A of the Principal Act operates to grant relief where tax instalment deductions made from the pay and allowances of a deceased member of the Defence Force are insufficient to meet the tax liability in relation to that member's service income.

This clause will effect a number of technical changes to the language of section 265A to incorporate appropriate references to the Veterans' Entitlements Act 1985 in lieu of the various statutes which that Act will replace. The amendments do not affect the practical operation of section 265A of the Principal Act.

The Veterans' Entitlements Act is to come into operation on 5 December 1985 and, by sub-clause 2(4) of the Bill, the amendment proposed by this clause will commence to apply on the same day.

Clause 23 : Application of amendments

This clause, which will not amend the Principal Act, specifies the years of income in which, or the dates from which the various amendments proposed in the Bill will first apply. An explananation of the application provisions is contained in the notes on the clauses to which each of the sub-clauses of clause 23 apply.

Clause 24 : Amendment of assessments

Clause 24, which will not amend the Principal Act, is a standard measure that will ensure that the Commissioner of Taxation has authority to re-open an income tax assessment made before the Bill becomes law if that should be necessary in order to give effect to the various amendments the Bill contains.

PART III - AMENDMENTS OF THE INCOME TAX (INDIVIDUALS) ACT 1985

Introductory Note

The amendments proposed in Part III of the Bill to the Income Tax (Individuals) Act 1985 will exclude from the operation of that Act (which imposes the tax payable by individuals and trustees generally), a person in the capacity of a trustee of a public trading trust. A trustee of such a trust is, by the proposal contained in clause 16 of the Bill, to be subject to the same tax arrangements as companies and trusts that are corporate unit trusts under Division 6B of Part III of the Income Tax Assessment Act 1936 (the "Assessment Act").

The tax payable by the trustee of a public trading trust will be imposed by the accompanying Income Tax (Companies, Corporate Unit Trusts and Superannuation Funds) Amendment Bill 1985.

Clause 25 : Principal Act

This clause facilitates reference to the Income Tax (Individuals) Act 1985 which, for the purposes of Part III of the Bill, is referred to as the "Principal Act".

Clause 26 : Title

By this clause, the long title of the Principal Act will be amended to change the reference to "corporate unit trusts" to "prescribed unit trusts". A definition of "prescribed unit trust" will be included in section 3 of the Principal Act by an amendment proposed by clause 27.

Clause 27 : Interpretation

This clause will amend sub-section 3(1) of the Principal Act to omit the definition of "corporate unit trust" (paragraph (a)) and to insert a definition of "prescribed unit trust" (paragraph (b)). The term "prescribed unit trust" is to mean a corporate unit trust within the meaning of Division 6B of Part III of the Assessment Act, or a public trading trust within the meaning of the Division 6C of Part III which is proposed to be inserted in the Assessment Act by clause 16 of this Bill.

Clause 28 : Imposition of income tax

Clause 28 will amend the Principal Act by substituting a reference to prescribed unit trust for the reference to corporate unit trust in paragraph 5(2)(c) of the Principal Act. By this change, the Principal Act will not impose tax payable by the trustee of a public trading trust. The tax on such a trustee will instead be declared and imposed by virtue of an amendment of the Income Tax (Companies, Corporate Unit Trusts and Superannuation Funds) Act 1985.

PART IV - AMENDMENTS OF THE INCOME TAX (INTERNATIONAL AGREEMENTS) ACT 1953

Introductory Note

The amendments to be made to the Income Tax (International Agreements) Act 1953 by clauses 29 to 32 of the Bill are in consequence of the proposals for taxing the net income of public trading trusts, and unit trust dividends paid to unitholders of prescribed trust estates, as contained in clause 16 of Part II of the Bill.

By way of background, the Income Tax (International Agreements) Act 1953 gives statutory effect to the various comprehensive taxation agreements entered into by Australia with other countries for the purposes of avoiding double taxation of income flowing between Australia and those countries and for preventing fiscal evasion.

Two main aspects of the operation of the Income Tax (International Agreements) Act are affected by Part IV of this Bill. The first concerns the credit for foreign tax paid on dividends derived by an Australian company in respect of which a rebate of tax is also allowable under section 46 or 46A of the Income Tax Assessment Act. As the rebate already provides relief from Australian tax on these dividends, no credit is available for the foreign tax paid. The amendments proposed by this Part will also ensure that credit is not available for the foreign tax on rebatable dividends derived by a public trading trust.

The other matter concerns the rate of dividend withholding tax imposed on Australian dividends paid to a resident of a country with which Australia has concluded a comprehensive taxation agreement. The normal rate of withholding tax on dividends is 30%, with a reduced rate, generally 15%, applicable to dividends paid to a resident of an agreement country. It is proposed that the same reduced rate be applicable to unit trust dividends paid by a public trading trust to a resident of an agreement country.

Clause 29 : Principal Act

This clause facilitates references to the Income Tax (International Agreements) Act 1953 which, for the purposes of Part IV of the Bill, is referred to as the "Principal Act".

Clause 30 : Interpretation

This clause proposes a number of amendments to section 3 of the Principal Act. Paragraph 30(a) proposes to insert in sub-section 3(1) of the Principal Act a definition of "prescribed trust estate" which is to mean a corporate unit trust under Division 6B of Part III of the Income Tax Assessment Act 1936, or a public trading trust under Division 6C of Part III of that Act (to be inserted in that Act by clause 16 in Part II of this Bill).

Reflecting the above change paragraphs 30(b) and (c) will omit the references to a corporate unit trust in sub-sections 3(4) and 3(11) of the Principal Act, and replace them with references to a "prescribed trust estate". In similar fashion, paragraph 30(d) will omit the definition of "corporate unit trust" from sub-section 30(12) of the Principal Act as a consequence of the insertion of the definition of "prescribed trust estate" in sub-section 3(1).

Clause 31 : Ascertainment of Australian tax

Section 15 of the Principal Act operates to calculate the amount of Australian tax payable in respect of a particular part of a taxpayer's income for the purposes of the application of a double taxation agreement provision or for any purpose of the Principal Act.

Sub-section 15(5A) of the Principal Act presently determines that where a part of the income of a trust estate that is a corporate unit trust within the meaning of Division 6B of Part III of the Income Tax Assessment Act 1936, consists of dividends in respect of which a trustee is entitled to a rebate under section 46 or 46A of that Act, then for the purposes of section 15 there shall be deemed to be no Australian tax paid on the dividends.

The amendment proposed by clause 31 will bring rebatable dividends received by a public trading trust within the scope of sub-section 15(5A) of the Principal Act so that, for the purposes of the Principal Act, no credit will be available for foreign tax paid on the dividends.

Clause 32 : Withholding Tax

Section 17A of the Principal Act limits the amount of withholding tax payable on dividends paid to a resident of an agreement country. By clause 32 it is proposed to omit existing sub-section 17A(3) of the Principal Act and substitute a new sub-section 17A(3) so that any reduced rate of withholding tax will also apply to a unit trust dividend paid by the trustee of a public trading trust.

PART V - AMENDMENTS OF THE INCOME TAX (RATES) ACT 1982

Introductory Note

This Act declares the rates of tax payable by individuals and certain trustees. The amendments proposed by this Part of the Bill are consequential on the proposal contained in clause 16 of the Bill to extend company tax arrangements to public unit trusts that operate a trade or business. The amendments will ensure that these public unit trusts, like companies and corporate unit trusts under Division 6B of Part III of the Income Tax Assessment Act 1936 (the "Assessment Act"), are excluded from the operation of the Income Tax (Rates) Act 1982.

The imposition and rate of the tax on trustees of public trading trusts are to be provided for by the accompanying Income Tax (Companies, Corporate Unit Trusts and Superannuation Funds) Amendment Bill 1985.

Clause 33 : Principal Act

This clause facilitates references to the Income Tax (Rates) Act 1982 which, for the purposes of Part V of the Bill, is referred to as "the Principal Act".

Clause 34 : Title

This clause will amend the long title of the Principal Act by substituting the word "prescribed" for the word "corporate", to indicate that the Act will no longer apply to both corporate unit trusts and public trading trusts.

Clause 35 : Interpretation

Paragraph 35(a) will insert in section 3 of the Principal Act a definition of "prescribed unit trust". A unit trust will be a prescribed unit trust if it is either a corporate unit trust within the meaning of Division 6B of Part III of the Assessment Act or it is a public trading trust within the meaning of proposed Division 6C of Part III of the Assessment Act as proposed to be inserted in that Act by clause 16 of this Bill.

Paragraph 35(b) will exclude from paragraph (b) of the definition of "tax" in sub-section 3(1) of the Principal Act, the reference to a "corporate unit trust", and replace it with the term "prescribed unit trust" that, by the amendment made by paragraph (a) of this clause, encompasses both a corporate unit trust and a public trading trust. The effect will be to exclude both categories of trusts from the operation of the Principal Act.

INCOME TAX (COMPANIES, CORPORATE UNIT TRUSTS AND SUPERANNUATION FUNDS) AMENDMENT BILL 1985

Introductory Note

This Bill will effect the changes necessary to the Income Tax (Companies, Corporate Unit Trusts and Superannuation Funds) Act 1985 to take account of the extension of company tax arrangements to certain public unit trusts operating a trade or business. The practical effect of this Bill is to formally declare and impose the rate of tax payable by the trustees of a relevant public trading trust in accordance with the provisions of section 102S to be inserted in the Income Tax Assessment Act 1936 by clause 16 of the accompanying Taxation Laws Amendment Bill (No.4) 1985.

Clause 1 : Short title, etc.

The proposed Act is to be cited as the Income Tax (Companies, Corporate Unit Trusts and Superannuation Funds) Amendment Act 1985. This clause also provides formally for the Income Tax (Companies, Corporate Unit Trusts and Superannuation Funds) Act 1985 to be referred to as "the Principal Act" in the amending Act.

Clause 2 : Commencement

By this clause it is proposed that the Bill will come into operation on the day on which it receives Royal Assent.

Clause 3 : Title

By clause 3 of the Bill the long title of the Principal Act will be amended (by substituting the word "prescribed" for the word "corporate") in recognition that the Principal Act will in future apply to both corporate unit trusts and public trading trusts.

Clause 4 : Short Title

Clause 4 of the Bill is to the same general effect as the amendment proposed by clause 3. It will amend the short title of the Principal Act in section 1 to also substitute the word "Prescribed" for the word "Corporate".

Clause 5 : Interpretation

By clause 5, two new definitions are to be inserted into section 3 of the Principal Act -

- "prescribed unit trust", which will encompass both a corporate unit trust, as already defined in the Principal Act by reference to Division 6B of Part III of the Income Tax Assessment Act 1936, and a public trading trust, as proposed to be separately defined in that Act;

- "public trading trust" is to mean a public trading trust within the meaning of Division 6C of Part III of the Income Tax Assessment Act 1936, proposed to be inserted in that Act by clause 16 of the accompanying Taxation Laws Amendment Bill (No. 4) 1985.

Clause 6 : Imposition of income tax

Sub-section 5(3) of the Principal Act lists those persons on whom the Principal Act does not impose tax, including certain trustees. The amendment proposed by this clause will ensure that the trustee of a public trading trust, whether a natural person or a company, is not so excluded.

Clause 7 : Rate of tax payable by trustees of public unit trusts

The trustee of a public trading trust to whom Division 6C of Part III of the Income Tax Assessment Act 1936 is to apply in a relevant year of income, is to be liable to pay tax on the net income of the trust at the rate of tax declared by the Parliament. This clause formally imposes this rate as 46%, in line with the present general company tax rate.

Clause 8 : Instalments of tax

This clause will amend section 14 of the Principal Act to ensure that the trustee of a public trading trust is liable to pay instalments of tax in the same way as instalments are paid by companies and corporate unit trusts.

Clause 9 : Application of amendments

By this clause, the amendments made by the Bill to impose and declare the rate of tax on public trading trusts have effect only for the purposes of the application of sub-section 12(2) of the Principal Act to income of the 1985-86 financial year - the first year in relation to which any tax would be payable by a trustee of an affected trust.

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