Tax Laws Amendment (2012 Measures No. 6) Bill 2012

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## Glossary

The following abbreviations and acronyms are used throughout this Bills Digest.

<table>
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<tr>
<th>Abbreviation</th>
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<tr>
<td>AWOTE</td>
<td>average weekly ordinary time earnings</td>
</tr>
<tr>
<td>CERD</td>
<td>International Convention on the Elimination of All Forms of Racial Discrimination</td>
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<tr>
<td>CGT</td>
<td>capital gains tax</td>
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<tr>
<td>CPI</td>
<td>consumer price index</td>
</tr>
<tr>
<td>DGR</td>
<td>deductible gift recipient</td>
</tr>
<tr>
<td>FBTAA</td>
<td>Fringe Benefits Tax Assessment Act 1986</td>
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<tr>
<td>FBT</td>
<td>fringe benefit tax</td>
</tr>
<tr>
<td>FMD</td>
<td>Farm Management Deposit</td>
</tr>
<tr>
<td>GST</td>
<td>goods and services tax</td>
</tr>
<tr>
<td>ICCPR</td>
<td>International Covenant on Civil and Political Rights</td>
</tr>
<tr>
<td>ICESCR</td>
<td>International Covenant on Economic, Social and Cultural Rights</td>
</tr>
<tr>
<td>ILUA</td>
<td>Indigenous Land Use Agreement</td>
</tr>
<tr>
<td>ITAA 1936</td>
<td>Income Tax Assessment Act 1936</td>
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<table>
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<th>Description</th>
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<tbody>
<tr>
<td>ITAA 1997</td>
<td><em>Income Tax Assessment Act 1997</em></td>
</tr>
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<td>MITs</td>
<td>managed investment trusts</td>
</tr>
<tr>
<td>NANE income</td>
<td>non-assessable non-exempt income</td>
</tr>
<tr>
<td>NMETO</td>
<td>net medical expenses tax offset</td>
</tr>
<tr>
<td>NTA</td>
<td><em>Native Title Act 1993</em></td>
</tr>
<tr>
<td>One Laptop</td>
<td>One Laptop per Child Australia Ltd</td>
</tr>
<tr>
<td>the new MIT regime</td>
<td>the new tax system for MITs</td>
</tr>
<tr>
<td>TLA No. 5 2011</td>
<td><em>Tax Laws Amendment (2011 Measures No. 5) Act 2011</em></td>
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<td>Yachad</td>
<td>Yachad Accelerated Learning Project Limited</td>
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Tax Laws Amendment (2012 Measures No. 6) Bill 2012

Date introduced: 29 November 2012

House: House of Representatives

Portfolio: Treasury

Commencement: The commencement and application of the measures in each Schedule is indicated in the key provisions section of this Bills Digest.

Links: The links to the Bill, its Explanatory Memorandum and second reading speech can be found on the Bill’s home page, or through http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation. When Bills have been passed and have received Royal Assent, they become Acts, which can be found at the ComLaw website at http://www.comlaw.gov.au/.

Purpose of the Bill

There are eight Schedules to this Bill and the purpose of the measures in each Schedule is briefly as follows:

Schedule 1 amends the Income Tax Assessment Act 1997 (ITAA 1997) and the Income Tax Assessment Act 1936 (ITAA 1936) to clarify that native title benefits are not subject to income tax, including capital gains tax (CGT).

Schedule 2 amends the list of deductible gift recipients (DGRs) identified by name in Division 30 of the ITAA 1997. It adds two new entities as DGRs and extends the listing of three other entities.

Schedule 3 amends the ITAA 1997 to extend the immediate deductibility of exploration expenditure provided to mining and petroleum explorers to geothermal energy explorers.

Schedule 4 amends Schedule 2 of the Tax Laws Amendment (2011 Measures No. 5) Act 2011 (TLA No. 5 2011) to extend until the end of the 2013–14 income year, the exemption from the interim streaming rules which was granted to managed investment trusts (MITs) and certain trusts treated as MITs.

Schedule 5 amends the ITAA 1936 to apply an income test to the net medical expenses tax offset (NMETO) from 1 July 2012.

Schedule 6 amends the limited recourse debt (LRD) provisions in the ITAA 1997 to ensure that the definition of LRD includes arrangements where the debtor is not fully at risk, in substance or in effect, in relation to the debt. These amendments ensure that tax deductions are not available for capital expenditure on assets which are financed by LRD, to the extent that the taxpayer is not effectively at risk for the expenditure and does not make an economic loss.

Schedule 7 amends the Fringe Benefits Tax Assessment Act 1986 (FBTAA) to remove the concessional treatment of ‘in-house’ fringe benefits that are purchased through salary sacrificing.

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Schedule 8 makes miscellaneous amendments to taxation laws and regulations.

Structure of the Bill

This Bill has eight Schedules and each Schedule deals with discrete amendments to various tax laws. This Bill’s Digest will consider the background, financial implications, compatibility with human rights, key provisions, commencement and application of the proposed amendments in each Schedule separately.

Committee consideration

The Bill has been referred to the House of Representatives Standing Committee on Economics for inquiry and at the time of writing the committee had not yet published its report.¹

The Bill has not yet been considered by the Senate Standing Committee for the Scrutiny of Bills or the Parliamentary Joint Committee on Human Rights.

Schedule 1—Tax treatment of native title benefits

Background

On 6 June 2012, the Attorney-General announced at the Australian Institute of Aboriginal and Torres Strait Islander Studies Native Title Conference that amendments would be made to tax law to ensure that native title benefits are not subject to income tax, including capital gains tax. The announcement was confirmed in a joint media release by the Attorney-General and the Minister for Families, Communities and Indigenous Affairs on the same date.²

Financial implications

The Explanatory Memorandum states that the financial impact of this measure is not zero, but rounded to zero, in each of the income years 2012–13 to 2015–16.³

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² N Roxon (Attorney-General and Minister for Emergency Management) and J Macklin (Minister for Families, Communities and Indigenous Affairs), The future of native title, joint media release, 6 June 2012, viewed 6 January 2013, http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressrel%2F1693291%22

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Statement of Compatibility with Human Rights

As required under Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011 (Cth), the Government has assessed the Bill’s compatibility with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of that Act. This assessment has been done independently for each Schedule. The Government considers that Schedule 1 to the Bill ‘is compatible with human rights because it advances the protection of human rights and to the extent that it may also limit human rights, those limitations are reasonable, necessary and proportionate’. 4

Key issues and provisions

Definition of native title benefits

Item 8 of Schedule 1 inserts ‘native title benefit’ into the Dictionary provision in subsection 995-1(1) of the ITAA 1997 and states that it has the same meaning as in proposed subsection 59-50(5) of the ITAA 1997, inserted by item 3 of Schedule 1.5 Proposed subsection 59-50(5) provides that a ‘native title benefit’ is an amount, or a non-cash benefit that:

- arises under an agreement made under an Act of the Commonwealth, state or territory, or under an instrument made under such an Act, or an ancillary agreement to such an agreement, to the extent that the amount or benefit relates to an act that would extinguish native title or that would otherwise be wholly or partly inconsistent with the continued existence, enjoyment or exercise of native title (proposed paragraph 59-50(5)(a)) or
- is compensation determined in accordance with Division 5 of Part 2 of the Native Title Act 1993 (NTA) (proposed paragraph 59-50(5)(b)).6

The Explanatory Memorandum provides a number of examples to illustrate this definition.7

Tax treatment of native title benefits

Proposed subsections 59-50(1) and (2) of the ITAA 1997 provide that, to the extent that:

- a native title benefit (as defined in proposed subsection 59-50(5) or
- an amount, or other benefit, that arises directly or indirectly from a native title benefit

would otherwise be included in assessable income under tax law, it is not assessable income and is not exempt income if received by an Indigenous person or an Indigenous holding entity.

Income that is non-assessable non-exempt (NANE) income is income on which no tax is payable. Further, it does not affect a person’s tax losses.8

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The Explanatory Memorandum provides a number of examples of the tax treatment of native title benefits.9

Capital gains tax implications of transfers of native title rights

Proposed section 118-77 of the ITAA 1997, inserted by item 4 of Schedule 1, provides that there are no CGT implications (that is no capital gain, or capital loss, is taken to occur) for an Indigenous person10 or an Indigenous holding entity:

• who transfers a native title right (or the right to a native title benefit) to an Indigenous holding entity or to an Indigenous person
• who creates a trust, that is an Indigenous holding entity, over such rights or
• whose ownership of the right ends.

Position of major interest groups

Treasury released Schedule 1 as a separate exposure draft titled Tax treatment of native title benefits on 6 June 2012, and received 20 submissions.11 This exposure draft was built on the results of the consultation paper Native title, Indigenous Economic Development and Tax, which was released for public comment between 18 May 2010 and 30 December 2010.12 According to the summary of the exposure draft consultation process:

There was strong support in submissions made to the 2010 consultation paper for clarifying that certain native title benefits are not subject to income tax.

Most submissions to the exposure draft supported the intent of the measure, but raised technical issues or sought to expand the application of the measure to other types of payments or activities.


8. Australian Taxation Office (ATO), ‘Amounts that you do not pay tax on 2012’, explains the difference between exempt income, non-assessable non-exempt income (NANE) and other amounts that are not taxable, ATO website, viewed 6 January 2013, http://www.ato.gov.au/content/00314010.htm
10. A definition of ‘Indigenous person’ will be inserted into the Dictionary at subsection 995-1(1) of the ITAA 1997 by item 6 of Schedule 1. The definition reflects the definitions of ‘Aboriginal peoples’ and ‘Torres Strait Islander’ in section 253 of the NTA.
Suggestions to expand the application of the measure would be contrary to the intent of the measure, which is to clarify the tax treatment of certain native title benefits by confirming that they are not subject to income tax, and as such were not adopted.\textsuperscript{13}

For example, the National Native Title Council (NNTC) argued in its submission that given the varied nature of native title agreements, more certainty was required that benefit sharing arrangements would receive NANE income treatment. It also requested that investment income derived from investing a native title benefit be tax exempt. Further, the NNTC maintained that agreements made between parties as if native title rights existed (known as ‘as if’ agreements) should also be tax exempt.\textsuperscript{14}

The Western Australian Government submission also recognised the complexity of native title agreements, but instead argued for a ‘normalisation’ of the tax treatment of native title whereby payments to individuals continue to be subject to income tax and payments to businesses only be exempt if their activities fall within current arrangements for charitable status.\textsuperscript{15}


Commencement and application

Item 2 of the table in clause 2 of the Bill states that Schedule 1 commences on Royal Assent.

Subitem 9(1) of Schedule 1 provides that the amendments made by items 1, 2 and 3 of Schedule 1 apply in relation to income years starting on or after 1 July 2008.

Subitem 9(2) of Schedule 1 provides that the amendment made by item 4 of Schedule 1 applies in relation to CGT events happening on or after 1 July 2008. As the EM notes, the retrospectivity of items 1 to 4 of Schedule 1 provide certainty and more favourable outcomes for taxpayers.\textsuperscript{17}


\textsuperscript{14} National Native Title Council (NNTC), *Submission: exposure draft materials to provide clarity on the tax treatment of native title benefits joint submission*, NNTC, 30 August 2012, viewed 6 January 2013, http://treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/2012/Tax%20treatment%20of%20native%20title%20benefits/Submissions/PDF/National_Native_Title_Council.ashx


\textsuperscript{17} Explanatory Memorandum, op. cit., p. 3.

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Schedule 2—Deductible gift recipients

Background

Organisations with deductible gift recipient status (DGRs) can receive income tax deductible donations. DGRs can be endorsed under the ITAA 1997 under a number of general categories or can be specifically listed in Division 30 of that Act. The income tax law allows deductions for taxpayers who make gifts of $2 or more to DGRs.

The proposed amendments give effect to previously announced measures. The listing of AE1 Incorporated was announced in the 2011–12 Mid-Year Economic and Fiscal Outlook (MYEFO). The listing of Teach for Australia was announced in the 2012–13 MYEFO. The time extension of One Laptop per Child Australia Ltd was announced in the 2012–13 Budget. The time extensions of Australia for UNHCR and Yachad Accelerated Learning Project Ltd were announced in the 2012–13 MYEFO.

Financial impact

The Explanatory Memorandum to the Bill states that the amendments are expected to have the impacts indicated in the table below.18

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<tr>
<th></th>
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<tbody>
<tr>
<td>AE1 Incorporated</td>
<td>−$0.8m</td>
<td>−$0.8m</td>
<td>−$0.8m</td>
<td>Nil</td>
</tr>
<tr>
<td>Australia for UNHCR</td>
<td>Nil</td>
<td>−$6.3m</td>
<td>−$7.0m</td>
<td>−$7.8m</td>
</tr>
<tr>
<td>One Laptop per Child Australia Ltd</td>
<td>Nil</td>
<td>−$0.1m</td>
<td>−$0.1m</td>
<td>−$0.1m</td>
</tr>
<tr>
<td>Teach for Australia</td>
<td>Nil</td>
<td>−$0.2m</td>
<td>−$0.2m</td>
<td>−$0.3m</td>
</tr>
<tr>
<td>Yachad Accelerated Learning Project Ltd</td>
<td>Nil</td>
<td>−$0.1m</td>
<td>−$0.1m</td>
<td>−$0.1m</td>
</tr>
<tr>
<td>Total</td>
<td>−$0.8m</td>
<td>−$7.5m</td>
<td>−$8.2m</td>
<td>−$8.3m</td>
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Human rights implications

The Statement of Compatibility with Human Rights included in the Explanatory Memorandum states that the Government considers that Schedule 2 is compatible with human rights as it does not raise any human rights issues.19

Key provisions

Listing of ‘Teach for Australia’ and ‘AE1 Inc’ as DGRs

Item 3 of Schedule 2 inserts proposed item 2.2.41 in the table in subsection 30-25(2) of the ITAA 1997 to list ‘Teach for Australia’ as a DGR. This table sets out specific education recipients who are listed as DGRs. Item 3 also specifies that taxpayers are able to claim deductions for gifts made to ‘Teach for Australia’ after 31 December 2012.

Item 4 of Schedule 2 inserts proposed item 9.2.9 in the table in subsection 30-80(2) of the ITAA 1997 to list ‘AE1 Inc’ as a DGR. This table sets out specific international affairs recipients who are listed as DGRs. Item 4 also specifies that taxpayers are able to claim deductions for gifts made to ‘AE1 Inc’ after 25 September 2011 and before 26 September 2014.

Extending DGR listing of ‘Australia for UNHCR’ indefinitely

‘Australia for UNHCR’ is currently listed as a DGR under item 9.2.10 in the table in subsection 30-80(2) of the ITAA 1997, which deals with specific international affairs recipients. The special conditions relating to item 9.2.10 provide that taxpayers are able to claim deductions for gifts made to ‘Australia for UNHCR’ after 27 June 2007 and before 28 June 2012. Item 5 of Schedule 2 amends these special conditions by omitting the words ‘and before 28 June 2012’ so that item 9.2.10 will apply indefinitely to all gifts made to ‘Australia for UNHCR’ at any time after 27 June 2007.

Extending the listing of ‘Yachad Accelerated Learning Project Limited’ and ‘One Laptop per child Australia Ltd’ for a limited period

‘Yachad Accelerated Learning Project Limited’ (Yachad) is currently listed as a DGR under item 2.2.34 in the table in subsection 30-25(2), which as set out above, deals with specific education recipients. The special conditions relating to item 2.2.34 require that, to be deductible by the taxpayer, the gift must be made to Yachad ‘after 29 June 2005 and before 1 July 2012’. Item 1 of Schedule 2 amends the special conditions by changing the latter date, so that the listing of Yachad is extended to 1 July 2015.

‘One Laptop per Child Australia Ltd’ (One Laptop) is currently listed as a DGR under item 2.2.38 in the table in subsection 30-25(2). The special conditions relating to item 2.2.38 require that, to be deductible by the taxpayer, the gift must be made to One Laptop ‘after 26 May 2010 and before 1


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July 2012’. Item 2 of Schedule 2 amends the special conditions by changing the latter date, so that the listing of One Laptop is extended to 1 July 2016.

**Commencement and application**

Item 2 of the table in clause 2 of the Bill states that Schedule 2 commences on Royal Assent.

The application of the amendments made by Schedule 2 has been indicated under the key provisions above.

**Schedule 3—Geothermal energy**

**Background**

Geothermal energy is heat energy contained or stored in rock, water or any other material that occurs within the Earth. It has the potential to be used for the generation of electrical power in a largely emissions-free manner.\(^{20}\)

Currently, tax law does not extend the same concessions given to mining and petroleum exploration to geothermal energy exploration.

The Policy Transition Group, which reported on the design of the Mineral Resource Rent Tax, recommended that tax law should be amended to include geothermal energy exploration into the wider definition of ‘exploration and prospecting’.\(^{21}\)

On 24 March 2011, the Minister for Resources, Energy and Tourism announced that tax law would be amended to extend the immediate deductibility of exploration expenditure currently available to mining and petroleum explorers to geothermal energy explorers.\(^{22}\)

Broadly, the amendments proposed in Schedule 3 will enable geothermal energy explorers to immediately deduct applicable exploration or prospecting expenditure on or after 1 July 2012 on the same basis as the deductions available to explorers traditionally prospecting for minerals.\(^{23}\)

**Financial impact**

The Explanatory Memorandum states that the measure will have the following revenue implications.\(^{24}\)

\[\text{Explanatory Memorandum, op. cit., paragraph 3.3, p. 31.}\]

\[\text{Ibid., paragraph 3.7, p. 32.}\]

\[\text{Policy Transition Group, Report to the Australian Government – minerals and petroleum exploration, December 2010, viewed 8 January 2013,}\]


\[\text{M Ferguson (Minister for Resources, Energy and Tourism), Tax deduction a major boost for geothermal energy in Australia, media release, 24 March 2011, viewed 8 January 2013,}\]

\[\text{http://minister.ret.gov.au/MediaCentre/MediaReleases/Pages/TaxDeductionAMajorBoostforGeothermalEnergyInAustralia.aspx}\]

\[\text{Explanatory Memorandum, paragraph 3.8, p. 32.}\]
Human rights implications

The Statement of Compatibility with Human Rights, included with the Explanatory Memorandum, states that the Government considers that this Schedule does not raise any human rights issues.25

Key provisions

Definitions of ‘geothermal energy resources’ and ‘geothermal energy extraction’

Items 29 and 31 of Schedule 3 insert the definitions of ‘geothermal energy resources’ and ‘geothermal energy extraction’ into subsection 995-1(1) of the ITAA 1997 and state that they have the meanings given in proposed subsections 40-730(7A) and 40-730(7B) respectively.

Item 22 inserts proposed subsection 40-730(7A) into the ITAA 1997, which states that ‘geothermal energy resources’ means matter occurring naturally within the Earth and containing energy as heat.

Item 22 also inserts proposed subsection 40-730(7B), which states that ‘geothermal energy extraction’ means operations that are for:

• the extraction of energy from ‘geothermal energy resources’ in an area and
• the purpose of producing assessable income.

Definition of ‘geothermal exploration information’

Item 32 of Schedule 3 inserts the definition of ‘geothermal energy information’ into subsection 995-1(1) of the ITAA 1997 and states that it has the same meaning as in proposed subsection 40-730(9).

Proposed subsection 40-730(9) inserted by item 23 of Schedule 3 states that ‘geothermal exploration information’ is geological, geophysical or technical information that:

• relates to the presence, absence or extent of geothermal energy resources in an area or
• is likely to help in determining the presence, absence or extent of such resources in an area.

24. Ibid., p. 6.
25. Ibid., paragraphs 3.78 to 3.81, pp. 49 and 50.
Definition of ‘geothermal exploration right’

Item 33 of Schedule 3 inserts the definition of ‘geothermal exploration right’ into subsection 995-1(1) of the ITAA 1997 to mean:

- an authority, licence, permit or right under an Australian law to explore for ‘geothermal energy resources’
- a lease of land that allows the lessee to explore for geothermal energy resources on the land or
- an interest in such an authority, licence, permit, right or lease.

Geothermal exploration rights are issued by state and territory governments.\(^{26}\)

Definition of ‘geothermal energy extraction right’

Item 30 of Schedule 3 inserts the definition of ‘geothermal energy extraction right’ into subsection 995-1(1) of the ITAA 1997 to mean:

- an authority, licence, permit or right under an Australian law to carry on ‘geothermal energy extraction’
- a lease of land that allows the lessee to carry on geothermal energy extraction on the land or
- an interest in such an authority, licence, permit, right or lease.

Including ‘geothermal exploration rights’ and ‘geothermal exploration information’ in the definition of depreciable assets to be deducted immediately

Subsection 40-30(2) of Division 40 of the ITAA 1997 lists those intangible assets that are depreciable assets. These at present include mining, quarrying or prospecting rights, and mining, quarrying and prospecting information. Item 5 of Schedule 3 inserts proposed paragraphs 40-30(2)(ba) and (bb) to include ‘geothermal exploration rights’ and ‘geothermal exploration information’ respectively as intangible depreciable assets.

At present the cost of depreciable assets such as mining, quarrying, or prospecting rights and information for minerals obtainable by mining operations can be deducted immediately if certain criteria in subsection 40-80(1) in Division 40 are met. Item 7 of Schedule 3 inserts proposed subsection 40-80(1A) to allow the cost of depreciable assets first used for exploration or prospecting for geothermal energy resources to be immediately deductible under criteria similar to those in subsection 40-80(1).

The Explanatory Memorandum gives a detailed explanation of the new law with examples of its application.\(^{27}\)

\(^{26}\) Ibid., paragraph 3.16, p. 35.

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Commencement and Application

Item 2 of the table in clause 2 of the Bill states that Schedule 3 commences on Royal Assent.

Item 34 of Schedule 3 forested out the application of the various amendments. Broadly, they come into operation on 1 July 2012.

Schedule 4—Extension of interim streaming provisions for managed investment trusts

Background

Schedule 2 of the Tax Laws Amendment (2011 Measures No. 5) Act 2011 (TLA No. 5 2011) amended the ITAA 1997 to ensure that, where permitted by the trust, the capital gains and franked distributions (including any attached franking credits) of a trust can be effectively streamed for tax purposes to beneficiaries by making them ‘specifically entitled’ to those amounts. The Explanatory Memorandum to the related Bill explains that this was an interim measure pending consideration of further improvements to the taxation of trust income.

Part 3 of Schedule 2 of the TLA No. 5 2011 provided an exemption to MITs from the application of these amendments for the years 2010–11 and 2011–12.

On 30 July 2012, the Assistant Treasurer and MinisterAssisting for Deregulation announced that the new tax system for MITs will have a start date of 1 July 2014, to coincide with the general update and rewrite of the trust provisions, and also committed to extending the interim streaming rules until the new start date.

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27. Ibid., paragraphs 3.14 to 3.75.
29. According to the ATO, ‘When a corporate tax entity distributes profits to its members, it has the option of passing to those members credits for income tax paid by the entity. This is called franking the distribution. Franking means ‘stamping’ or marking distributions as carrying franking credits that can be passed (imputed) to members’. See the ATO website at: http://www.ato.gov.au/businesses/content.aspx?menuid=0&doc=/content/43227.htm&page=20&H20

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Financial impact

The Explanatory Memorandum to the Bill states that the amendments are expected to have an unquantifiable but not significant impact on revenue.\(^{32}\)

Human rights implications

The Statement of Compatibility with Human Rights, which is included in the Explanatory Memorandum, states that the Government considers that Schedule 4 is compatible with human rights as it does not raise any human rights issues.\(^{33}\)

Key provisions

Item 51 of Schedule 2 of the TLA No. 5 2011 provides for the application of the provisions of that Schedule, and gives MIT trustees the option to be exempt from interim streaming measures, or to choose to have them apply. Currently trustees can make such a choice for the 2010-11 or 2011-12 income years.

Item 2 of Schedule 4 of the Bill repeals and replaces subitem 51(6) of Schedule 2 of the TLA No. 5 2011, to allow MIT trustees to choose to have the interim streaming measures apply beyond the 2011-12 income year.

Subitem 51(7) of the TLA No. 5 2011 provides that the trustee must make this choice in writing, within two months of the end of the relevant income year. Proposed paragraph 51(7)(c) adds to the existing conditions of choice, so that a choice can only be made in relation to the following income years:

- the 2010–11 income year
- the 2011–12 income year
- the 2012–13 income year and
- the 2013–14 income year.

Thus, the interim streaming provisions do not apply to a MIT for the income years 2010–11 to 2013–14, unless the trustee of the MIT elects, or has previously irrevocably elected, to apply those provisions to those income years.

Commencement and application

Item 2 of the table in proposed section 2 of the Bill states that Schedule 4 commences on the day this Act receives the Royal Assent.

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33. Ibid., paragraphs 4.16 to 4.20, pp. 54 and 55.
Schedule 5—Rebate for medical expenses

Background

The net medical expenses tax offset (NMETO) ‘provides taxpayers with a non-refundable tax offset for out-of-pocket medical expenses’. In the 2012–13 Budget, the Government announced that it would introduce a means test for NMETO from 1 July 2012.

The proposal was broadly to align the NMETO income test with the test for the Medicare levy surcharge. The Medicare Levy Surcharge thresholds in 2012–13 are $84,000 for singles and $168,000 for couples or families. A taxpayer who has a taxable income above the threshold may only claim NMETO if their relevant annual out-of-pocket expenses exceed $5000 (indexed annually) and the rate of reimbursement will be reduced to 10 per cent for expenses above this level. Where the taxpayer has more than one dependent child the income threshold is increased by $1500 for each dependent child after the first.

People with income below the surcharge thresholds will not be affected by the proposed changes. That is, they will be able to claim NMETO for relevant annual out-of-pocket expenses that exceed $2120 in 2012–13 (indexed annually) and will receive a rebate of 20 per cent for expenses above this level.

The Explanatory Memorandum to the Bill sets out in Table 5.1 the main features of the income test on the rate of NMETO. For ease of reference this table is set out below:

<table>
<thead>
<tr>
<th>Status of taxpayer</th>
<th>Adjusted taxable income for rebates</th>
<th>Out-of-pocket medical expenses</th>
<th>Rate of NMETO available (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single</td>
<td>$84,000 or less</td>
<td>$2120 or less</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Greater than $2120</td>
<td></td>
<td>20</td>
</tr>
<tr>
<td>Greater than $84,000</td>
<td>$5000 or less</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Greater than $5,000</td>
<td></td>
<td>10</td>
</tr>
<tr>
<td>Family¹</td>
<td>$168,000² or less</td>
<td>$2120 or less</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Greater than $2120</td>
<td></td>
<td>20</td>
</tr>
</tbody>
</table>

34. Explanatory Memorandum, op. cit., paragraph 5.4, p. 57.
36. Explanatory Memorandum, op. cit., paragraph 5.13, p. 58.
37. Ibid., paragraph 5.16, p. 59.
A taxpayer is eligible for the family income threshold where they are married on the last day of the year or have dependants on any day of the year. Where a taxpayer is married (according to section 7 of the A New Tax System (Medicare Levy Surcharge–Fringe Benefits) Act 1999) the adjusted taxable income for rebates of the taxpayer and the person they are married to, are added together to calculate their income for income threshold purposes.

The income threshold is increased by $1500 for each dependent child after the first.

**Financial impact**

The Explanatory Memorandum states that this measure will increase revenue by $370 million over the forward estimates period as follows:

<table>
<thead>
<tr>
<th></th>
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<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-</td>
<td>-</td>
<td>$115.0m</td>
<td>$125.0m</td>
<td>$130.0m</td>
</tr>
</tbody>
</table>

**Human rights implications**

The Government considers that the amendments proposed by Schedule 5 are compatible with human rights. The Statement of Compatibility with Human Rights states:

> This Schedule is compatible with human rights because it advances the protection of human rights in relation to health by ensuring a sustainable health care system and, to the extent that it may limit access to support for certain individuals, those limitations are reasonable, necessary and proportionate.\(^{38}\)

**Key provisions**

Division 17 of Part III of the ITAA 1936 deals with concessional rebates or tax offsets. Section 159P, in Division 17, deals with the rebate for medical expenses.

**Definition of indexable amount**

Section 159HA of the ITAA 1936 deals with indexation for the purposes, among others, of section 159P. Subsection 159HA(7) provides a definition of ‘indexable amount’.

**Item 9 of Schedule 5** repeals the current definition of indexable amount and substitutes a new definition, which includes a table listing various indexable amounts and the first indexable year relating to each such amount. The indexable amounts relevant to NMETO are:

- ‘medical expense rebate higher phase-in limit’ specified in proposed subsection 159Q(5) and listed as item 4 in the table, with the year 2013–14 being the first indexable year and

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\(^{38}\) Ibid., pp. 68–69.
• ‘medical expense rebate lower phase-in limit’ specified in proposed subsection 159Q(6) and listed as item 5 in the table, with the year 2011–12 being the first indexable year.

Definition of ‘medical expense rebate higher phase-in limit’

Item 20 of Schedule 5 inserts proposed section 159Q, titled ‘Rebate for medical expenses—phase-in limits’.

Item 3 of Schedule 5 inserts the definition of ‘medical expense rebate higher phase-in limit’ into subsection 6(1) of the ITAA 1936 and states that it has the meaning given by proposed subsection 159Q(5).

Proposed subsection 159Q(5) states that the ‘medical expense rebate higher phase-in limit’ is $5000. A note to this subsection states that the amount is indexed annually under section 159HA. The index number to be used is stated in subsection 159HA(7) to be the All Groups Consumer Price Index (CPI) number.

The method of deriving the indexing factor is described in subsection 159HA(3). This subsection states that the indexing factor for an indexing year of income is ascertained by dividing the sum of the index numbers for the quarters of the 12 month period ending on 31 March immediately before the indexing year of income by the sum of the index numbers for the quarters of the preceding 12 month period ending on 31 March.

Definition of ‘medical expense rebate lower phase-in limit’

Item 4 of Schedule 5 inserts the definition of ‘medical expense rebate lower phase-in limit’ into subsection 6(1) of the ITAA 1936 and states that it has the meaning given by proposed subsection 159Q(6).

Proposed subsection 159Q(6) states that the ‘medical expense rebate lower phase-in limit’ is $2000. A note to this subsection states that the amount is indexed annually under section 159HA and as described above the indexing factor is to be ascertained under subsection 159HA(3) using the appropriate CPI index numbers.

Definition of ‘rebatable medical expense amount’

Item 5 of Schedule 5 inserts the definition of ‘rebatable medical expense amount’ into subsection 6(1) of the ITAA 1936 and states that it has the meaning given by subsections 159P(1) and (3). The effect of the amendment to subsections 159P(1) and (3) proposed by item 16 of Schedule 5, is that what is currently referred to in subsections 159P(1) and (3) as the ‘rebatable amount’ will be referred to as the ‘rebatable medical expense amount’.

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However, although the terminology is changed, the amendments proposed by Schedule 5 do not change the method by which the amount of the net medical expenses is worked out.39

When does the medical expense rebate higher phase-in limit of $5000 (or the CPI indexed amount) apply to a taxpayer?

**Proposed subsection 159Q(1)** describes when the medical expense rebate higher phase-in limit of $5000 (as indexed) applies to a taxpayer and inserts a table explaining the application of the higher medical expense rebate phase-in limit.

**Item 1 of the table** applies to the principal individual who is married (within the meaning of *A New Tax System (Medicare Levy Surcharge—Fringe Benefits) Act 1999* (Medicare Levy Surcharge Act)).40 If the total adjusted taxable income for rebates for the year of the principal individual and the individual to whom he or she is married, exceeds the principal individual’s family tier 1 threshold, the higher phase-in limit of $5000 will apply.

**Item 2 of the table** states that if the principal individual is not married but has one or more dependants, and their adjusted taxable income for rebates for the year exceeds the family tier 1 threshold for the year, the higher phase-in limit applies.

**Item 3 of the table** applies the higher phase-in limit to all other individuals (unmarried and without dependants) whose adjusted taxable income for rebates for the year exceeds their singles tier 1 threshold for the year.

**Item 2 of Schedule 5** inserts the expression ‘family tier 1 threshold’ into subsection 6(1) of the ITAA 1936 and states that it has the meaning given by the Medicare Levy Surcharge Act.

**Item 6 of Schedule 5** inserts the expression ‘singles tier 1 threshold’ into subsection 6(1) of the ITAA 1936 and states that it has the meaning given by the Medicare Levy Surcharge Act.

**Working out the rebate or offset**

**Item 17 of Schedule 5** repeals subsection 159P(3A), which currently sets out the basis of working out the rebate, and substitutes proposed subsections 159P(3A) and (3AA).

**Proposed subsection 159P(3A)** states that a taxpayer is entitled to a rebate of tax if one or more rebatable medical expense amounts are applicable to the taxpayer.

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Proposed paragraph 159P(3AA)(a) states that the rebate is, if the medical expense rebate higher phase-in limit of $5000 applies to the taxpayer, 10 per cent of the amount by which the total of the rebatable medical expense amount exceeds $5000.

Proposed paragraph 159P(3AA)(b) states that if the medical expense rebate higher phase-in limit does not apply to the taxpayer, the rebate is 20 per cent of the amount by which the total of the rebatable medical expense amount exceeds the medical expense rebate lower phase-in limit of $2000 (as indexed).

Commencement and application

Item 2 of the table in clause 2 of the Bill states that Schedule 5 commences on Royal Assent.

Item 21 of Schedule 5 states that the amendments made by this Schedule apply to assessments for the 2012–13 year of income and later income years.

Schedule 6—Limited recourse debt

Background

On 8 May 2012, the Australian Government announced, as part of the 2012–13 Budget, that it would clarify that LRD includes arrangements where the creditor’s right to recover the debt is effectively limited to the financed asset or security provided.41

The Government considers that the scope of LRD needs to be clarified in response to the High Court’s decision in Commissioner of Taxation v BHP Billiton Limited.42 As set out in the Explanatory Memorandum, in that case the Court held that the definition of ‘limited recourse debt’ at section 243-20 of the ITAA 1997 only encompassed ‘debt arrangements where the recourse is contractually limited or is capable of being legally limited’.43 According to the Explanatory Memorandum this was not how the provision was intended to apply. Instead, it was

... intended to apply to a debt arrangement irrespective of whether the limited recourse element of the debt is achieved using an explicit contractual limitation or because of the overall effect of the arrangement.44

Consultation on a discussion paper was conducted by the Treasury between 16 July 2012 and 10 August 2012. Four submissions were received.45

42. 244 CLR 325. See also http://www.austlii.edu.au/au/cases/cth/HCA/2011/17.html
43. Explanatory Memorandum, op. cit., paragraph 6.10, p. 72.
44. Ibid., paragraph 6.9, p. 72.
The characteristics of LRD used to finance long term projects are succinctly set out in the discussion paper.46 The creditor seeks to primarily rely on the cash flows from the project assets for repayment and security. The objective of the sponsor of the project is to limit exposure to the creditor’s financial recourse in the event of default on the loan.

The discussion paper also sets out the two ways in which this is achieved.47 The first method is for the project sponsor to obtain the loan direct from the creditor, and the creditor agrees to limit its right of financial recourse to the assets that are secured by the loan. The second method is where a special purpose entity is established by the sponsor as the borrower and that entity’s assets will comprise the assets financed wholly or predominantly by the loan. In the event of default, the creditor can only seek recourse on the assets of the special purpose entity. It will be seen that both methods achieve the same objective of limiting the right of financial recourse of the creditor to the assets of the project in the event of default.

Consultation on exposure draft legislation and related explanatory material was conducted by the Treasury between 25 October 2012 and 12 November 2012. Four submissions were received.48

**Position of major interest groups**

Comment was received by Treasury, through the discussion paper and the exposure draft legislation, from Ashurst, BDO, the Institute of Chartered Accountants Australia (ICAA), the Property Council of Australia, and CPA Australia. They raised concerns that the new definition of LRD in the exposure draft legislation was too broad and recommended more appropriate targeting. The ICAA and the Property Council were also concerned with the retrospective nature of the changes (that is, that they will apply to pre-existing debt arrangements). While no changes were made to the legislation in response to concerns regarding its broad application, the Government did clarify its position within the Explanatory Memorandum:

In response to concerns that the measure is too broad, the Explanatory Memorandum to the Bill was amended to clarify that the existing ‘carve-outs’ in the limited recourse debt tax provisions continue to operate. This ensures that the limited recourse debt provisions will not apply to situations where it would

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47. Ibid., paragraphs 5 and 6.

be unreasonable to do so. These changes ensure that the measure appropriately targets only those arrangements within the policy intent of the measure.\textsuperscript{49}

### Financial impact

The Explanatory Memorandum states that the amendment is estimated to have no revenue impact but will protect a significant amount of revenue that would otherwise be at risk.\textsuperscript{50}

### Human rights implications

The Government considers that this Schedule is compatible with human rights as it does not raise any human rights issues.\textsuperscript{51}

### Key provisions

Division 243 of the ITAA 1997 sets out the circumstances when an additional amount must be included in the assessable income of an entity at the termination of a LRD arrangement.

Subsection 243-15(1) states that Division 243 applies if:

- a LRD has been used to wholly or partly finance or refinance expenditure
- at the time the debt arrangement is terminated, the debt has not been paid in full by the debtor and
- the debtor can deduct an amount as a capital allowance for the income year in which the termination of the debt occurs, or has deducted or can deduct an amount for an earlier income year in respect of the expenditure or the financed property.

Subsections 243-20 (1) to (4) describe the types of arrangements that would be LRDs.

Subsection 243-20(1) states that a LRD is an obligation imposed by law on an entity (the debtor) to pay an amount to another entity (the creditor) where the rights of the creditor as against the debtor in the event of default in payment of the debt or of interest is limited wholly or predominantly to any or all of the following:

- rights in relation to any or all of: the debt property or the use of the debt property; goods produced, supplied, carried, transmitted or delivered or services provided by means of the debt property; or the loss or disposal of the whole or part of the debt property or of the debtor’s interest in the debt property


\textsuperscript{50} Explanatory Memorandum, op. cit., p. 8.

\textsuperscript{51} Ibid., paragraphs 6.20 to 6.23, pp. 76 and 77.
- rights in respect of a mortgage or other security over the debt property or other property and
- rights that arise out of any arrangement relating to the financial obligations of an end-user of the financed property towards the debtor, and are financial obligations relating to the debt property.

Subsection 243-20(2) states that an arrangement is a LRD where, notwithstanding the absence of an express limitation in the loan, it is reasonable to conclude that the rights of the creditor as against the debtor in the event of default are capable of being limited in the manner described in subsection 243-20(1).

Paragraphs (a), (b) and (c) of subsection 243-20(2) provide that in reaching this conclusion regard should be given to:

- the assets of the debtor (other than assets that are indemnities or guarantees provided in relation to the debt)
- the arrangement to which the debtor is a party
- whether all of the assets of the debtor would be available for the purpose of the discharge of the debt (other than assets that are security for other debts of the debtor or any other entity) and
- whether the debtor and creditor are dealing at arm’s length in relation to the debt.

Item 1 of Schedule 6 repeals and replaces subsection 243-20(2). The effect of the change is that a debt is a LRD if it is reasonable to conclude that the creditor’s right of recourse are in substance or effect limited wholly or predominantly to rights in relation to the financed property or property provided to secure the debt.

Subsection 243-20(3) provides that an arrangement where there is no property financed by the debt or provided as security is an LRD, if it is reasonable to conclude that in the event of default the rights of the creditor against the debtor are capable of being limited.

Item 3 of Schedule 6 inserts proposed subsection 243-20(3A) after subsection 243-20(3) so that the same conditions set out in paragraphs (a), (b) and (c) of the current subsection 243-20(2) (set out above) apply when considering whether an arrangement is a LRD under subsection 243-20(2) or (3) of the ITAA 1997. However, under proposed paragraph 243-20(3A)(c), there is no need to consider whether all of the debtor’s assets would be available for the purpose of discharging the debt when determining whether the rights of a creditor are limited in substance or effect in a way that satisfies proposed paragraph 243-20(2)(b).

Subsection 243-20(4) currently provides that notional loans under Division 240 of the ITAA 1997 are LRDs. For income tax purposes, Division 240 treats some arrangements (such as hire purchase agreements) as if they involve the sale of property to a notional buyer using loan funds provided by the notional seller.

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Commencement and application

Item 2 of the table in clause 2 of the Bill states that Schedule 6 commences on Royal Assent.

Item 4 of Schedule 6 states that the amendments made by this Schedule apply to debt arrangements terminated at or after 7.30 pm, by legal time in the Australian Capital Territory on 8 May 2012, thereby making the changes effective as of the announcement on budget night.

Schedule 7—In-house fringe benefits under salary packaging arrangements

Background

In the 2012–13 MYEFO released on 22 October 2012, the Australian Government announced that it would remove the concessional fringe benefits tax (FBT) treatment for in-house fringe benefits if they are accessed by way of a salary sacrifice arrangement. This measure will apply from 22 October 2012 for salary sacrifice arrangements entered into from its announcement on 22 October 2012, and from 1 April 2014 for salary sacrifice arrangements entered into prior to its announcement on 22 October 2012.52

Financial impact

The Explanatory Memorandum at page 9 states that this measure will have the following revenue implications over the forward estimates years.

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$15.0m</td>
<td>$45.0m</td>
<td>$145.0m</td>
<td>$155.0m</td>
<td></td>
</tr>
</tbody>
</table>

This measure is also expected to result in an increase in GST payments to the states and territories of $85 million over the forward estimates period.53

Human rights implications

The Government concludes that Schedule 7 is compatible with human rights and, to the extent that the amendments in that Schedule may limit human rights because the proposed measures have certain retrospective applications, those limitations are reasonable, necessary and proportionate to the aim of the proposed measures.54


53. Ibid.

54. Explanatory Memorandum, op. cit., paragraph 7.59, p. 91.
Key provisions

The current FBT law provides concessions when different types of benefits are provided to employees by employers in-house, where the employer is in the business of providing the same goods and services to their clients. Concessions take the form of the manner in which the benefits are valued as well as the extent to which the benefits are taxed. The thrust of the proposed measures is to deny these concessions where the in-house benefits are accessed under a salary packaging arrangement.

What is a salary packaging arrangement?

Item 12 of Schedule 7 inserts a definition of ‘salary packaging arrangement’ into subsection 136(1) of the Fringe Benefits Tax Assessment Act 1986 (FBTAA). Under this definition ‘salary packaging arrangement’ means an arrangement under which a benefit is provided to an employee if:

- the benefit is provided in return for the employee agreeing to a reduction in the employee’s salary or wages that would not have happened if the arrangement to grant the benefit had not been entered into or
- the arrangement is part of the employee’s remuneration package, and the benefit is provided in circumstances where it is reasonable to conclude that the employee’s salary or wages would be greater if the benefit was not provided.

Amendments to in-house property fringe benefits

Section 42 of the FBTAA currently provides for the taxation of property fringe benefits provided by an employer to an employee, such as goods, real property including land and buildings, and rights to property including shares and bonds. Different concessionary valuation rules apply to in-house property provided by an employer to an employee.

Item 2 of Schedule 7 inserts proposed paragraph 42(1)(aa) into subsection 42(1) to provide that if any property is provided to a recipient under a salary sacrifice arrangement by an employer, the taxable value of the in-house fringe benefit will be the notional value of the recipient’s property at the time the property is provided to the recipient.

Subsection 136(1) of the FBTAA defines ‘notional value’ in relation to the provision of property to mean the amount the person could reasonably be expected to pay to obtain the property or other benefit under an arm’s length transaction. The Explanatory Memorandum clarifies with an example that illustrates that the expected amount would be the market or fair value.

Amendments to in-house residual fringe benefits.

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56. Ibid., paragraphs 7.20 to 7.24, pp. 83 and 84.
Residual benefits are those benefits received by an employee from an employer and covered by Division 12 of Part III of the FBTAA which are not specifically dealt with in any other provision of the FBTAA. Residual benefits will be in-house benefits if they are similar to the rights, services or facilities provided by the employer to the public in the ordinary course of the business of the employer.

Exempt residual benefits are currently dealt with in section 47 of the FBTAA. Subsection 47(1) provides an exemption that applies for public transport from home to work proved by employers and associates of the employer in the public transport business. Item 6 of Schedule 7 inserts proposed paragraph 47(1)(f) to make it a condition for the exemption that the benefit is not provided under a salary packaging arrangement.

Changes to the valuation rules for in-house residual fringe benefits

The valuation rules for all in-house residual benefits are in sections 48 and 49 of the FBTAA. The amendments by items 7 and 9 of Schedule 7, which insert proposed paragraphs 48(aa) and 49(aa), will provide that the taxable value of an in-house residual fringe benefit given under a salary packaging arrangement is its notional value at the comparison time. Here again, the application of the definition of ‘notional value’ in subsection 136(1) of the FBTAA will result in the market value being adopted to determine the taxable value of the benefit.

Commencement and application

Item 2 of the table in clause 2 of the Bill states that Schedule 7 commences on Royal Assent.

Subitem 13(1) of Schedule 7 states that that the amendments made by the Schedule apply in relation to benefits provided on or after 22 October 2012.

Subitem 13(2) states that the material changes by items 1 to 11 of Schedule 7, do not apply in relation to benefits provided to an employee under an existing salary sacrifice arrangement to the extent that benefits are provided before the earlier of:

(a) 1 April 2014, and
(b) the first time on or after 22 October 2012 that the existing salary packaging arrangement is varied in a material way.

Subitem 13(3) states that an ‘existing salary packaging arrangement’ is one that is entered into by the employer and employee before 22 October 2012.

Schedule 8—Miscellaneous amendments

Background

Schedule 8 to the Bill makes a number of miscellaneous amendments to tax laws to ensure that those laws operate as intended. These changes, which are made periodically, include the correction of technical or drafting defects, the removal of anomalies, and addressing unintended outcomes.
The Explanatory Memorandum states that progressing such amendments gives priority to the care and maintenance of the tax system as recommended by a 2008 recommendation of the Tax Design Review.\(^{57}\)

**Financial impact**

The Explanatory Memorandum to the Bill states that the amendments made by Schedule 8 will have a negligible effect on revenue over the forward estimates.\(^{58}\)

**Human rights implications**

The Government considers that Schedule 8 is compatible with human rights as it does not encroach upon any applicable rights or freedoms.\(^{59}\)

**Key provisions**

A comprehensive list of the amendments and their intended effects is available on pages 93–98 of the Explanatory Memorandum.

**Commencement and application**

*Item 3*, in the table at clause 2 of the Bill, states that the amendments made by Part 1 of Schedule 8 commence on 1 July 2007. According to the Explanatory Memorandum, these amendments to superannuation regulations

... correct a technical oversight in the law that has existed since [that date], but are not expected to have any practical impact on the operation of the law in this area.

*Item 4*, in the table in clause 2 of the Bill, states that the amendments made by Part 2 of Schedule 8 commence on Royal Assent.