¶5-210 Further tax on uncontrolled partnership income

The rate of further tax on uncontrolled partnership income between 2014/15 to 2016/17 is, with one exception (see below), 47% reduced by the average rate of ordinary tax — calculated without rebates or credits — applicable to the taxpayer's total taxable income (*Income Tax Rates Act 1986*, s 12(7); 35). The rate for 2017/18 is 45% reduced by the average rate of ordinary tax. The imposition of the further tax has the consequence that the partner pays tax on the income at the top marginal tax rate.

▶ Example

B has a taxable income of $50,000 for 2016/17, of which $10,000 is uncontrolled partnership income. B has no primary production income. Assume that there are no deductions allowable against the uncontrolled partnership income. B's tax liability is calculated as follows:

Tax payable at 2016/17 rates (¶42-000) on taxable income of $50,000		$7,797
Plus:	further tax on uncontrolled partnership income (ie $10,000 × 31.41%*)	3,141
		10,938
Plus:	Medicare levy (2% × $50,000)	1000
	Total tax payable	$11,938

* The rate of further tax is calculated as:

$$47\% - \left(\frac{\text{gross tax on taxable income}}{\text{total taxable income}} \times 100\right)\%$$

$$= 47\% - \left(\frac{\$7,797}{\$50,000} \times 100\right)\%$$

$$= 47\% - 15.59\%$$

$$= 31.41\%$$

Exception for primary producers subject to averaging

The exception is where the taxpayer is a primary producer who is subject to the averaging system. In certain situations, only part of the primary producer's income is subject to averaging (¶18-210). As two different rates of tax will be levied in such cases, one on income subject to averaging and another on the remaining income, it is necessary to identify separately uncontrolled partnership income that qualifies for averaging and uncontrolled partnership income that does not qualify for averaging (s 94(10A) to (10C)).

[FTR ¶864-000]

Chapter 6 Trustees ● Beneficiaries ● Deceased Estates

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Introduction

¶6-000 Taxation of trusts

This chapter deals with the taxation treatment of the income of ordinary trusts (usually created by will or instrument of trust), deceased estates, corporate unit trusts and public trading trusts. The trust income provisions are largely contained in ITAA36, although there are CGT and imputation provisions in the ITAA97 that are relevant to trusts. Legislative references in this chapter are to the ITAA36 unless otherwise specified. Certain funds, such as ACNC registered charities, may be exempt from tax. These are discussed in Chapter 10.

Some of the tax planning aspects relating to trusts are considered in Chapter 31 (particularly ¶31-540) and the CGT provisions that affect trusts are considered in Chapter 12 (particularly ¶11-290). The use of trusts to divert personal exertion income to family members is discussed at ¶30-600.

Special rules apply in calculating the tax on certain trust income of minor beneficiaries, ie persons under 18 years of age. These rules are discussed in Chapter 2 at ¶2-160 and following.

The rules that apply in relation to franked distributions received through a trust are discussed in Chapter 4 (in particular, see ¶4-860) and the rules that apply to capital gains received through a trust are discussed in Chapter 11 (in particular, see ¶11-060).

Review of taxation of trusts

In December 2010, the then Assistant Treasurer announced that, to address the "major uncertainties" after the High Court's decision in *Bamford*, there would be a public consultation process as the first step towards updating the trust provisions of ITAA36 Div 6 and rewriting them into ITAA97. Any move to tax trusts as companies was ruled out. Subsequently, legislative action, intended to be an interim measure only, was taken to deal with the streaming of capital gains and franked distributions and the inappropriate use of exempt entities as beneficiaries (¶6-077, ¶6-274).

Since then, the reform initiative appears to have stalled. Although a consultation paper and a policy options paper on the reform of ITAA36 Div 6 were released and a revised commencement date of 1 July 2014 for any amendments was announced, nothing else has happened. Indeed, it is not clear what the view of the present government is.

Trusts and Trustees

¶6-010 Trusts and trustees

A trust of property or income may be described as a fiduciary obligation imposed on a person (the trustee) to hold property or income for a particular purpose or purposes, or for the benefit of other persons or classes of persons who may or may not include the trustee. The fiduciary obligation may be imposed on the trustee either by the person establishing the trust (who may be the same as the trustee), by another person, by court order or declaration, or by operation of law. Although the trustee may hold the legal title to property, etc, the trustee is compelled in equity to deal with it in accordance with the express or implied terms of the trust.

The executor or administrator of a deceased person's estate is not strictly the trustee of the estate until executorial or administrative functions are completed, but an executor or administrator is expressly made a trustee for income tax purposes by the expanded definition of "trustee" in s 6(1). A company formed by the trustee of a will in accordance with its terms to carry out some or all of the trusts is not a trustee for tax purposes. The expanded definition of "trustee" also includes a person acting in a fiduciary capacity.

The Official Receiver in Bankruptcy of an insolvent deceased estate is a trustee, as is the receiver and manager of the assets of a company appointed by the debenture holders and a mortgagee in possession.

A trust for income tax purposes is property, or an interest in property, that is vested in and under the control of a person who is a trustee, and that produces income. A deceased estate is a trust pending completion of its administration and thereafter until all the assets have been distributed to the beneficiaries. A person who has only limited powers to deal with property as an intermediary for the legal owner is not a trustee of a trust. An agent who receives moneys, etc, for a principal is not a trustee.

The following have been held to constitute a trust:

- moneys held under a court order by solicitors acting as trustees pending the outcome of proceedings to determine who was entitled to the moneys (*Harmer*)
- compensation paid into an accident compensation fund for the benefit of dependants of deceased workers (*Registrar, Accident Compensation Tribunal (Vic)*)
- moneys paid into a joint bank account ''on trust'' pending the determination of the parties' respective entitlements contingent upon the occurrence of future events (*Walsh Bay Developments*)
- money stolen by an employee from his employer (the money was held on constructive trust) (*Zobory*).

It is important to note that the provisions of Div 6, which operate to determine the circumstances in which the trustee or a beneficiary is taxed, only apply if there is income of a trust estate. That requires that the trustee must stand in relation to a proprietary right by virtue of which income of the trust arises (*Leighton*). In *Leighton*, the Full Federal Court held that the taxpayer (a non-resident individual) was not a trustee in respect of income derived on an accruals basis by two non-resident companies that carried on share trading activities; the proceeds of sales of shares which came to be held by the taxpayer did not represent the income of either of the companies but rather represented the realisation of the income that they had already derived.

Although a liquidator of a company is within the statutory definition of trustee a liquidator is not a trustee of a trust estate in any ordinary sense (*Australian Building Systems*).

For details of the withholding requirements relating to trust investments where no TFN or ABN is quoted, see ¶26-200.

[FTR ¶50-517, ¶50-519]

¶6-015 Resettlement of a trust

There was previously considerable doubt as to whether and, if so, in what circumstances one trust estate could come to an end and a new trust estate commence. This particular issue often arose in the context of an amendment to a trust instrument and the question was whether the amendment would cause a ''resettlement''. Of course, if a new trust arose this could have significant income tax and CGT consequences. It may cause, for example:

- the trust property to be realised at trustee level (with potential trading stock, depreciation and CGT implications)
- carried forward tax benefits to be lost
- beneficiaries to dispose of their interests in the original trust and to acquire interests in the new trust.

In *Commercial Nominees*, the High Court (affirming a decision of the Full Federal Court) held that no new trust was created where significant changes were made to a superannuation fund trust deed, primarily because there was a continuing trust estate (ie the property of the fund). The High Court observed that the fund, both before and after the changes, was administered as a single fund, and treated that way by the regulatory authority.

More recently, the question of the continuity of a trust was considered by the Full Federal Court in *Clark*. The trust in that case was a unit trust and no amendment of the trust deed was involved. However, the Commissioner contended that there were several transactions which caused a break in the continuity of the trust. A majority of the court took the view that the indicia of continuity applied by the High Court in *Commercial Nominees* (namely, the constitution of the trust, the trust property and membership) applied generally and not only in the context of a superannuation fund. The majority considered that, when the High Court in *Commercial Nominees* spoke of trust property and membership as providing two of the indicia for the continued existence of the eligible entity or trust estate, the court was not suggesting that there had to be a strict or even partial identity of property for the first and objects for the second. It was speaking more generally: that there had to be a continuum of property and membership, which could be identified at any time, even if different from time to time; and without severance of one or both leading to the termination of the trust in question. In the present case, the Commissioner never contended, nor on the evidence could he, that there was a severance in the continuum of trust property and objects of the particular trust. Their identity changed from time to time, but not their continuum. An application by the Commissioner for special leave to appeal to the High Court from the decision of the Full Federal Court was refused.

Commissioner's views

The Commissioner's current views in relation to the amendment of trust deeds are set out in TD 2012/21. According to that determination, the Commissioner accepts that, as a general proposition, the approach adopted by the Full Federal Court in *Commercial Nominees* is authority for the proposition that assuming there is some continuity of property and membership of the trust, an amendment to the trust that is made in proper exercise of a power of amendment contained under the deed will not have the result of terminating the trust, irrespective of the extent of the amendments so made so long as the amendments are properly supported by the power of amendment.

The Commissioner accepts as an accurate statement of the current law that continuity of trust is a function of whether the trust continues in existence under trust law in contradistinction to having terminated. Amendments validly made pursuant to a power of amendment that will not lead to the creation of a new trust include amendments adding to, or deleting, beneficiaries, the extension of the vesting day, amendments to the definition of income and amendments to permit the ''streaming'' of different classes of income. The position is the same with court sanctioned amendments or variations.

However, the determination states that even in instances where a pre-existing trust does not terminate, it may be the case that assets held originally as part of the trust property commence to be held under a separate charter of obligations as a result of a change to the terms of the trust — whether by exercise of a power under the deed (including a power to amend) or court approved variation — such as to lead to the conclusion that those assets are now held on terms of a distinct (ie different) trust. Thus, depending on the facts, the Commissioner considers that the effect of a particular amendment might be such as to lead to the conclusion that a particular asset has been settled on terms of a different trust by reason of being made subject to a charter of rights and obligations separate from those pertaining to the remaining assets of the trust.

Trust Returns

¶6-020 Trust return

An annual return (often referred to as Form T) must be lodged for a trust, irrespective of the amount of income derived by the trust (¶44-060). Corporate unit trusts and public trading trusts should use the company return form: ¶3-045. The trust return is to be lodged by any one of the trustees who is a resident of Australia. If there is no trustee resident in Australia, the return must be lodged by the trust's public officer (¶6-050) or, where no public officer is appointed, by the trust's agent in Australia. Trust returns are usually required to be lodged by 31 October after the end of the income year to which the return relates (¶24-060).

Under the group consolidation regime, the head company of a wholly-owned group of entities (including trusts) may lodge a single consolidated tax return (¶8-010).

The trustee of a ''transparent trust'' or a ''secured purchase trust'' is not required to lodge a return provided that, broadly speaking, the income of the trust estate is vested indefeasibly in the beneficiary (PS LA 2000/2).

The return form and the associated instructions should be checked to see what information needs to be provided with returns. Many elections available to taxpayers under the tax law are not required to be in writing or lodged with returns. Whether or not an election has been made will generally be evident from the calculation of taxable income as disclosed in the return and from the records required to be kept to verify that calculation (¶24-040).

False statements about trust income

If a trustee makes an incorrect statement about the net income of a trust estate that results in a beneficiary having a shortfall amount, the trustee is liable to pay an administrative penalty (¶29-160).

[FTR ¶79-300ff]

¶6-030 Trustee of deceased estate

For the year in which a taxpayer died, the trustee of the deceased estate is generally required to lodge an individual tax return of the deceased's income up to the date of death (¶2-030, ¶2-080). The trustee is also generally required to lodge a deceased estate trust return for the remainder of the income year for the income received or derived after death by the deceased estate.

The individual tax return of the deceased's income up to the date of death may take into account expenses incurred by the trustee in relation to the income tax affairs of the deceased (¶16-850). Medical expenses incurred by the deceased and paid by the trustee may be taken into account in the return in calculating the offset available for medical expenses (¶15-320).

The Commissioner has released a draft practical compliance guideline for smaller and less complex estates to enable the trustee to wind up the estate without concern that they may have to fund any of the deceased's liabilities from their own assets (*Draft* PCG 2017/D12).

The trust return for the deceased estate must include income *derived* by the estate after the death of the deceased, and amounts *received* by the trustee after the death where those amounts would have been assessable to the deceased had they been received during the deceased's lifetime (¶6-180).

Generally, trust returns must continue to be lodged for each financial year until the estate is fully administered, unless the trust is non-taxable.

Rate of tax

For the first three income years after death, the income of a resident deceased estate is concessionally taxed at ITAA36 s 99 rates (¶42-030), ie normal individual tax rates. No Medicare levy is payable (¶42-033).

For a checklist of the tax consequences of death, see ¶44-170.

[FTR ¶695-040]

¶6-040 Personal liability of trustee

A trustee is answerable as the taxpayer for the doing of all things required by the tax law in relation to income derived by the trustee in a representative capacity. (ITAA36 s 254). Under that provision, a trustee is authorised and required to retain out of that income sufficient moneys to pay taxes (including penalty tax and interest) that are or will become payable by the trustee in a representative capacity, including where the trustee holds money on trust under a court order (*Fermanis v Cheshire Holdings*). The Commissioner's view that a trustee's liability to retain does not depend on an assessment having been made was rejected by the High Court in *Australian Building Systems*. A trustee is not personally liable for tax, except to the extent of any failure to meet the retention requirements. A trustee's right of personal indemnity from a residual beneficiary in respect of proper trust expenses, including tax, was affirmed in *Balkin v Peck*, even though the beneficiary had argued that it should not be required to indemnify the trustee because the tax resulted from the trustee's failure to take the trust offshore to avoid tax.

If a trustee complies with all the requirements of the tax law and then distributes the corpus to the beneficiaries without any notice of an intention by the Commissioner to issue additional assessments, the Commissioner cannot recover taxes thereafter assessed to the trustee from the beneficiaries to whom the distributions have been made. (Trust recoupment tax, payable where there has been a ''new generation'' trust stripping scheme, is a special case: ¶6-270.)

If a trustee lets trust property at a gross undervalue to a non-beneficiary tenant, this may amount to a breach of trust unless there is an intention to thereby indirectly benefit the beneficiaries. The letting at undervalue may support an inference that the property was let partly for non-income earning purposes, with the result that deductions for outgoings on the property may need to be apportioned (*Madigan*: ¶16-650; *Fletcher*: ¶16-010, ¶31-370).

[FTR ¶782-060]

¶6-050 Public officer of trust

A trust that does not have a resident trustee and that has a business in Australia or Australian source property income (except dividends, interest or royalties subject to withholding tax) is required to appoint a public officer to ensure that the trustee's taxation responsibilities are met. The qualifications for the public officer are the same as for public officers generally (¶3-030). The Commissioner has power to exempt (conditionally or unconditionally) particular trusts from the requirement to appoint a public officer.

The appointment of a public officer must be made within 90 days after the earlier of: (a) the date on which any business was commenced to be carried on by the trust in Australia; or (b) the date on which the trust commences to derive relevant property income from Australian sources. Failure to appoint a public officer is a strict liability offence that may result in a fine not exceeding 1 penalty unit (currently $210) for each day that an appointment is not duly made.

[FTR ¶781-700]

Method of Taxing Trust Income

¶6-060 Trust not separate taxable entity

A trust is not a separate taxable entity. This is despite the fact that a return of trust income must usually be filed by the trustee and that, in certain circumstances, the trustee may be liable to be assessed and to pay tax on the whole or part of the trust income in that representative capacity.

In general terms, it is the beneficiaries who are ultimately entitled to receive and retain the trust income (¶6-085) who are taxable on the net income as defined for income tax purposes (¶6-080). The trustee is generally taxed only on the balance (if any) of the net income as defined for tax purposes as is referrable to income to which no beneficiary is presently entitled, or to which a beneficiary *is* presently entitled but which the beneficiary cannot immediately receive because of some legal incapacity such as infancy or insanity (s 96). (Corporate unit trusts and public trading trusts are a special case: ¶6-280 – ¶6-330.)

Where the Commissioner is uncertain as to which taxpayer is liable to tax, alternative assessments may be issued in respect of the same income (¶25-100), eg one to the trustee and one to another person, provided there is no double recovery of tax (*Trustee of the Balmain Trust*).

Subject to certain qualifications relating to foreign source income, trust income is taxed in the year it is *derived by the trust*, and it is taxed either to the trustee or to the beneficiaries, or a portion of it is taxed to the trustee and a portion to the beneficiaries. Thus, the beneficiaries may be taxed on their respective shares of the net income of the trust for tax purposes even though the trustee has not physically distributed that income to them by the end of the year in which it is derived. However, it is clear that, if some or the whole of the income derived in one year is taxed to the trustee or to beneficiaries who have not yet received it, it does not again become subject to tax when it is subsequently distributed to the beneficiaries (¶6-130).

The primary provisions relating to the taxation of trust income are contained in Pt III Div 6 (s 95AAA to 102). The primary provisions were modified, from and including the 2010/11 income year, where the trust has a net capital gain, a franked distribution or a franking credit included in its net income for tax purposes (see below).

The net income of a trust for tax purposes is taxed either to the beneficiary or trustee as follows:

- the beneficiary is assessable if the beneficiary is presently entitled to income of the trust, is not under a legal disability and is a resident at the end of the income year (¶6-110)
- the trustee is assessable on behalf of a beneficiary who is presently entitled to income of the trust but is either under a legal disability or is not a resident at the end of the income year (¶6-120), and
- the trustee is assessable on net income of the trust to the extent to which no beneficiary (or the trustee on behalf of a beneficiary) is assessed on it (¶6-230).

Undistributed foreign source income is not taxed in the year it is derived by the trust where either: (a) the beneficiary presently entitled to it is not a resident; or (b) there is no beneficiary presently entitled and, subject to special accruals measures (¶6-075), the trust is a non-resident trust. However, the income is assessable in the income year in which it is distributed to a beneficiary who is a resident at any time during that year. Where foreign source income to which no beneficiary is presently entitled is taxed to the trustee under s 99 or s 99A, because the trust is a resident trust, the distribution of that income to a non-resident beneficiary may entitle the beneficiary to a refund of the tax paid by the trustee (¶6-150).

The broad effect of the modification of the primary provisions in relation to capital gains and franked dividends is that capital gains and franked distributions are taken out of the operation of Pt III Div 6 by Div 6E and are dealt with by provisions in ITAA97 Subdiv 115-C (capital gains) and Subdiv 207-B (franked distributions). Provided the trust deed confers the necessary power, the trustee can ''stream'' capital gains and franked distributions to beneficiaries by making them ''specifically entitled'' (¶6-107).

According to the Commissioner, there has been an increase in the use of New Zealand foreign trusts by Australian residents as a vehicle for cross border tax planning. However, Australia's right to tax the trustees of NZ foreign trusts on Australian source income under Div 6 is not affected by the treaty. For the purposes of determining residency under the treaty, the relevant person is the trustee and not the trust (TR 2005/14).

[FTR ¶50-501ff]

¶6-070 Multiple trusts

One person may create several trusts, either in the one trust instrument or by means of several separate trust instruments, in favour of the same or different beneficiaries.

With one specific exception, the incomes of separate and distinct trusts are not aggregated even though one person may be trustee of each. But, for this advantage to accrue, there must be a clear intention to create separate and distinct trusts. While it may not be necessary to keep separate bank accounts, to divide the corpus physically and to invest the funds of each trust separately, literal compliance with the terms of the trust instrument is necessary.

The exception arises where a beneficiary under two or more trusts is a minor whose income is taxed under the special rules discussed at ¶2-160. Where the beneficiary's income from one trust does not exceed $416 (so that tax would not normally be payable), but the beneficiary has income under one or more other trusts and the total exceeds that amount, then the trustee must pay tax on the beneficiary's income at the rate applying to minor beneficiaries (¶2-220, ¶2-250) (*Income Tax Rates Act 1986*, s 13(4)).

[FTR ¶50-912]

¶6-075 Accumulating income of non-resident trusts

Various special measures prevent the deferral of Australian tax on trust income accumulated in a non-resident trust for the benefit of an Australian resident beneficiary of the trust (Pt III Div 6AAA). These special measures extend to trusts that do not have the derivation of trust income as an object but instead concentrate on realised capital gains at the end of a period of time.

Accruals basis of taxation. The attributable income of an Australian controlled non-resident trust is required to be assessed on an accruals basis to a resident who has directly or indirectly transferred value to the trust where the transfer was made, in the case of a discretionary trust, at any time and, in the case of a non-discretionary trust, after 12 April 1989. The accruals provisions do not apply in relation to arm's length transfers or to certain post-marital or family relief trusts. See ¶21-320 for the meaning of ''attributable income'' and ¶21-290 for a discussion of the accruals measures.

Interest charge on distributions. A distribution to an Australian beneficiary out of accumulated income of a non-resident trust that has not been taxed under the accruals measures or the ordinary trust measures bears an interest charge, measured by reference to the period from the end of the income year in which the non-resident trust derived the income to the end of the income year (of the beneficiary) in which the income is distributed (¶21-350).

[FTR ¶51-370, ¶51-398]

¶6-077 Net capital gain and franked dividends: special rules

Some fundamental changes to the taxation of trust income (and, in particular, where the net income of a trust for tax purposes includes a franked distribution or a net capital gain) were made with effect from and including the 2010/11 income year. The following points should be particularly noted:

- Where the net income of a trust (¶6-080) does not include a net capital gain or a franked distribution, the changes had no practical consequence and the principles of Div 6 that had previously applied continue to apply. This requires determining whether a beneficiary is presently entitled to a share (ie a fraction or percentage) of the income of the trust (ie the distributable trust income as determined in accordance with trust principles and the trust deed) for the particular income year and then applying that fraction or percentage to the net income of the trust as calculated for tax purposes (¶6-110, ¶6-120). The trustee is taxed on any net income that is not attributed to a beneficiary in this way.

- Where the net income of a trust for tax purposes includes a net capital gain or a franked distribution then the capital gains and franked distributions that are reflected in the net income are taken outside the operation of Div 6 (by Div 6E) and are subject to the special rules in ITAA97 Subdiv 115-C (capital gains) and 207-B (franked distributions). These special rules enable the trustee to stream capital gains and franked distributions (provided the trust deed confers the necessary power on the trustee) by making beneficiaries ''specifically entitled'' (¶6-107) to amounts of a capital gain or a franked distribution. The way ITAA97 Subdiv 115-C and 207-B operate is described at ¶11-060 and ¶4-860.

- To the extent that a capital gain or franked distribution is not attributed to a specifically entitled beneficiary then it is attributed to the beneficiaries of the trust in accordance with their adjusted Division 6 percentages. A beneficiary's adjusted Division 6 percentage is the percentage of the income of the trust (including capital gains that are treated as income and franked distributions) to which a beneficiary is presently entitled, adjusted for any part of the capital gains or franked distributions to which any beneficiary is specifically entitled.

- In practical terms, although capital gains and franked distribution are taken outside the operation of Div 6, capital gains and franked distributions to which no beneficiary is made specifically entitled are (broadly) taxed to beneficiaries and/or the trustee in the same way as the other income of the trust.

Tax exempt beneficiaries

There are two anti-avoidance provisions which may apply where a tax exempt beneficiary is presently entitled to income of a trust. Where they apply these provisions operate to deny the present entitlement of the exempt beneficiary to income of the trust (so that the trustee is assessed on an appropriate share of the net income). See ¶6-274.

Calculation of Trust Income

¶6-080 Net income of a trust

Since a trust is not a taxable entity (¶6-060), the calculation of the ''net income'' of a trust is simply the first step in determining the amounts on which the trustee and/or the beneficiaries are assessable.

The net income of a trust is the total assessable income of the trust calculated as if the trustee were a resident taxpayer in respect of that income, less all allowable deductions (s 95(1)).

The calculation of the net income requires both Australian *and* foreign source income and related deductions to be taken into account. The tax treatment of net income attributable to foreign sources depends, in the case of income to which no beneficiary is presently entitled, on whether the trust is a resident trust and, in the case of a presently entitled beneficiary, on the residence of the beneficiary. Net income of a non-resident trust may be attributable in certain circumstances to a resident (¶6-075).

The character of a receipt for tax purposes (ie income or capital) is not determined by trust law or the terms of the particular trust deed. In other words, neither trust law nor the provisions of the trust deed can alter the character of a receipt for tax purposes (*ANZ Savings Bank*). Profits on the sale of capital assets would generally be an accretion to corpus for trust purposes, but may be assessable income for tax purposes, for example, under the CGT provisions (¶11-030).

In calculating the net income of a trust, a trustee carrying on a business must use generally accepted accounting principles, including accrual accounting (*Zeta Force*).

The assessable income of a trust includes the whole of the trust's interest in the net income of a partnership of which it is a member, even if that share has not been received. Whether a gain or loss from an investment is made by a trustee is on capital or income account depends on the application of the normal principles (business transaction, isolated profit-making transaction etc) (TD 2011/21).

In general, all deductions for expenses which would be available if a resident taxpayer had derived the trust's assessable income are taken into account in calculating the net income of a trust. Where the deductions exceed the assessable income, the resulting loss is taken into account in calculating the net income of the trust for succeeding income years, ie the loss is *not* distributed among the beneficiaries or the trustee as representing corpus. However, under the trust loss measures, a trust may not be able to deduct a prior year loss or certain debt deductions (for bad debts and debt/equity swaps) unless it satisfies certain tests (¶6-262). In addition, past losses that, under trust law or the terms of the trust instrument, are required to be met out of corpus are not allowable in calculating the net income of the trust for tax purposes in relation to a life tenant or a beneficiary with no beneficial interest in the trust corpus.

▶ Example 1

For the prior income year, The Clooney Trust suffered a loss of $800. For the current income year, its net trust income for tax purposes, before taking into account the prior year loss, is $2,000. Under the terms of the trust, the loss is to be met out of corpus. One of the two beneficiaries (Andrew) is entitled to half the trust income for life but to no interest, contingent or otherwise, in corpus. The other beneficiary (Felicia) is entitled to the remaining half of the trust income and also has a contingent interest in the trust corpus. The net trust income for tax purposes for the current year is: (a) so far as Andrew is concerned, $2,000 of which his share is $1,000; and (b) so far as Felicia is concerned, $1,200 (ie $2,000 – $800) of which her share is $600 (this assumes the trust satisfies the trust loss requirements: ¶6-262).

As regards current year losses, the trust loss provisions may require a trust to work out its net income in a special way if it does not satisfy similar tests to those that apply in relation to prior year losses (¶6-262, ¶6-265).

Trust losses that are deductible in calculating the net income of the trust for tax purposes are first offset against any exempt income derived by the trust (¶16-895). If the trust's exempt income for the year exceeds the unrecouped loss, the balance is treated as exempt income of a beneficiary to the extent of the beneficiary's individual interest in that exempt income, subject to a limited exception (¶6-110). Trust losses are never available as such to reduce the other income of a beneficiary.

▶ Example 2

If, in the above example, the trust also derives $600 exempt income in the current income year, the net trust income is: (a) so far as Andrew is concerned, $1,000 (ie 50% of $2,000); and (b) so far as Felicia is concerned, $900, ie 50% of ($2,000 – ($800 – $600)). No part of the exempt income is included in Felicia's exempt income because the exempt income has been fully taken into account in calculating the net income of the trust estate (¶6-110). The amount of $300 (ie 50% of $600) is included in Andrew's exempt income.

The net income of a trust for tax purposes will not necessarily correspond with the actual net income of the trust for trust accounting purposes. The position where the net income for income tax purposes exceeds the net income for trust purposes is considered at ¶6-200. The converse situation, where the net income for trust purposes exceeds the net income for income tax purposes, is considered at ¶6-130.

Based on the ''refinancing principle'' recognised in *Roberts & Smith* (¶16-740), interest incurred by a trustee on a loan used to finance the payment of a returnable amount is deductible. A returnable amount arises where: (a) an individual has subscribed money for units in a unit trust, and has a right of redemption in relation to the units and the money is used by the trustee to purchase income-producing assets; and (b) a beneficiary has an unpaid present entitlement to some or all of the capital or net income of the trust estate, and the amount to which the beneficiary is entitled has been retained by the trustee and used in the gaining or producing of assessable income of the trust (TR 2005/12). For example, this would be the case if the borrowed funds are used to repay the beneficiary an amount lent by the beneficiary to the trustee who uses the amount for income-producing purposes. Amounts attributable to internally generated goodwill or the unrealised revaluation of assets are not ''returnable amounts''. In the absence of a returnable amount, interest is not deductible if the purpose of the loan is merely to discharge an obligation to make a distribution to a beneficiary.

Foreign trust with capital gain or loss

If a trust is a foreign trust for CGT purposes (¶12-720), a capital gain or capital loss from a CGT event happening in relation to an asset of the trust that is not taxable Australian property is disregarded under ITAA97 s 855-10, despite the fact that the trust is treated as a resident taxpayer when calculating its net income under ITAA36 s 95 (see above); also, in such circumstances the beneficiaries are not treated as having capital gains or making capital losses under ITAA97 Subdiv 115-C (*Draft* TD 2016/D4). Whether a distribution to a beneficiary by the trustee that is attributable to such a capital gain is assessable will largely turn on whether ITAA36 s 99B (¶6-130) is attracted. However, if s 99B is attracted, the beneficiary would not be able to offset a prior year net capital loss or a current year capital loss against the amount, and the discount capital gain concession would not be available (*Draft* TD 2016/D5).

PAYG instalment income of a trust

Under the PAYG system, unless a trustee is absolutely certain that no beneficiary is a quarterly PAYG instalment taxpayer, the trust must calculate the beneficiaries' instalment income quarterly. This is based on the trust's instalment income for the quarter (generally, only its ordinary income). The trustee must notify each affected beneficiary, so that PAYG instalments can be paid (¶27-270).

[FTR ¶50-545, ¶50-685]

¶6-085 The income of a trust

The income of a trust estate is an underlying concept of the trust assessing provisions of ITAA36 Div 6. It is the share of the income of a trust to which a beneficiary is presently entitled which determines the amount (share) of the net income for tax purposes on which the beneficiary (or the trustee on the beneficiary's behalf) is assessable. A beneficiary's share of the income of a trust is also the basis for determining

the beneficiary's adjusted Division 6 percentage (which is relevant where the trust has a net capital gain, a franked distribution or a franking credit included in its net income for tax purposes).

The ''income'' of a trust estate is not a defined term and is simply the distributable trust income determined in accordance with trust law principles and the trust deed (*Bamford*). This means that, in determining the income of a trust for an income year any definition of income in the trust deed will be relevant, as well as any powers conferred on the trustee by the trust deed to characterise an amount as being income or capital.

''Net income'' for tax purposes is a defined term and is discussed at ¶6-080.

Commissioner's views

The Commissioner has issued a draft ruling on the meaning of the expression ''the income of the trust estate'' in ITAA36 Div 6 (*Draft* TR 2012/D1). This draft ruling was issued in March 2012 but, unfortunately, has not as yet been finalised. Points made in the draft ruling include:

- the ''income of the trust estate'' (ie the trust's distributable income for an income year) is measured in respect of distinct income years (being the same years in respect of which the trust's net income is calculated)
- ''income'' and ''trust estate'' are distinct concepts, income being the product of the trust estate. This means that something which formed part of the trust estate at the start of an income year cannot itself, for the purposes of ITAA36 Div 6, be treated by the trustee as income of the trust for that year
- the ''income of the trust estate'', is a reference to the income available for distribution to beneficiaries or accumulation by the trustee, (commonly referred to as ''distributable income'')
- notwithstanding how a particular trust deed may define income, the ''income of the trust estate'' must be represented by a net accretion to the trust estate for the relevant period
- if the trust's net income includes notional income amounts, those amounts cannot (except in the circumstances noted below) be taken into account in calculating the ''income of the trust estate''. Examples of amounts that may be included in calculating a trust's net income but which may not form part of the income of the trust estate are: the amount of a franking credit; so much of a share of the net income of one trust (the first trust) that is included under ITAA36 s 97 in the calculation of the net tax income of another trust, but which does not represent a distribution of income of the first trust; so much of a net capital gain that is attributable to an increase of what would have otherwise been a relevant amount of capital proceeds for a CGT event as a result of the market value substitution rule; and an amount taken to be a dividend by ITAA36 Div 7A that is paid to the trustee of the trust.

The draft ruling states that the effect of a clause in the trust instrument (or the valid exercise of a power by the trustee) to equate the distributable income of the trust with its net income is that an amount of notional income is able to satisfy any notional expenses chargeable against trust income. However, to the extent that the total notional income amounts for an income year exceed notional expense amounts of the trust estate for that year, they cannot form part of the ''income of the trust estate'' for ITAA36 Div 6 purposes (the trust estate's ''distributable income'') for that year.

Present Entitlement

¶6-100 Meaning of presently entitled

''Present entitlement'' is a critical concept in the trust provisions. This is because the method of taxing trust income varies according to whether it is income to which a beneficiary is presently entitled or income to which no beneficiary is presently entitled. Note that, where a franked distribution or a capital gain is streamed, the relevant concept in relation to these amounts is now the statutory concept of specific entitlement which is a wider concept than the concept of present entitlement; a beneficiary who or which is presently entitled to a relevant amount will be specifically entitled, but a beneficiary may be specifically entitled without being presently entitled. For discussion of the specific entitlement concept, see ¶6-107.

The High Court has held that, for a beneficiary to be ''presently entitled'' to trust income, several conditions must be satisfied (*Whiting*; *Taylor*; *Union Fidelity Trustee Co of Australia*; *Bamford*).

First, the beneficiary must have an indefeasible, absolutely vested, beneficial interest in possession in the trust income. The interest must not be contingent but must be such that the beneficiary may demand immediate payment of that income. Or, if the beneficiary is under a legal disability such as infancy or insanity, the interest must be such that the beneficiary would have been able to demand immediate payment of the income had there been no disability or incapacity. For example, parties to a dispute concerning moneys held under a court order by solicitors acting as trustees were held not to be presently entitled beneficiaries as their interest was, at best, contingent; accordingly, the solicitors were liable to tax as trustees on the interest income earned from the investment of the disputed funds (*Harmer*). Similarly, where the funds in a joint bank account constituted a trust, the parties were neither jointly nor individually presently entitled to the interest on the funds where their respective entitlements, as set out in the constituent deed, were contingent on the occurrence of future events (*Walsh Bay Developments*).

Secondly, a beneficiary can only be presently entitled to income that is legally (ie according to trust law) available for distribution to the beneficiary, even though it may not be in the trustee's hands for distribution at the relevant time. In the case of a deceased estate, the beneficiaries will not be presently entitled to income until it is possible to ascertain the residue with certainty (after provision for debts, legacies, etc). However, it is not necessary for the estate to be wound up. Where, during the administration of the estate, it is apparent to the executor that part of the net income will not be required to pay debts, etc, and the executor pays some of the income to or on behalf of the beneficiaries, those beneficiaries will be presently entitled to the income to the extent of the amounts actually paid (IT 2622).

In *Pearson*, the trustee of a discretionary trust was not presently entitled to the net income of a unit trust where:

- there was no provision in the trust deed of the unit trust (in which the trustee held all the units) to make the trustee presently entitled, nor did the unitholders have any legal right to demand payment of undistributed net income, and
- as the sole unitholder, the trustee could have brought the unit trust to an end.

Beneficiaries may be presently entitled even if, under the terms of the trust, the entitlement is only to have money applied for their benefit and not paid directly to them (*Sacks v Gridiger*). Further, a beneficiary does not cease to be presently entitled to income merely because the income has been distributed to persons not entitled to it (*Case R32*).

By way of legislative extension of the concept of present entitlement, a taxpayer is taken to be presently entitled in the following situations.

- A presently entitled beneficiary who is paid an amount of income, or for whose benefit income is applied, is to be taken as continuing to be presently entitled to that income, notwithstanding its payment or application (s 95A(1)).
- A person who is not otherwise presently entitled to the income of a trust but who has a vested and indefeasible interest in it is deemed to be presently entitled to the income (s 95A(2)) (*Estate Mortgage*). A solicitor's client was deemed under this provision to be presently entitled to interest income earned on funds held in the solicitor's name as security for costs in proceedings brought by the client (*Dwight*). Income to which a beneficiary is deemed to be presently entitled under s 95A(2) is assessed to the trustee under s 98 (¶6-120) where the beneficiary is a natural person (whether under a legal disability or not) and is not a beneficiary in the capacity of trustee of another trust.
- A beneficiary in whose favour a trustee exercises a discretion to pay or apply trust income is deemed to be presently entitled to the amount so paid or applied (s 101: ¶6-105).

In certain situations involving tax avoidance, a presently entitled beneficiary will be deemed not to be presently entitled (¶6-270, ¶6-274).

For the CGT consequences where a beneficiary is absolutely entitled to a CGT asset as against the trustee of a trust (disregarding any legal disability), see ¶11-210.

Even if the trust deed permits the distribution of income of an accounting period to be made after the end of the accounting period, to be effective for tax purposes a beneficiary must be presently entitled to income by the last day of the income year in which the income is derived by the trust (that is, by 30 June in the case of a trust with a regular accounting period) (*Harmer*; *Colonial First State Investments*). However, if the trust deed requires a distribution of income for an accounting period to be made at a time before the end of an accounting period the distribution must be made by the time stipulated in the deed if it is to be effective for the purposes of trust law and tax law.

[FTR ¶50-565, ¶50-588, ¶50-615]

¶6-105 Discretionary trusts

Where a trustee is given a discretion to pay or apply trust income to or for the benefit of specified beneficiaries, a beneficiary in whose favour the trustee exercises the discretion is deemed to be presently entitled to the amount so paid or applied (s 101). In such a case, the beneficiary is assessable on the appropriate amount of the net income for tax purposes, except where the beneficiary is under a legal disability, in which case the trustee is assessable.

For s 101 to apply, there must be an effective exercise by the trustee of the discretion to pay or apply income for the benefit of a beneficiary before the end of the income year in which the income is derived by the trustee (or earlier date if required by the trust deed). For the 2010/11 and earlier income years, the Commissioner in practice allowed an extra two months after the end of the income year in which to make a distribution, provided there was no contrary provision in the trust instrument (IT 328 and IT 329 (both withdrawn)).

Where the trustee is a company, a discretion to pay or apply trust income can be exercised without the company passing a formal resolution to that effect (*Vegners*).

Where there is an ineffective exercise by the trustee of the discretion to pay or apply income for the benefit of a beneficiary, but the trust instrument contains a vesting clause that operates in default of an effective exercise of the discretion, the beneficiary or beneficiaries specified in that default vesting clause will be presently entitled to the trust income (eg *Case X40*). This has been held to be the case even where the default vesting clause may be ambiguous (*Marbray Nominees*). The Commissioner accepts this decision and has stated that, where there is ambiguity in the wording of a default vesting clause, it

will generally be construed to give effect to the settlor's intention (IT 2356). For a default income clause to be effective for tax purposes it would need to be activated by the end of the particular income year.

Income is applied for the benefit of a beneficiary if the trustee takes steps that have the effect of immediately and irrevocably vesting a specific portion of the income of the year in the beneficiary, so that the beneficiary's contingent interest in the income becomes an absolute one. The following steps have been held to be sufficient to constitute an application of income for the benefit of a beneficiary:

- a resolution that income "shall belong to" the minor beneficiaries (*Vestey's Settlement*)
- a declaration determining that part of the income was "to be held for the credit of" the contingent beneficiaries (*Ward*), and
- a resolution that the income "be set aside and apportioned for and shall belong to" the beneficiaries (*Case E47*).

A discretionary beneficiary may be deemed to be presently entitled notwithstanding that the beneficiary was unaware of their entitlement to trust income or even of the existence of the trust (*Vegners*). However, a beneficiary may disclaim an entitlement to trust income on it coming to their knowledge (*Cornell*) either actually or constructively (*Confidential*). Any evidence of actual dissent is sufficient and the disclaimer need not be evidenced by deed. For a disclaimer to be effective, it must be an actual disclaimer of the whole interest and not merely part of the interest. In the case of a discretionary trust, each entitlement arising as the result of the exercise of the trustee's discretion to appoint income is a separate gift, the subject matter of the gift being the income (as defined by the deed) for the relevant accounting period (*Ramsden*). Thus, the fact that a beneficiary as a discretionary object receives distributions of income in earlier years does not prevent the beneficiary from disclaiming a gift in a later income year merely because they had accepted gifts from the trustee in the past (ID 2010/85).

The interest of a default beneficiary is a separate gift arising by operation of the trust deed and relates to all accounting periods such that a disclaimer confined to one only of those accounting periods is necessarily ineffective whilst an assent in one year will prevent a disclaimer in a later year (*Ramsden*). While a disclaimer of an interest in trust income may be effective to avoid tax liability on the income, renunciation of the right to be considered as a discretionary object of the trust will not be effective to avoid liability if it is actually an attempt to "undo the past". In *Nguyen*, a deed of renunciation five years after acknowledgment of present entitlement to trust income was held to be ineffective.

Retrospective disclaimers made by default beneficiaries were ineffective as they did not occur within a reasonable period after notice of the gift and did not constitute a rejection of their entire interests in the trust income (*Ramsden*). The effect of purported disclaimers was recently considered by the AAT in *Case 9/2016*.

Purported distributions will be treated as shams with no effect where the "beneficiaries" either do not exist or are never intended to receive the benefit of the trust income. The ATO has given special attention to such arrangements involving non-resident beneficiaries (*Case 46/96*). Taxpayers may be expected to provide evidence of the distribution of moneys to non-resident beneficiaries and of the fact that the beneficiaries were aware that they were entitled to the moneys. In a case where there was no evidence that 29 non-residents had any entitlements to trust income from film production totalling $565,500 or that any funds were actually paid to them, the AAT held that the purported creation of the entitlements was a sham. As a result, the wife of the film producer was liable for tax on the total amount as a default beneficiary (*Hasmid Investments*).

Trustees of closely held trusts and of discretionary trusts (with some exceptions, eg family trusts) must disclose, in the trust's tax return, the identity of trustee beneficiaries who are entitled to any distributions made by the trust (¶6-275). Failure to disclose such beneficiaries (and the TFN of resident beneficiaries) will result in the distribution becoming taxable at the highest marginal tax rate (plus Medicare levy) in the hands of the trustee (¶6-230). For this purpose, "closely held trusts" are trusts that are not widely held (a "widely held trust" is a trust that is listed on the stock exchange or a trust where more than 20 individuals hold 75% or more of the interest in the income or capital of the trust). Also, trustees of closely held trusts including family trusts are now subject to TFN withholding rules (¶6-277).

As to the position where a sole trader's trading assets are transferred to a trustee of a discretionary trust, see ¶9-290.

[FTR ¶51-025, ¶51-230ff]

Specific Entitlement

¶6-107 Meaning of specific entitlement

The way that capital gains that are reflected in the net capital gain of a trust and franked distributions received by a trust are streamed is by the trustee making a beneficiary or beneficiaries specifically entitled to an amount of the capital gain or franked distribution. The trustee must have the necessary power to do this under the trust instrument.

For a beneficiary to be specifically entitled to an amount of a capital gain or franked distribution:

(1) the beneficiary must receive, or be reasonably expected to receive, an amount equal to the "net financial benefit" referable to the capital gain or franked distribution in the trust, and

(2) the entitlement must be recorded in its character as such in the accounts or records of the trust no later than: (a) two months after the end of the income year in the case of a capital gain; and (b) the end of the income year in the case of a franked distribution. The end of the income year will also be relevant in the case of a capital gain to the extent to which it is treated as income under the trust deed.

Broadly, a beneficiary will be specifically entitled to the fraction of the (gross) tax amount that equals their fraction of the net trust amount referable to the capital gain or franked distribution. For example, a beneficiary that receives an amount specified to be half of the trust's profit from the sale of an asset will generally be specifically entitled to half of the (tax) capital gain realised on the asset (ITAA97 s 115-228(1); 207-58(1)).

When a beneficiary has a specific entitlement to a capital gain or franked distribution, the associated tax consequences in respect of that distribution apply to that beneficiary (¶4-860, ¶11-060).

Capital gains and franked distributions to which no beneficiary is specifically entitled are attributed proportionally to beneficiaries and/or the trustee based on their "adjusted Division 6 percentage", that is, broadly, their share (expressed as a percentage) of the income of the trust excluding amounts of capital gains and franked distributions to which any beneficiary is specifically entitled.

To be specifically entitled, a beneficiary must receive, or reasonably be expected to receive, an amount equal to their "share of the net financial benefit" that is referable to the capital gain or franked distribution (see (1) above). This does not require an "equitable tracing" to the actual trust proceeds from the event that gave rise to a capital gain or the receipt of a franked distribution. For example, it does not matter that the

proceeds from the sale of an asset or a franked distribution were re-invested during the year, provided that a beneficiary receives (or can be expected to receive) an amount equivalent to their share of the net financial benefit.

The Commissioner's view is that (depending on the circumstances) a beneficiary can be said to be specifically entitled to receive a share of the net financial benefit of a capital gain even if the making of the capital gain is not established until after the end of the income year (eg because of the settlement of a contract after the end of the income year) (TD 2012/11).

The entitlement can be expressed as a share of the capital gain or franked distribution. More generally, the entitlement can be expressed using a known formula even though the result of the formula is calculated later. For example, a trustee could resolve to distribute to a beneficiary:

- $50 referable to a franked distribution
- half of the ''trust gain'' realised on the sale of an asset
- the amount of franked distribution remaining after calculating directly relevant expenses and distributing $10 to another beneficiary
- 30% of a ''net dividends account'' that includes all franked and unfranked distributions, less directly relevant expenses charged against the account (so long as their entitlement to net franked distributions can be determined), or
- the amount of (tax) capital gain included in the calculation of the trust's net tax income remaining after the application of the CGT discount concession. (In such a case the beneficiary would generally be specifically entitled to only half of the gain, and that entitlement is taken to be made up equally of the taxable and discount parts of the gain.)

A beneficiary under a deceased estate who was entitled to a remainder interest was specifically entitled to a capital gain that arose to the trustee of the deceased estate from the happening of CGT event E5 (beneficiary becoming absolutely entitled to a trust asset) on the death of the life tenant (ID 2013/33).

"Net financial benefit"

A ''net financial benefit'' is the ''financial benefit'' or actual proceeds of the trust (irrespective of how they are characterised) reduced by (trust) losses or expenses (subject to certain conditions).

''Financial benefit'' is defined to mean anything of economic value (including property and services) (ITAA97 s 974-160). It includes a receipt of cash or property, an increase in the value of units in a unit trust, the forgiveness of a debt obligation of the trust or any other accretion of value to the trust. When determining a beneficiary's fraction of the net financial benefit referable to a ''capital gain'', the (gross) financial benefit referable to the gain is reduced by trust losses or expenses only to the extent that tax capital losses were applied in the same way. When determining a beneficiary's fraction of the net financial benefit referable to a ''franked distribution'', the (gross) financial benefit is reduced by directly relevant expenses only.

Other points

Some other points to note are:

- no beneficiary can be specifically entitled to the part of a capital gain that arises because of the market value substitution rules
- the net financial benefit referable to a franked distribution will normally equal the amount of the franked distribution after being reduced by directly relevant expenses (eg any annual borrowing expenses (such as interest) incurred in respect of the underlying shares)

- the net financial benefit referable to a capital gain will generally be the trust proceeds from the transaction or circumstances that gave rise to the CGT event, reduced by any costs incurred in relation to the relevant asset. This may be further reduced by other trust losses of a capital nature (to the extent consistent with the application of capital losses for tax purposes)
- care must be taken where a capital gain is treated under the trust deed as being partly capital and partly income as could be the case where a discount capital gain is treated as capital to the extent that it is reduced by the CGT discount concession but is otherwise treated as income
- it is not possible to stream tax amounts to beneficiaries where there is no referable net financial benefit remaining in the trust — such as when the gross benefit has been reduced to zero by losses or directly relevant expenses. However, if the trustee deals with all of the franked distributions received by the trust as a single ''class'' (or as part of a broader class), the provisions apply to the total franked distributions as if they were a single franked distribution (ITAA97 s 207-59), and
- it is not possible to make a beneficiary specifically entitled to franking credits, or to separately stream franked distributions and franking credits.

Note that the changes that apply from and including the 2010/11 income year did not alter the rules that allow franking credits to flow proportionally to beneficiaries that have a share of a trust's (positive) income for an income year notwithstanding that the franked distributions of the trust were entirely offset by expenses.

When and How Beneficiary is Taxed

¶6-110 Beneficiary presently entitled and not under legal disability

A beneficiary who is presently entitled to a share of the income of a trust (¶6-085) and is not under a legal disability is assessable on (s 97(1)):

- that share of the net income for tax purposes (¶6-080) that is attributable to a period when the beneficiary was a resident, whatever the source of the income, and
- that share of the net income for tax purposes that is attributable to a period when the beneficiary was not a resident and that is also attributable to sources in Australia.

The reference to a beneficiary being presently entitled to a ''share'' of the income of a trust is a reference to a proportion, fraction or percentage and the reference to that share of the net income is a reference to that same fraction, proportion or percentage of the net income (*Bamford*). This is called the ''proportionate'' approach to the operation of Div 6 and its implications are considered in TD 2012/22. Just how the proportionate approach operates depends on the wording of the distribution resolution. The determination shows, by example, the effect of distribution resolutions based on fixed amounts, fixed amounts ''and the balance'' and distributions by proportions. The consequences of later amendments to the net income of a trust for tax purposes are also explained.

Where a trust has a net capital gain or a franked distribution, the provisions noted at ¶6-077 apply.

In the case of a deceased estate, the ATO accepts an apportionment of net income between the executor and the beneficiaries in the income year in which the estate is fully administered (IT 2622: ¶6-190).

The beneficiary's share of the net income is aggregated with other assessable income of the beneficiary subject to Australian tax and, after taking into account all deductions, the total taxable income is taxed at the rate applicable to the beneficiary. Where franked distributions are received by the trust, the beneficiary may be entitled to a franking rebate (¶4-860).

Generally, the exempt income of a beneficiary includes the beneficiary's individual interest in the exempt income of a trust. However, exempt income of the trust is not included in the beneficiary's exempt income to the extent that it is taken into account in calculating the net income of the trust (s 97(1)(b): ¶6-080). The High Court has held that exempt income is only ''taken into account'' in determining the net income of a trust estate when the trust has a loss that, in effect, absorbs the exempt income. If the trust has incurred a loss in a prior year, this must first be offset against any net exempt income of the trust; as a consequence, the beneficiary's interest in the exempt income is reduced (¶16-895). The separation of annuity income into exempt income and assessable income under s 27H (¶14-510) does not involve ''taking exempt income into account'' in calculating net income (*ANZ Savings Bank*).

The non-assessable non-exempt income of a beneficiary (¶10-890) includes the beneficiary's individual interest in the non-assessable non-exempt income of a trust.

The Commissioner takes the view that the assessable income of an investor under s 97 should include the amount of any commission paid by the investment fund to an intermediary (eg an investment adviser, accountant or solicitor) in relation to the capital of the investor where the intermediary is under an obligation to pass on the amount to the investor. The amount to be included in assessable income is reduced by deductions, such as fees charged by the intermediary for collection and administration of the commission (TR 93/36).

A distribution by the trustee of a unit trust (eg a cash management, equity, mortgage or property trust) is assessable to the unitholder in the income year in which the unitholder is presently entitled to a share of the income of the unit trust, rather than in the year in which the distribution is received by the unitholder. Unless the trust deed provides otherwise, a unitholder is entitled to a share of the income of a unit trust at the end of the period in which the income is derived (TD 94/72). This does not, however, apply to corporate unit trusts (¶6-280).

Trust income to which a resident beneficiary is deemed to be presently entitled by virtue of s 95A(2) (¶6-100) is normally assessed to the trustee under s 98, even if the beneficiary is not under a legal disability. The beneficiary continues to be assessable under s 97 where the beneficiary is a company or a beneficiary in the capacity of trustee of another trust.

Where a private company beneficiary is presently entitled to income of a trust but the present entitlement is not paid, a loan made by the trustee to a shareholder of the company beneficiary (or to an associate of a shareholder) is treated as a loan by the company to the shareholder (or associate) and potentially subject to the deemed dividends provisions of ITAA36 Div 7A (¶4-110). The Div 7A implications of an unpaid present entitlement have, however, diminished because the Commissioner now takes the view that where a company is an unpaid presently entitled beneficiary there will be circumstances in which the company will be taken to have made a loan to the trust for the purposes of ITAA36 Div 7A because there will be an in-substance loan by the company to the trust or a loan to the trust by the provision of financial accommodation (¶4-200). The practical effect of a loan by the company to the trust would be to extinguish the present entitlement and the Div 7A trust rules would not apply. However, the loan that arises from the company to the trust would potentially fall within the Div 7A company loan rules (¶4-210).

[FTR ¶50-580, ¶50-600]

¶6-120 Beneficiary presently entitled but under legal disability

Where a beneficiary is presently entitled to a share (proportion) of the income of a trust (¶6-085) but is under a legal disability, the trustee is liable to pay tax on that share (proportion) of the net income (¶6-080) (s 98). Minors, bankrupts and insane persons are under a legal disability because they cannot give a discharge for money paid to them.

If the beneficiary is a resident for the whole of the income year, the trustee is assessable on the whole of the beneficiary's share of the net income, including net income attributable to foreign sources. If the beneficiary is a non-resident for the whole or a part of the year, the trustee is assessable on the beneficiary's share of the net income, but excluding so much of it as is attributable both to foreign sources and to a period when the beneficiary was a non-resident. The ATO will accept an apportionment of net income between executors and beneficiaries in the income year in which a deceased estate is fully administered (IT 2622: ¶6-190).

The beneficiary is also assessable on their share of the net income of the trust if that person is a beneficiary in more than one trust or has income from other sources (eg salary or wages, rent, interest or dividends). In such a case, the beneficiary's individual interest in the net income of the trust is aggregated with their other income. However, to prevent double taxation, the beneficiary is entitled to a credit against the total tax assessed for the tax paid or payable by the trustee in relation to the beneficiary's interest in the net income (s 100). The credit cannot exceed the tax otherwise payable by the beneficiary, even though the trustee assessment may have been for a greater amount. Where the trust derives franked dividend income, the tax payable by the trustee that is allowable as a credit to the beneficiary is the gross tax payable by the trustee reduced by the beneficiary's share of the trust's imputation rebate (TD 93/186).

▶ Example

Melinda, who is 17, is absolutely entitled to a one-third share of the income ($54,000) of the Beetle Trust, although she cannot actually receive it until she is 18. She is also a discretionary beneficiary of the Morris Trust. In the relevant year, the trustee of the Morris Trust pays $4,000 towards Melinda's university fees. In addition, she earns $1,800 from a holiday job. She is assessable on $23,800 ($18,000 + $4,000 + $1,800), but the tax otherwise payable is reduced by the aggregate of the tax paid by the trustees of the two trusts on her share of the net income of each trust.

Where the beneficiary is under 18 years of age and is a ''prescribed person'', special rates of tax apply to certain types of trust income to which the beneficiary is presently entitled (¶2-160 and following). A beneficiary who is presently entitled to income of a trust in the capacity of the trustee of another trust is treated as not being under a legal disability in respect of their present entitlement to that share (s 95B).

Where the only source of income of a beneficiary under a legal disability is a distribution from one trust, the beneficiary is not required to lodge a tax return (TD 92/159).

A trustee carrying on a primary production business may make farm management deposits (FMDs) on behalf of a presently entitled beneficiary who is under a legal disability (¶18-290). In such a case, the beneficiary is assessable under s 97 on their share of the trust income, regardless of whether the beneficiary is under a legal disability (s 97A). This means that the deduction for the deposit will be allowed in the beneficiary's assessment, instead of being reflected in the trustee's assessment.

The same result applies where an FMD is lodged on behalf of a beneficiary who is not under a legal disability and is deemed to be presently entitled because of their vested and indefeasible interest (¶6-100).

[FTR ¶50-600]

¶6-130 Distributions of trust income

Trust income that has been previously assessed to the trustee or the beneficiary is not assessable when received by the beneficiary. On the other hand, receipts of previously untaxed trust income may be assessable to the beneficiary. This is the case where an amount is paid to, or applied for the benefit of, a beneficiary who is a resident at any time during the income year and the amount represents trust income of a class that is taxable in Australia but which has not previously been subject to tax in the hands of the beneficiary or trustee (s 99B; *Howard* (Full Federal Court); ID 2011/93).

This does not affect the (reduced) deduction that may apply where eligible art gifts (¶16-965) or heritage gifts (¶16-967) are made subject to benefits being reserved to the taxpayer making the gift.

[FTR ¶38-512]

¶16-977 Contributions to fundraising events

A deduction is available to an individual for:

- a contribution of cash exceeding $150, or property with a value exceeding $150, which is made for the right to attend or participate in a fundraising event conducted by a deductible gift recipient (DGR). The deduction is reduced by the GST-inclusive value of any minor benefit received in return. The minor benefit must not exceed the lower of $150, or 20% of the contribution (s 30-15, item 7), and/or
- a contribution of cash exceeding $150 for the purchase of goods or services resulting from a successful bid at a fundraising auction conducted by a DGR. The deduction is reduced by the GST-inclusive market value of the goods or services on the day the contribution is made, and the market value must not exceed the lower of $150, or 20% of the contribution (s 30-15, item 8).

The deduction for contributions for the right to participate in a fundraising event is limited to two contributions for the same event. However, there is no limit to the number of deductions for successful bids for goods or services at a fundraising auction.

Eligible fundraising events

Eligible fundraising events are limited to one-off events conducted by DGRs in Australia, eg fetes, balls, gala shows, performances and similar events, and even golf games. The DGR must use the funds raised at the event/auction for the same purpose that enables them to qualify as a DGR.

Eligible contributions of property

Where the contribution is property provided in exchange for a right to attend or participate in a fundraising event, it must be valued at more than $150 if purchased within 12 months of the contribution being made. For this purpose, the property's value is the lower of its market value on the day the contribution is made and the amount the contributor paid for the property.

There is a special rule for contributions consisting of shares listed on an Australian stock exchange that were not purchased within 12 months of the fundraising contribution. Such shares are valued at their market value on the day of the contribution, provided that value exceeds $150 but is less than or equal to $5,000.

In all other circumstances where the property was not purchased within 12 months of the contribution being made, the property's value is determined by the Commissioner. To qualify, the Commissioner's valuation must exceed $5,000, and the GST-inclusive value of the right to attend or participate in the fundraising event must not exceed $150.

The deduction for contributions of property is limited to those for the right to attend or participate in a fundraising event. Gifts of goods or services for fundraising auctions are not deductible under these rules, but may qualify under the general rules commencing at ¶16-950.

DGR to assess minor benefit

The DGR is responsible for determining the market value of the minor benefit given in return for a contribution. Where the DGR issues a receipt to a contributor, it must state either the GST-inclusive market value of the right to participate in the fundraising event or, where a successful bid at a fundraising auction has been made, the GST-inclusive market value of the goods or services purchased by the contributor.

Chapter 17 Depreciating Assets

Introduction

¶17-000 Overview of uniform capital allowance system

Deductions for the decline in value of depreciating assets are available under the uniform capital allowance system (ITAA97 Div 40). In addition to the rules for depreciating assets (covered in this chapter), Div 40 contains rules that provide deductions for certain other capital expenditure.

Chapter 18 deals with deductions for telephone lines (¶18-060), horticultural plants (¶18-070), water facilities (¶18-080), fodder storage assets (¶18-085), fencing assets (¶18-090, landcare operations (¶18-100) and timber depletion (¶18-120).

Deductions for mining and quarrying operations, exploration and prospecting, transport and site rehabilitation are covered in Chapter 19. Pooled project expenditure (¶19-050), environmental impact assessments (¶19-060) and environmental protection (¶19-110) are also discussed.

The write-off for business capital costs is outlined at ¶16-156 and the deduction for mains electricity supply is at ¶16-820.

A separate regime (Div 43) applies to capital works expenditure on buildings and structural improvements (¶20-470). Other assets are also excluded from Div 40, such as assets deductible under the film concession provisions (¶20-330).

Small business taxpayers

Small business entities have the option of choosing simplified depreciation arrangements (¶7-250).

¶17-005 Deduction for depreciating assets

The cost of a depreciating asset is generally of a capital nature and is therefore not immediately deductible as an ordinary business expense (¶16-060). However, deductions may be available for the decline in value of a depreciating asset to the extent that the asset is used for a taxable purpose (ITAA97 Div 40). The decline in value is calculated by spreading the cost of the asset over its effective life and using either the prime cost or the diminishing value method. Effective life is either self-assessed or determined by the Commissioner (a statutory effective life applies in limited cases). Balancing adjustments may be required if a balancing adjustment event occurs (¶17-630) and any CGT consequences must also be considered. In some cases, roll-over relief is available.

Certain expenditure on software development (¶17-370) or low-cost depreciating assets (¶17-810) may be grouped into a ''pool'' and deductions allowed for the decline in value of the pool. An immediate write-off is available for non-business assets costing $300 or less (¶17-330).

The deductions for the decline in value of depreciating assets may be subject to a number of anti-avoidance provisions. In particular, the provisions dealing with hire purchase arrangements (¶23-250), tax-preferred asset financing (¶23-210) and limited recourse financing (¶23-260). The effectiveness of sale and leaseback arrangements is discussed at ¶23-240.

As the cost of an entity's depreciating assets is reset when it forms a consolidated group (¶8-210), the head company and the joining or leaving entity work out their own depreciation for the part of the year that the asset is theirs (ITAA97 s 716-25; ITTPA s 701A-10) (¶8-580). Special rules apply for low-value and software pools (ITAA97 Subdiv 716-G).

For the consequences of acquiring depreciating assets in foreign currency transactions, see ¶23-070.

[FITR ¶86-800]

Requirements for Deduction

¶17-010 Assets used for taxable purposes

A deduction is available for the decline in value of a ''depreciating asset'' (¶17-015) that is held by the taxpayer at any time during the year. The deduction is reduced to reflect the extent to which the asset was used during the income year for a purpose other than a ''taxable purpose'' (eg private or domestic purposes or to produce exempt income) (ITAA97 s 40-25).

''Use'' requires the employment of the asset so that it can reasonably be expected to decline in value (TD 2007/5; ID 2007/116; ID 2006/151). Where a car was acquired by a lessee from the lessor and immediately sold to a third party, it was not ''used'' (ID 2003/552).

A depreciating asset may be used for a taxable purpose even though it does not, of itself, generate assessable income. The provider of a fibre optic cable network was entitled to a deduction for the entire decline in value of the cable network even though only eight of the 12 fibre optic strands gave rise to an assessable licence fee (*Reef Networks*). See also ID 2004/958 (where the taxpayer granted to a partnership, of which he was a partner, the exclusive use of the asset to enable the partnership to provide a service to the taxpayer).

▶ Planning point

As no decline in value deduction is available if income-producing operations have not commenced (TD 2007/5), assets should start being used after such operations have commenced.

"Held in reserve"

A deduction is also available for the decline in value of a depreciating asset that is not actually used for a taxable purpose during the year but is installed ready for use for a taxable purpose and held in reserve. An asset is held in reserve if it is on hand and in such a state that it is ready to perform its function, its use being contingent on some future event occurring in a taxpayer's existing income-producing activities (ID 2006/151; ID 2004/146).

Decline in value deductions and employees

An employee may be entitled to a deduction for the decline in value of assets that the employee holds and uses in relation to a job even if such use is not a condition of employment. It is enough for the use of the asset to be within the scope of the particular duties of employment (IT 2198). Where an employee claims a deduction for the decline in value of an asset, the substantiation requirements must be considered (¶16-210).

If the employee is reimbursed for an expense by the employer, the employee's entitlement to a deduction for the expense is generally either reduced or disallowed altogether (ITAA36 s 51AH). However, for depreciating assets acquired on or after 1 July 2008, s 51AH does not apply to disallow depreciation deductions (see also *Notice of Withdrawal of Draft* TD 2005/D17 and ¶17-030). Note that employees can not claim depreciation deductions for FBT eligible work-related items (under FBTAA 1986 s 58X) acquired after 13 May 2008 which were provided as expense payment of property fringe benefits (s 40-45(1)).

Even items intrinsically private in nature may qualify for deduction in appropriate circumstances (¶16-170), eg the decline in value of TVs and DVD players may be deductible to journalists, entertainers and football coaches if the necessary connection with the job can be shown (*Case R113*; *Case T17*). Teachers may claim deductions for the decline in value of items such as calculators, voice recorders and computers. Deductions may be allowed for briefcases, carry-bags, kit bags, suitcases, etc, that are used as an integral part of employment (*Case P56*; *Case R89*). Such claims are reduced to reflect the degree of private use.

Taxpayers with physical disabilities are not entitled to deductions for the decline in value of medical appliances such as wheelchairs, hearing aids, artificial limbs, spectacles, etc, even though without them the taxpayer could not do his/her job. Expenditure on such appliances may qualify for the net medical expenses tax offset (¶15-320) (IT 2217; TR 93/34).

Taxable purpose

The deduction for the decline in value of a depreciating asset is reduced to the extent that the asset was used or installed ready for use for a purpose other than a taxable purpose (eg furniture in a private home). "Taxable purpose" (s 40-25(7)) is the purpose of producing assessable income (¶16-010; *Case 9/2009*; ID 2009/137), exploration or prospecting (¶19-040), mining site rehabilitation (¶19-100) or environmental protection activities (¶19-110). If the asset is used partly for private purposes and partly for producing income, the deduction must be apportioned (¶17-570).

If the tax-preferred leasing provisions (¶23-210) apply to an asset, the taxpayer is taken not to be using the asset for a taxable purpose (except to the extent that the use of the asset is not a tax-preferred use or a private use, or that financial benefits are not to be provided to the taxpayer by tax-preferred entities).

Leisure facilities and boats

A deduction is generally not available for the decline in value of a leisure facility, except to the extent that the use of the asset constitutes a fringe benefit for FBT purposes, or occurs in the course of the taxpayer's business or for the taxpayer's employees, (s 40-25(3), (4): ¶16-420).

For the rules that apply to deductions for boat expenses (including the decline in value) from the 2007/08 income year, see ¶16-420.

[FITR ¶86-880]

¶17-015 Depreciating assets

A "depreciating asset" is defined as an asset that has a limited effective life and that is reasonably expected to decline in value over the time it is used (ITAA97 s 40-30; see, for example, ID 2003/820 and ID 2004/721). An asset is something that is capable of being put to use in the business of the holder and, for example, extends to an open pit mine site improvement (TR 2012/7). Land and items of trading stock are specifically excluded, as are intangible assets (such as licences and permits: ID 2002/755). However, the following intangible assets are included:

- mining, quarrying or prospecting rights (¶19-010; ID 2010/45)
- mining, quarrying or prospecting information (¶19-010)
- geothermal-exploration rights or information that started being held between 1 July 2012 and 30 June 2014
- items of intellectual property (see below)
- in-house software (¶17-370)
- indefeasible rights to use a telecommunications cable system (IRU). For expenditure incurred before 12 May 2004, only indefeasible rights to use *international* telecommunications submarine cable systems were depreciating assets. An amount paid for the increase in capacity of an IRU may be included in its cost
- spectrum licences
- datacasting transmitter licences, and
- telecommunications site access rights acquired by licensed telecommunications carriers (if the expenditure was incurred on or after 12 May 2004). Site access rights are rights of a carrier to share or install a facility or to enter premises for such a purpose. A facility is any part of the infrastructure of a telecommunications network or anything used in connection with such network.

The definition of a depreciating asset includes items of plant (¶17-040) as well as other assets that are wasting in nature. Depreciating assets are not limited to assets that lose value steadily over their effective lives, nor are they limited to things that only ever decline in value. All that is required is for the asset to lose its value overall (other than scrap value) by the end of its effective life, even though the asset may hold or even increase its value for a time. Forestry roads and timber mill buildings are depreciating assets and subject to ITAA97 Div 40 (before 1 July 2001, such items were subject to special provisions: ¶18-000).

The Commissioner's effective life tables reproduced in Chapter 43 (commencing at ¶43-000) provide a practical checklist of what constitutes a depreciating asset.

Improvements to land and fixtures on land are treated as separate depreciating assets for Div 40 purposes, whether or not they can be removed from the land (s 40-30(3)). An open pit mine site improvement that enhances the use of the land to the miner constitutes

an improvement to land (TR 2012/7); a gully dam constructed on land as an improvement to land is a separate depreciating asset (ID 2008/50). Whether an accommodation unit (such as those used in a caravan/tourist park) is a chattel or a fixture depends on the circumstances of each case. An accommodation unit is a chattel when it merely rests on land or it is affixed in such a way as to facilitate easy removal, or where the purpose and mode of affixing are for the more complete enjoyment of the unit as a chattel. However, an accommodation unit fixed to the ground may lose its identity as a chattel and become part of that land, that is, a fixture (TD 97/24).

The renewal or extension of a right is treated as the continuation of the original right, rather than as a separate depreciating asset (s 40-30(5)). Conversions of a mining, quarrying or prospecting right are taken to be a continuation of the original right if that right ends and the new right relates to the same area. The Full Federal Court ruled that separate rights to explore and recover petroleum were the same depreciable asset in *Mitsui & Co*.

Certain assets may qualify as depreciating assets but may be specifically excluded from the application of the uniform capital allowance system (¶17-030).

Items of trading stock (¶9-150) are not depreciating assets. Spare parts held for maintenance and repair purposes are depreciating assets. Spare parts are otherwise deductible on either an incurred basis or a usage basis (IT 333: ¶16-730) or, in some situations, may be treated as trading stock (¶9-150).

Composite assets

Whether a particular item (rather than its components) is a depreciating asset is a question of fact and degree to be determined in the light of all the circumstances of the case (s 40-30(4)). For example, a car is one depreciating asset (rather than its individual components), but a portable GPS device installed in the car is a separate asset. On the other hand, the separate assets constituting a floating restaurant (eg the ship, cutlery, crockery, furniture, stoves and refrigerators) are treated as separate depreciating assets.

In the Commissioner's view, for a component or a group of components of a composite asset to be a depreciating asset in its own right, its commercial or economic value must be able to be separately identified or recognised, using its purpose or function as a guide (TR 2017/D1). The function of the composite asset should be considered against its components, in the circumstances in which they are used. TR 2017/D1 outlines the guiding principles for this purpose and a number of examples to illustrate them. The test is similar to the ''functionality test'' used to identify a ''unit of plant'' under the former depreciation rules (TR 94/11; ID 2003/491; ID 2004/271; ID 2004/579; ID 2007/88; ID 2009/130).

▶ Examples

1. Where an electricity distribution network owner builds a distribution line or an addition to an existing line to supply customers who were not previously supplied, there is a new depreciating asset which is separate from any existing distribution infrastructure (*Draft* TR 2017/D1).

2. While an open pit mine consists of the actual pit as well as haulage roads and the pit wall (eg batters, benches, switchbacks), the entire pit, rather than any lesser combination of any of its component features, constitutes the depreciating asset (TR 2012/7).

3. Rail transport trackwork that contains many components in an integrated interdependent manner is a single deprecating asset because the asset has multiple components purchased as a system to function together (*Draft* TR 2017/D1).

4. A warehouse purchases storage racks to make up a single storage row. The individual storage racks, not being functionally complete in themselves, are not separate depreciating assets, but each storage row made up of many racks will be a single depreciating asset because it performs a separate identifiable function in the context of the taxpayer's particular activity.

Buildings and foundations

Although a building is a depreciating asset, expenditure on buildings is generally deductible under the capital works provisions (Div 43; ¶20-470) and not under the uniform capital allowance system (¶17-030). However, expenditure on ''plant'' is not subject to the capital works provisions (¶20-510).

Generally, a deduction is not allowed under the depreciating assets provisions (Div 40) for buildings used to house a depreciating asset. However, the Commissioner allows depreciation on the whole or part of a building where plant and building become so integrated that plant includes the whole or part of the building (see the Commissioner's effective life determinations reproduced in Chapter 43 (commencing at ¶43-000); TR 2007/9). Components such as air conditioning systems, lifts and escalators are plant. A building forms an integral part of plant to the extent that it is absolutely essential to the support of the working plant (IT 31).

▶ Example

An electrical switchboard, mains, submains cables, gas and telephone installations, security items and vehicle control equipment are not plant, but rather form part of the structure of the building (*Woodward*).

For the Commissioner's ruling on residential rental property deductions and, more generally, on the distinction between plant and premises, see ¶17-040.

Where the whole of a building is plant, the concrete foundations or footings in which the uprights of the structure are embedded also qualify as plant. The cost of excavating for foundations is accepted as part of the depreciable cost, but not general site preparation.

If only part of a building is plant, the cost of the building is apportioned. Indirect construction costs having a link to both the plant and non-plant components of a building may be allocated in proportion to direct costs.

Intellectual property

Depreciating assets include certain items of intellectual property, namely the rights that a person has under Commonwealth or foreign law (ID 2006/169) as patentee, or as owner of a registered design or a copyright, or as licensee of any of those items (however, trademarks and other items of intellectual property are not depreciating assets: ID 2004/858). The decline in value of such items is calculated over the statutory effective life (¶17-280) and using the prime cost method (¶17-490).

A deduction for the decline in value of film copyright acquired on or after 1 July 2004 is available over the effective life of the copyright (either self-assessed or determined by the Commissioner), using either the prime cost or diminishing value method (¶17-280), provided no deduction was claimed under the former film concessions in ITAA36 Pt III Div 10B and 10BA. The cost of the copyright is reduced by the amount of any ''producer offset'' available under the rules discussed at ¶20-340.

The cost of registering or extending a patent, registered design or copyright is included in the ''cost'' of the relevant asset and is deductible over the effective life of the asset (TD 2004/32; ID 2002/810 to ID 2002/812).

Under transitional provisions, unrecouped pre-1 July 2001 expenditure on items of intellectual property that were amortised under the former provisions continues to be written off under Div 40, on the prime cost basis, using the same cost and effective life.

A company that purchased and operated medical and dental practices was not entitled to depreciation deductions in respect of patient records because copyright did not subsist in the patient records and lists of the practices that the taxpayer purchased. Even if copyright had passed to the taxpayer under the sale agreements it would not have been depreciable as no amount of the purchase price was allocated to copyright (*Primary Health Care*; TD 2005/1).

See also TR 2002/19 (licence arrangements), ID 2004/982 (integrating purchased software and an algorithm into a computer program), TA 2005/3 (copyright in assets containing significant amounts of knowledge and/or information such as client lists or records, procedural manuals, industrial processes, secret formulae, or staff training packages).

Spectrum licences and datacasting transmitter licences

The decline in value of a spectrum licence is calculated over the term of the licence (¶17-280) and using the prime cost method (¶17-490). There are special rules dealing with replacement spectrum licences (ITAA97 s 40-120). Unrecouped pre-1 July 2001 expenditure on licences for which a deduction was available under the former provisions continues to be amortised under Div 40, on the prime cost basis, using the same cost and effective life.

The decline in value of pre-1 July 2001 datacasting transmitter licences is calculated as if the effective life of the licence was 15 years less the period elapsed from the date of issue of the licence until 1 July 2001 (ITTPA s 40-33).

[FITR ¶86-890 – ¶86-931]

¶17-020 Holder of asset entitled to deduction

A deduction for the decline in value of a depreciating asset for an income year can only be claimed by a person who ''held'' the asset at any time during the income year. The general rule is that the owner (or the legal owner, if there is both a legal and an equitable owner) holds the asset (ITAA97 s 40-40, item 10). The Commissioner accepts that proprietors in strata schemes registered under state or territory legislation can claim capital allowance deductions on the basis that they hold the legal and beneficial ownership of common property (TR 2015/3, and see below). A proposed measure in the 2017 Federal Budget will limit the eligibility for deductions for plant and equipment in a residential rental property to the original ''holder'' of the plant and equipment, and not for subsequent holders (see below).

The following rules (Items 1 to 9A) specify who is taken to hold the depreciating asset in different circumstances (ITAA97 s 40-40). The specific rules apply in preference to Item 10, ie the holder is the owner of the asset only if none of the special circumstances apply (ID 2004/957).

(1) A luxury car in respect of which a lease is granted (¶17-220) is held by the lessee (while the lessee has the right to use the car) and *not* by the lessor (Item 1). Where the lease ends or is terminated early and the lessee becomes the holder under Item 10, no balancing adjustment occurs (ID 2003/756).

(2) A depreciating asset that is fixed to land that is subject to a quasi-ownership right (or an extension or renewal of the right) is held by the owner of the right, while the owner has the right to remove the asset (Item 2). A ''quasi-ownership right'' is a lease of the land, an easement in connection with the land, or any other right, power or privilege over or connected with the land, eg a sublease (ITAA97 s 995-1(1); ID 2009/156). For Div 40 purposes, a fixture on land, whether removable or not, is an asset separate from the land (ITAA97 s 40-30(3)). See TR 2006/13 (assets held under sale and leaseback arrangements) and ID 2012/9 (right to remove asset).

▶ Example

Lessee leases land from Lessor and affixes a depreciating asset to it. Although Lessor now legally owns the asset, Lessee has the right to remove the asset while the lease subsists and for a reasonable time afterwards. Lessee is the holder of the asset while the right to remove the asset remains. If both Lessor and Lessee contribute to the cost of the fixture, Lessee is a holder under Item 2 and Lessor is a holder under Item 10. They are each entitled to a deduction for the decline in value of the asset based on the cost of the asset to each of them.

(3) An improvement (whether a fixture or not) to land subject to a quasi-ownership right (or an extension or renewal of the right), made or improved by any owner of the right for the owner's own use, where the owner has no right to remove the asset, is held by the owner of the quasi-ownership right (while it exists) (Item 3). An improvement to land, whether removable or not, is an asset separate from the land (s 40-30(3)). For example, see ID 2005/278 (improvements to land leased by another entity).

▶ Example

Lessee leases land and a building from Lessor and carries on a business in the building. Lessee installs an in-ground watering system on the land at his expense and for the benefit of his business. Under the lease, he is not permitted to remove fixtures from the land. Lessee is the holder of the watering system while the lease exists.

(4) A depreciating asset that is subject to a lease where the asset is fixed to land and the lessor has the right to recover the asset is held by the lessor (while the right to recover exists) (Item 4). See TR 2006/13 for assets held under sale and leaseback arrangements.

▶ Example

Damian leases an ammonia plant to Simon, which Simon attaches to land he owns. Under the lease, Damian has a right to recover the plant at the end of the lease. Damian is the holder of the plant while the right to recover the plant exists. Simon is also the holder of the plant under Item 10 (and may be able to deduct his costs, eg installation and modification costs).

(5) A *right* that an entity legally owns, but that another entity (the economic owner) exercises or has the right to exercise immediately, is held by the economic owner if the economic owner has a right to become its legal owner and it is reasonable to expect: (i) that the economic owner will become the legal owner; or (ii) that the right will be disposed of at the direction and for the benefit of the economic owner (Item 5; ID 2010/2). Such asset is *not* held by the legal owner. An economic owner may lack legal title because the asset is subject to a legal mortgage, a hire purchase agreement, a product financing agreement, a reservation of title arrangement, or a bare trust.

▶ Example

Joe borrows money from Financier and secures the loan by granting a mortgage over a patent he has. Under the mortgage agreement, legal title to the patent is assigned to Financier but Financier grants Joe a licence to continue to use the patent in his business. Joe is the holder of the patent because he exercises the rights over the subject matter of the patent, has the right to become the legal owner of the patent and it is reasonable to expect that he will.

(6) Item 6 deals with the case where an entity (the former holder) would be taken to hold an asset, and another entity (the economic owner) possesses the asset (or has a right against the former holder to possess the asset immediately) and has a right against the former holder to become the holder (under these rules). In this case, if it is reasonable to expect that the economic owner will exercise that right or that the asset will be disposed of at the direction, and for the benefit, of the economic owner, the asset is held by the economic owner. It is *not* held by the former holder. Item 6 would apply to hire purchase agreements under which the hirer has an option to purchase the asset after paying the final instalment under the agreement (in this case, the legal owner of the asset is *not* the holder). For the interaction of this Item and the provisions of ITAA97 Div 240 (¶23-250), see TR 2005/20. For examples of the application of this rule, see ID 2007/170, ID 2007/171, ID 2011/71 and ID 2012/80. For sale and leaseback arrangements generally, see ¶23-240.

▶ Example

In order to acquire additional finance for her business, Emma sells an asset to a financier and agrees to repurchase it for a price equal to the original sale price plus a finance charge. Emma remains in possession of the asset and continues to use it and the financier is the legal owner. She is the holder of the asset because she has the right to possess the asset, the right to become its legal owner and it is reasonable to expect that she will.

(7) A partnership asset is held by the partnership (Item 7). It is *not* held by any particular partner (eg ID 2002/1037; ID 2002/1083; ID 2009/135).

(8) Mining, quarrying or prospecting information (whether or not generally available) is held by the entity that has the information, provided it is relevant to mining operations carried on or proposed to be carried on by the entity or it is relevant to the business carried on by the entity that includes exploration or prospecting for minerals or quarry materials (Item 8).

(9) Any other mining, quarrying or prospecting information is held by the entity that has it, provided the information is not generally available (Item 9).

(10) Geothermal exploration information (whether or not generally available) is held by the entity that has the information provided it is relevant to geothermal energy extraction carried on, or proposed to be carried on, by the entity; or to a business carried on by the entity that includes exploration or prospecting for geothermal energy resources from which energy can be extracted by geothermal energy extraction. Note that these assets are no longer depreciable if they start being held from 1 July 2014 (former Item 9A).

If, under any of the above rules, the holder ceases to hold the asset, a balancing adjustment event arises (¶17-630).

The holder of a depreciating asset is treated as its owner for the purposes of the provisions dealing with property held under certain leveraged and non-leveraged leases (¶23-210, ¶23-220). In this case, no other person can be treated as the owner of the asset (ITAA97 s 40-135).

Jointly held assets

Where two (or more) taxpayers are considered to hold the asset (eg a lessor under the general rule in Item 10 and a lessee under Item 3), they are considered to hold the asset jointly. In such case, each taxpayer is entitled to a deduction for the decline in value of the asset, calculated on the basis of the cost of the asset to each taxpayer, and as if the taxpayer's *interest in* the underlying asset were the underlying asset (ITAA97 s 40-35). A composite asset (¶17-015) that is a single depreciating asset is also considered to be jointly held even if two or more taxpayers own discrete parts of the asset (TR 2017/D1).

The deduction is therefore in relation to the interest, and does not take into account the decline in value of the underlying asset. The interest takes the characteristics of the underlying asset (eg its decline in value is calculated on the basis of the effective life of the underlying asset). If the underlying asset starts to be or ceases to be jointly held, there is no balancing adjustment, but rather the asset is taken to be split or merged (¶17-630).

Capital allowance deductions (under ITAA97 Div 40) that are attributable to the derivation of income from strata scheme common property, are allowed to the proprietors (and not the owners corporation) in proportion to their lot entitlements and to the extent of the income producing use of their individual lots. However, proprietors and strata schemes that previously relied on withdrawn IT 2505 may elect to continue to treat common property as being held on trust for the proprietors (TR 2015/3, including para 98).

The rules also apply where both lessor and lessee contribute to the cost of the asset, and where there are multiple interests in the same land or depreciating asset and more than one holder of the asset contributes to the cost of the asset (eg joint lessees). The joint holding rules do not lead to a duplication of deductions because the deduction to which each of the joint holders is entitled is based on the cost to that holder.

"Owner"

"Owner" is not defined in ITAA97 and, accordingly, has its ordinary meaning. To qualify for a deduction as the holder of a depreciating asset, the taxpayer does not have to personally use it in carrying on a trade or business, provided it is used for a taxable

purpose. For example, if the asset is leased by the taxpayer to someone else, it is the taxpayer owner who generally gets the deduction. Thus, if furnished premises are leased, it is the lessor and not the lessee who claims deductions for the decline in value of furniture, fittings and other equipment owned by the lessor (under the general rule in Item 10). However, if the lessee installs an asset in the premises and owns and uses it for income-producing purposes, the lessee can generally claim deductions for the decline in value of that asset (under Item 2 or 3). See TR 2006/13 for assets held under sale and leaseback arrangements.

A measure was proposed in the 2017 Federal Budget to limit, from 1 July 2017, the depreciation deduction for plant and equipment in a residential investment property to the taxpayer who actually incurred the outlay for the assets, ie the original owner of the plant and equipment. Accordingly, where a taxpayer becomes the subsequent owner of the plant and equipment (by virtue of having purchased the property), despite being the owner, they will not be eligible to claim depreciation deductions for the plant and equipment that were purchased by the previous owner. Therefore, for subsequent owners, the cost of acquisitions of existing plant and equipment items will only be reflected in the cost base for capital gains tax purposes. Existing investments will be grandfathered such that plant and equipment forming part of residential investment properties as of 9 May 2017 (including contracts already entered into at 7.30 pm (AEST) on 9 May 2017) will continue to give rise to deductions for depreciation until either the taxpayer no longer owns the asset, or the asset reaches the end of its effective life. Only taxpayers who purchase plant and equipment for their residential investment property after 9 May 2017 will be able to claim a deduction over the effective life of the asset.

Motor vehicle lease novation arrangements

The Commissioner's views on the taxation consequences of certain motor vehicle lease novation arrangements are set out in TR 1999/15 (see also *Jones* and ¶16-310). These arrangements involve the novation (or transfer) by an employee to an employer of some of the obligations under a motor vehicle lease. The ruling applies to both luxury and non-luxury cars. Under such arrangements, the employer/lessee is the holder of the car (if either Item 1 or 6 applies). On early termination or expiry of the lease, the employee becomes the holder and a balancing adjustment must be made (ID 2003/759 to ID 2003/762). The FBT implications of such arrangements are outlined at ¶35-150.

[FITR ¶86-935, ¶86-945 – ¶87-000]

¶17-030 Excluded assets for capital allowances

The following assets are specifically excluded from the operation of the uniform capital allowance system (ITAA97 s 40-45; ITTPA s 40-47):

- capital works for which an amount is deductible under ITAA97 Div 43 (¶20-470) or would have been deductible, had the expenditure not been incurred before a particular day or had the works been used for the required purpose (¶20-480). Assets for which an amount is not deductible under Div 43 for any other reason are not excluded (ID 2005/21). As capital works that are "plant" (¶17-040) are excluded from Div 43, deductions for the decline in value of plant are available under ITAA97 Div 40 (¶17-015)
- certain assets provided by an employer as expense payment benefits or property benefits that are exempt from FBT under *Fringe Benefits Tax Assessment Act 1986*, s 58X (¶35-645)
- an asset for which the taxpayer could deduct an amount under the former film concession provisions in ITAA36 Div 10B; 10BA of Pt III.

No deduction is available for the decline in value of an R&D depreciating asset if expenditure on the asset has given rise to a tax offset under the R&D provisions (ITAA97 s 355-715; ¶17-420). In addition, where expenditure on in-house software has been

pooled, the special provisions dealing with software pools (¶17-370) apply, rather than the general rules dealing with the decline in value of individual assets. Similarly, if the special provisions dealing with horticultural plants (¶18-070), water facilities (¶18-080), fodder storage assets (¶18-085), fencing assets (¶18-090), landcare operations (¶18-100), electricity connections (¶16-820) or telephone lines (¶18-060) apply, the general rules outlined in this chapter (including those dealing with balancing adjustments) do not apply. For this purpose, capital repairs, alterations, additions or extensions to water facilities, fodder storage assets, fencing assets, and landcare operations are treated as a separate depreciating asset (s 40-53).

Finally, no deduction is available for the decline in value of cars for the 2016/17 income year and later income years if car expense deductions are calculated using the cents per kilometre method (ITAA97 s 40-55: ¶16-370).

Small business entities can choose to calculate depreciating assets deductions under Div 328, instead of Div 40 (¶7-250).

[FITR ¶87-010 – ¶87-030]

¶17-040 Plant subject to capital allowances

The cost of ''plant'' (defined in ITAA97 s 45-40) is excluded from expenditure deductible under the capital works provisions (¶20-510) and is therefore subject to the uniform capital allowance system (¶17-030). The concept of ''plant'' is also relevant to the landcare operations provisions (¶18-100), the lease assignment provisions (¶23-230) and the water conservation provisions (¶18-080).

The primary factor in determining whether an item qualifies as plant is its function (TR 94/11). If the function is to provide the setting or environment within which income-producing activities are conducted (eg an office building, a rock wall: ID 2007/160; demountable car park: IT 2130), an item does not qualify as plant. Conversely, if the function is essentially the permanent means or apparatus used to produce the income (eg machines or manufacturing equipment) the item qualifies as plant, whether it is fixed or movable. Thus breakwaters installed by a port authority, in playing a role in keeping vessels in place while inspections and repairs were carried out, were plant but a retaining wall, whose primary function was to protect reclaimed land, the cliffs and a factory, was not (*Port of Portland*).

An item used to create a particular atmosphere or ambience for premises used in a cafe, restaurant, licensed club, hotel, motel or retail shopping business performs a function that is so related to that business to warrant the item being held to come within the ordinary meaning of plant. This is because the atmosphere or ambience is intended to attract customers and is a definable element in the service which the business provides and for which its customers are prepared to pay (TR 2007/9). The item will only come within the ordinary meaning of plant if it does not form part of the premises. Describing an item as decor does not of itself mean that the item comes within the ordinary meaning of plant.

In addition to the kinds of property that fall within its ordinary meaning, ''plant'' also includes (s 45-40):

- articles, machinery, tools and rolling stock
- animals used as working beasts in a business other than a primary production business, eg racehorses
- plumbing fixtures and fittings, including wall and floor tiling, provided principally for the personal use of employees (or their children) in the taxpayer's business
- fences, dams and other structural improvements on land used for agricultural or pastoral pursuits and structural improvements on land used for forest operations (in either case whether the land is so used by its owner or another person), and

structural improvements used wholly and exclusively for pearling or similar operations (provided they are situated at or near a port or harbour from which those operations are conducted) *other than*:

- structural improvements used for domestic or residential purposes except as accommodation for employees (not necessarily of the taxpayer), tenants or share-farmers engaged in those pursuits or operations, and
- forestry roads.

Residential rental premises or plant (TR 2004/16)

In deciding whether an item is part of residential rental premises or plant, the following matters are relevant:

- whether the item appears visually to retain a separate identity
- the degree of permanence with which it has been attached
- the incompleteness of the structure without it, and
- the extent to which it was intended to be permanent or whether it was likely to be replaced within a relatively short period.

Where an item neither forms part of the premises nor falls within the extended definition of ''plant'', it will come within the ordinary meaning of plant. This will only occur where the function performed by the item is so related to the particular taxpayer's income-earning activities, or the function of the item is so special, that it warrants the item held to be plant. Such an occasion is likely to be rare in the context of a residential rental property.

An item cannot be an article if: (a) it is a structure erected or built on, or into, land; or (b) it forms part of the premises. However, an item may be an article even though it is attached to the premises. Carpet, curtains, desks and bookshelves are articles.

Machinery is plant whether or not it forms an integral part of a building or is a part of the setting of the landlord's rent-producing activities. The process of determining whether something is machinery involves: (a) identifying the relevant thing (unit) or things (units) based on a consideration of functionality; and (b) deciding whether that thing or each of those things satisfies the ordinary meaning of machinery.

The ordinary meaning of machinery includes devices, such as computers and microprocessors, which utilise in various processes minute amounts of energy in the form of electrical impulses. It also includes heating appliances, such as stoves, cooktops, ovens and hot water services. However, it does not include anything that is merely a reservoir or conduit, such as ducting, piping or wiring, although connected with something that is machinery. In other words, if the ducting, piping or wiring forms part of a unit that is a machine then it is machinery. Conversely, if it is merely connected to, but not part of, a unit that is a machine, then it is not machinery.

It follows that kitchen cupboards, fences, insulation batts, built-in wardrobes and ducted vacuum system tubing are not plant (but the power unit, hose and brush elements of the vacuum system are plant). For the Commissioner's determination of the effective lives of items that are used by residential property operators, see Chapter 43 (commencing at ¶43-000).

The above issue will have limited application to the original purchasers of plant and equipment for a residential rental property following the announcement of a measure in the 2017 Federal Budget to limit the eligibility for deductions for plant and equipment in residential rental properties to the original ''holder'' of the asset, and not for subsequent holders (¶17-020).

[FITR ¶99-600]

¶17-045 Non-arm's length dealings and capital allowances

If a taxpayer is not dealing at arm's length and incurs expenditure that is greater than the market value of what the expenditure is for, the amount paid is taken to be the "market value" (¶17-050). This applies in determining both the first and the second element of cost of the depreciating asset (¶17-100, ¶17-105). The rule stops the taxpayer from being able to claim a higher capital allowance deduction based on an artificially inflated purchase price.

Similarly, if a taxpayer is not dealing at arm's length and disposes of property for an amount that is less than market value, the amount received is taken to be the market value (¶17-640). This stops the taxpayer from obtaining a more favourable tax result by calculating its balancing adjustment on disposal of the asset on the basis of an artificially reduced disposal price.

The non-arm's length rule also applies to the deductions for certain primary production expenditure (¶18-050) and to the mining, project infrastructure and environmental protection deductions outlined at ¶19-000.

Dealing at arm's length

Parties are generally "at arm's length" if they are unrelated and neither party is effectively controlled by the other. In an arm's length situation, each party normally stands upon their rights and conducts their business in a formal manner without trusting the other's control or overmastering influence.

In determining whether parties are "dealing with each other at arm's length", an assessment must be made of whether the parties deal with each other as arm's length parties normally do, so that the outcome of their dealing is a matter of real bargaining (*Furse*).

A connection between the parties to a transaction is not conclusive evidence that they are not dealing with each other at arm's length, but is merely a factor to be taken into account. There may be transactions between related parties where the parties do deal with each other at arm's length. This may happen even if there is a close relationship between the parties or if one party has the power to control the other. It is not enough to look only at the relationship between the parties without examining the nature of the particular dealing between them (*Barnsdall*).

Parties at arm's length are not *dealing with each other* at arm's length if they collude to achieve a particular result or one party submits the exercise of its will to the dictation of the other (*Granby*). If more than one item of property is transferred as part of one transaction and one of the parties is indifferent to the apportionment of the consideration between the various items of property, the parties are considered not to be dealing with each other at arm's length because the acceding party has submitted the exercise of its will to the wishes of the other party (*Collis*).

[FITR ¶88-550]

¶17-050 Definition of market value

"Market value" is defined (ITAA97 s 995-1(1)) as having a meaning affected by ITAA97 Subdiv 960-S. Subdivision 960-S contains special rules for working out the market value of assets and non-cash benefits. For an asset, its market value is reduced by any input tax credits (¶34-100) to which the taxpayer would be entitled if it had acquired the asset solely for a creditable purpose. In working out the market value of a non-cash benefit, anything that would prevent or restrict the conversion of the benefit into money is to be disregarded. The Commissioner may approve valuation methods to establish the market value of assets or non-cash benefits. If a taxpayer uses an approved valuation method for an asset or non-cash benefit, the calculation is binding on the Commissioner. For an item that is not an asset or a non-cash benefit, the ordinary meaning of "market value" applies. The ordinary meaning of "market value" is the price that a willing but

not anxious buyer would have to pay to a willing but not anxious seller for the item (*Spencer*). This test was later adopted in *Abrahams* where the market value was said to be "the price which a willing but not anxious vendor could reasonably expect to obtain and a hypothetical willing but not anxious purchaser could reasonably expect to have to pay . . . if the vendor and purchaser had got together and agreed on a price in friendly negotiation".

Market value has also been described as the best price that may reasonably be obtained for property if sold in the general market. If there is no general market, eg as in the case of shares in a private company, such a market is to be assumed. In addition, all possible buyers should be taken into account, even a buyer who, for his/her own reasons, is prepared to pay an excessive price (*Brisbane Water County Council*).

If shares are listed on a stock exchange, the most appropriate market to use for determining value is normally the stock exchange market (*Clifford*). The price bid for an item of property at auction may also provide a measure of market value (*Collis*). A market value determined on the basis of a trade-in price is not appropriate if this is not the price obtainable in the best available market (14 CTBR *Case* 29).

If considerable amounts are involved, a taxpayer would be prudent to obtain the services of a qualified valuer if there is any doubt about the fair market value, so that the taxpayer has a contemporaneous and expert record that enables the ready ascertainment of the market value of the property at a particular date. The Commissioner will apply the guidelines contained in *Market valuation for tax purposes*.

[FITR ¶767-590]

Cost of Depreciating Assets

¶17-080 Cost as initial basis for calculating decline in value

The decline in value of a depreciating asset is calculated on the basis of the "cost" of the asset to the particular taxpayer (¶17-480). Cost is also relevant in calculating any capital gain or loss if a balancing adjustment event happens for the asset (¶17-670). The cost of a depreciating asset held by the taxpayer consists of the first element of cost (generally the consideration provided by the taxpayer to hold the asset) and the second element of cost (generally the consideration provided by the taxpayer to bring the asset to its present condition and location from time to time) (ITAA97 s 40-175). While the first element of cost (¶17-100) applies to almost every asset, the second element (¶17-105) only applies to some assets. The cost rules apply regardless of whether the asset is acquired new or secondhand. An incorrectly calculated cost amount may be rectified.

Special rules deal with split assets and merged assets (¶17-100) and with the assets of consolidated groups (¶8-200, ¶8-580). In some cases the cost of an asset is modified (¶17-090).

The cost of a pre-1 July 2001 asset is determined under the pre-1 July 2001 rules.

[FITR ¶69-150 – ¶69-240, ¶87-270 – ¶87-440]

¶17-090 Adjustments to cost

Certain amounts are excluded from the cost of a depreciating asset.

- The cost of a depreciating asset excludes amounts that are not of a capital nature (ITAA97 s 40-220), whether or not deductible (eg whether or not deductible under the general deductions provisions: ¶16-000). Once plant has been installed and handed over to its owner in an operational state, the cost of bringing the plant into full operation is revenue expenditure and immediately deductible (TD 93/126).

- The cost of a depreciating asset that is not plant excludes amounts incurred before 1 July 2001 or under a contract entered into before that date (ITAA97 s 40-200). Any amounts incurred on plant before that date may form part of the cost of a depreciating asset under transitional provisions (¶17-080).

- Where an offset has been available in respect of expenditure on an R&D asset, the expenditure is not also allowable under the capital allowance provisions (ITAA97 s 355-715; ¶17-420).

Once the cost of a depreciating asset has been established under the rules at ¶17-100 and ¶17-105, it may have to be further adjusted as follows:

- the cost of a car exceeding the car limit may be reduced to that limit (¶17-200)

- the cost of a car acquired at a discount under a scheme to avoid the car limit may be increased by the discount (¶17-210)

- the cost of a copyright in a film is reduced by the amount of the producer offset available under the rules discussed at ¶20-340 (ITAA97 s 40-45)

- each element of the asset's cost is reduced to the extent that any part of the cost is deductible under a provision other than the uniform capital allowance provisions or the special provisions for small business taxpayers (ITAA97 s 40-215)

- cost may be reduced if a commercial debt is forgiven (¶17-510)

- cost of an asset may be reduced if the asset it replaces has been disposed of involuntarily (¶17-720), or

- cost of an asset does not include an amount that is denied deductibility (under ITAA97 s 26-97) because it is funded by certain amounts derived by participants of the National Disability Insurance Scheme (ITAA97 s 40-235).

The foreign currency denominated cost of a depreciating asset is converted at the exchange rate applicable when the taxpayer began to hold the asset or when satisfying the liability to pay for it, whichever occurs first (¶23-070). See also the foreign exchange gains and losses rules.

The TOFA rules (¶23-020) may affect the calculation of the cost of a depreciating asset where a financial arrangement is used as consideration for acquiring the asset.

GST and depreciating assets

The cost of a depreciating asset (and, in a year after the first year of use, the opening adjustable value) is reduced by any input tax credits relating to the acquisition of the asset or to second element costs of the asset, and by certain decreasing adjustments relating to the asset. If the decreasing adjustment is due to a change in planned use, it is included in assessable income (ITAA97 Subdiv 27-B). If the cost is taken to be market value, that is also a GST-exclusive value.

The cost of the asset (and, in a year later than the first year of use, the opening adjustable value) may be increased by certain increasing adjustments relating directly or indirectly to the asset. If the increasing adjustment is due to a change in planned use, it is deducted. For detailed explanation of increasing and decreasing adjustments, see the *Australian Master GST Guide*.

▶ Example

George, who is registered for GST, buys a ladder for $550 that will be used 80% of the time in his plumbing business. The remaining 20% usage is for non-taxable purposes. The cost of the asset is taken to be the purchase price reduced by $40, ie $510 (calculated as $550 – [(1/11 × $550) × 80%]). If the decline in value is $110 over two years, the opening adjustable value at the start of Year 3 is $400.

If the usage changes at the commencement of Year 3 to a 100% taxable purpose, there will be an assessable decreasing adjustment of $10 (ie [1/11 × $550] – $40).

If, instead, the usage changed to a 50% taxable purpose, there would be a deductible increasing adjustment of $15 (calculated as $40 – [1/11 × $550] × 50%).

[FITR ¶87-400, ¶87-420, ¶87-425]

¶17-100 First element of cost

The first element of cost generally represents the amount the taxpayer has paid or is taken to have paid in order to hold the depreciating asset, and is worked out when the taxpayer begins to hold the asset (ITAA97 s 40-180).

The first element of cost is subject to certain exclusions and modifications and is GST-exclusive (¶17-090).

If an amount is paid for two or more things including one depreciating asset, the amount is apportioned on a reasonable basis between those things, generally based on relative market values (ITAA97 s 40-195). That is not necessarily the adjustable value of the asset (ID 2002/818).

For expenditure incurred on or after 1 July 2005, the first element of cost includes an amount paid or taken to be paid in relation to starting to hold the asset, if that amount is directly connected with holding the asset. It does not include an amount that forms part of the second element of cost of another depreciating asset.

The first element of the cost of a mining, quarrying or prospecting right may be reduced by the market value of exploration benefits received under farm-in farm-out arrangements (s 40-1130; ¶19-010).

The lessor's deduction for decline in value of an asset subject to a sale and leaseback arrangement is based on the cost of the asset to the lessor, not the cost to the lessee (TR 2006/13).

The amount the taxpayer is taken to have paid

The cost rules specify the amount that the taxpayer is taken to have paid to hold a depreciating asset (ie first element of cost) or to bring it to its current location and condition (ie the second element of cost). The taxpayer is taken to have paid the greater of the following two amounts (ITAA97 s 40-185):

(1) the consideration given, ie the sum of the following:

(a) any amount paid to buy or create the asset (eg labour and materials) or to bring the asset to its current location and condition. This would cover incidental costs (eg stamp duty) and if the taxpayer makes a prepayment, it is the amount of the prepayment. It includes amounts that the taxpayer *is taken to have paid*, such as the price of the notional purchase made when trading stock is converted to a depreciating asset (¶9-245), the cost of an asset held under a hire purchase arrangement under ITAA97 s 240-25 (¶23-250), and a lessor's deemed purchase price when a luxury car lease ends (ITAA97 s 242-90: ¶17-220; ID 2005/197). If the asset is a Div 230 financial arrangement or a Div 230 financial arrangement is involved in the consideration, ITAA97 s 230-505 applies (¶23-020)

(b) the amount of a liability to pay money. Only the part of the liability that has not been satisfied is taken into account

(c) where there is a reduction in a right to receive money (eg a debt is waived), the amount of the liability when it is terminated

(d) the market value of a non-cash benefit provided by the taxpayer. A non-cash benefit is any property or services that are not money (ITAA97 s 995-1(1)). Where a company issues shares for depreciating assets, TR 2008/5 applies (¶3-260). See also ID 2004/559 (cost to the employee of an asset obtained under a salary sacrifice arrangement)

(e) the market value of a non-cash benefit that the taxpayer becomes liable to provide. Only the part of the liability that has not been satisfied is taken into account, and

(f) where the liability to provide a non-cash benefit to the taxpayer is terminated, the market value of the benefit when the liability is terminated, and

(2) amounts included in assessable income because a taxpayer started to hold the asset (ie where an amount is assessable under ITAA36 s 21A (¶10-030) for receiving the depreciating asset as a non-cash benefit) or gave something to start holding it (this would be the case where the taxpayer exchanges a depreciating asset for another and as a result a balancing adjustment amount is assessable). In the case of second element costs, the relevant amount is the amount included in assessable income because the taxpayer received the benefit or gave something to receive the benefit (ie the benefit that brought the asset to its current condition and location, eg the modification to a truck). In determining the amount included in assessable income, the value of anything provided by the taxpayer that reduced the amount actually included in assessable income must be ignored.

For examples of the application of the above cost rules, see ID 2003/1085, ID 2004/116 and ID 2008/93.

▶ Example 1: Amount included in assessable income under s 21A

If Aco provides medals (with a market value of $20,000) and a payment of $75,000 to Bco in return for a stamping machine (with an arm's length value of $100,000), Aco will include $25,000 (ie $100,000 – $75,000) in its assessable income. The first element of cost of the machine for Aco is the greater of: (a) the sum of the amount paid ($75,000) and the market value of the medals provided ($20,000), ie $95,000; and (b) the amount that would have been included in assessable income, if one ignored the contribution of $75,000 made by Aco, ie $100,000. This produces a first element of cost of $100,000.

▶ Example 2: Assessable balancing adjustment amount

Mary exchanges a tractor with an adjustable value (¶17-485) to her of $10,000 in return for a plough with a market value of $15,000. The termination value of the tractor is the market value of the plough, ie $15,000 (¶17-640). The assessable balancing adjustment to be made as a result of disposing of the tractor is $5,000 (ie $15,000 – $10,000). The first element of cost of the plough is the greater of: (a) the market value of the tractor she provided; and (b) the amount that was assessable for giving the tractor in order to start holding the plough (ie $15,000), ignoring the value of the tractor.

If the plough had a market value of $5,000, the deductible balancing adjustment would be $5,000 (ie $10,000 – $5,000). In this case, the first element of cost of the plough would be the greater of: (a) the market value of the tractor; and (b) the amount that would have been assessable (ie $5,000), ignoring the adjustable value of the tractor.

▶ Example 3: Consideration provided by taxpayer

Fiona, a house painter, buys a panel van from Andrew in exchange for: painting his home (market value of painting services is $4,000), terminating a $1,000 debt owed to her by him, undertaking to repaint his home in 10 years (market value of the painting services that she is under a liability to provide is $1,500), and incurring a liability to pay him $1,000. The first element of cost of the panel van is $7,500 (ie the sum of $4,000 + $1,000 + $1,500 + $1,000).

Specified amounts of first element of cost

In the following cases, the first element of cost is specified in s 40-180, rather than being the amount that the taxpayer is taken to have paid to hold the asset under the above rules (cases 1 to 13 do not apply to determine the second element of cost). If more than one item covers the asset, the last applicable item applies.

(1) If a depreciating asset is split into two or more assets, the first element of cost of each new asset is a reasonable proportion of the sum of the adjustable value (¶17-485) of the original asset before the split and of the splitting costs (the splitting costs are calculated under the above rules for determining the amount that a taxpayer is taken to have paid) (ITAA97 s 40-205). Such reasonable proportion may be based on the relative market values of the new assets. See also ¶17-630.

(2) If a depreciating asset or assets is or are merged into another depreciating asset, the first element of cost of the new asset is a reasonable proportion of the sum of the adjustable value or values of the original asset or assets just before the merger and of the merger costs (the merger costs are calculated under the above rules for determining the amount that a taxpayer is taken to have paid) (ITAA97 s 40-210). See also ¶17-630.

(3) If the taxpayer stops using a depreciating asset for any purpose expecting never to use it again (thus triggering a balancing adjustment event: ¶17-630), but continues to hold it, the first element of cost of the asset is the termination value (¶17-640) of the asset at the time of the event.

(4) If the taxpayer has not used a depreciating asset and expects never to use it (thus triggering a balancing adjustment event: ¶17-630), but continues to hold it, the first element of cost of the asset is its termination value (¶17-640) at the time of the event.

(5) If a partnership asset was held, just before becoming a partnership asset, by one or more partners, the first element of cost of the asset to the partnership is the market value (¶17-050) of the asset when the partnership started to hold it.

If a balancing adjustment event happens to a depreciating asset because there is a change in the holding of, or interests in, an asset and one of the entities that held the asset before the change has an interest in it after the change (¶17-780), and the asset was a partnership asset before the change or becomes one as a result of the change, the first element of cost of the asset is the market value of the asset when the change occurred.

(6) If a balancing adjustment event happens to a depreciating asset but roll-over relief (¶17-710) applies, the first element of cost of the asset for the transferee is the adjustable value (¶17-485) of the asset to the transferor just before the event occurred.

(7) If the taxpayer is the legal owner of an asset hired under a hire purchase agreement, the hirer (the economic owner) is the holder of the asset as long as it has the right to become the legal owner of the asset. If the hirer does *not* become the legal owner (eg because it does not exercise the option to purchase the asset), the legal owner is taken to start "holding" the asset and the first element of cost of the asset is its market value at that time.

(8) If the taxpayer starts to hold the asset under a non-arm's length dealing for a cost exceeding its market value, the first element of cost of the asset is taken to be its market value (¶17-045, ¶17-050) at that time.

(9) If the taxpayer starts to hold the asset under a private or domestic arrangement (eg as a gift or under a consumer loyalty program by redeeming reward points: ID 2002/915), the first element of cost of the asset is its market value (¶17-050) at that time.

(10) If the Minister for Finance has determined a cost under *Airports (Transitional) Act 1996*, s 49A, 49B, 50A, 50B, 51A or 51B, the first element of cost of the asset is that amount.

(11) The first element of cost of an asset that was previously owned by an exempt entity (and to which ITAA97 Div 58 applies: ¶17-130) is the notional written down value of the asset or the undeducted pre-existing audited book value of the asset, plus any acquisition costs (ITAA97 s 58-70(3), (5)).

(12) If the asset has devolved to the taxpayer as the legal personal representative of a deceased person, the first element of cost of the asset is its adjustable value (¶17-485) at the time of death. If the asset was allocated to a low-value pool, the cost is so much of the closing pool balance for the year of death as is attributable to that asset.

(13) If, as a result of a person's death, the asset has passed to the taxpayer as the beneficiary or joint tenant, the first element of cost of the asset is its market value when the taxpayer started holding it, less any capital gain that was disregarded by the deceased or by the legal personal representative.

(14) If a balancing adjustment occurs in relation to a mining, quarrying or prospecting right, the first element of cost is the amount that would be the asset's adjustable value on the day the balancing adjustment event occurs (ignoring ITAA97 s 40-285(3), which would otherwise deem the adjustable value to be nil).

If a credit union business is voluntarily transferred to another eligible credit union business under the *Financial Sector (Transfers of Business) Act 1999*, any depreciating assets are taken to have been transferred at their adjustable value (ID 2004/887).

[FITR ¶87-290 – ¶87-370]

¶17-105 Second element of cost

The cost of a depreciating asset (which is relevant to calculating the decline in value of the asset) comprises a first element (¶17-100) and a second element of cost. The second element is the amount the taxpayer is taken to have paid to bring the asset to its present condition and location from time to time (ITAA97 s 40-190). For example, the second element of cost would include the cost of modifications, alterations or improvements made to the asset by the taxpayer during the relevant income year. It also includes the cost of transporting the asset to its current location such as freight, import duties, installation charges and legal costs (eg ID 2003/514 to ID 2003/516; ID 2009/74). It does not include expenses that are not capital or capital in nature, eg repairs, annual registration and compulsory third party insurance costs of a car.

If the cost of bringing the asset to its present condition or location is incurred in a non-arm's length dealing for a cost exceeding the market value of the benefit (eg a service), or in a private or domestic arrangement, the second element of cost is the market value of that benefit. For example, if an associate of the taxpayer provides modifications to the taxpayer's panel van for $6,000, but the modifications have a market value of $3,000, the second element of cost of the van is $3,000.

In any other circumstances, the second element of cost is calculated as the amount the taxpayer is taken to have paid under the rules discussed at ¶17-100 to bring the asset to its present condition and location.

If the taxpayer has paid an amount for two or more things including bringing a depreciating asset to its present condition and location, the amount is apportioned on a reasonable basis (generally based on relative market values) (ITAA97 s 40-195).

Certain amounts cannot form part of the second element of cost of an asset (¶17-090). Generally, cost is the GST-exclusive amount (¶17-090).

For expenditure incurred on or after 1 July 2005, the second element of cost includes all costs reasonably attributable to a balancing adjustment event (eg demolition costs: ID 2006/275). This allows such costs to be taken into account in calculating the balancing adjustment, rather than reducing the termination value (as used to be the case under former s 40-315).

Installation, dismantling and transport costs

Generally, installation costs do *not* include the cost of *structural* alterations to the building in which plant is to be housed and that may be necessary for its efficient integration into the operations, eg extensions to a building to make room for new plant

are not part of the cost of installing that plant (9 TBRD *Case* J65; IT 2197). However, the Commissioner's depreciating asset effective life tables (commencing at ¶43-000) show certain special factory buildings and foundations forming an integral part of plant as qualifying for deduction, but usually with longer effective lives than the plant or machinery itself.

Alterations and additions to depreciating assets and dismantling, transporting and re-erecting costs (eg on removal to new premises) would constitute second element costs. However, the cost of *minor* removals and rearrangements of depreciating assets within existing premises is claimable as an outright deduction in the year incurred. Likewise, maintenance, repairs and similar recurrent revenue expenditure are deductible outright and not added to cost for capital allowances purposes. Furthermore, expenditure incurred by a taxpayer in installing *leased* plant may be deductible under ITAA97 s 8-1 in the same way as normal lease payments (IT 2197).

Expenditure on temporary buildings and facilities directly related to the construction of plant may, in some circumstances, be part of the depreciable cost of that plant (IT 2618).

[FITR ¶87-380]

¶17-130 Depreciating assets and tax-exempt entities

There is a limit to the deductions for the decline in value of depreciating assets that can be claimed by: (i) tax-exempt entities that become taxable; and (ii) taxable entities that acquire the depreciating assets of tax-exempt entities in connection with the acquisition of a business. Taxable entities are only allowed to claim deductions for the decline in value of a depreciating asset based on either: (i) the depreciating asset's notional written down value; or (ii) the asset's undeducted pre-existing audited book value recorded in the tax-exempt entity's audited annual accounts before 4 August 1997 (ITAA97 Div 58; ¶17-100). Under Div 58, taxpayers use the ordinary Div 40 rules with some minor modifications for all privatised depreciating assets (ID 2007/84 to ID 2007/86). In particular, a transition entity in an entity sale situation (where the income of an exempt entity becomes, to any extent, taxable) is obliged to make a choice, after the transition time, to determine the effective life of the depreciating asset it holds at the transition time and may later recalculate such effective life (ID 2006/287 to ID 2006/289). For an example of the operation of the pre-1 July 2001 provisions, see ID 2001/316 and ID 2002/716. Division 58 (rather than ITAA36 Sch 2D Div 57: ¶10-630) applies to all depreciating assets, including non-plant assets.

[FITR ¶87-350]

Car Limit

¶17-200 Cost price limit

A limit is placed on the first element (¶17-100) of the cost of cars over a certain price (ITAA97 s 40-230). The limit for cars first held in the 2016/17 income year and the 2017/18 income year is $57,581 (TD 2016/8 and TD 2017/18 respectively).

For example, if a car is bought in July 2017 for $60,000, the deduction for the decline in value of the car is calculated as if the first element of cost were only $57,581. The cost of a car includes a radio, air conditioner etc, attached to the vehicle at the time of purchase, but not a radar detector (IT 2611). The limit applies regardless of whether the vehicle is new or secondhand.

The car limit is indexed each year for inflation. For details of the limits for previous years, see ¶43-110. The particular car limit that applies to a car is the limit for the financial year (not the income year) in which the car is first held by the taxpayer.

"Car" is defined to mean a motor vehicle (other than a motorcycle) designed to carry a load of less than one tonne and fewer than nine passengers. Furthermore, the car limit only applies to cars designed mainly for carrying passengers. It applies independently of the luxury car tax provisions.

The car limit applies both to cars used by their owners and to cars owned by leasing companies. In *Citibank*, a lessor who used the finance method of accounting for direct financing leases to record income from luxury car leases (¶17-220) failed to avoid the effect of the car limit. The gross rental receipts were held to be income from which allowable deductions, including depreciation, were to be deducted to arrive at taxable income. For the application of the car limit to novated car leases, see ID 2005/197.

Stretched limousines may be subject to the car limit, but only to the extent of the first element of cost (subsequent modifications to "stretch" the original vehicle are included in the second element of cost). Hearses are not subject to the car limit (TD 2006/39). Vehicles fitted out for transporting disabled persons seated in wheelchairs for profit, eg modified taxis, are excluded from the car limit, as are cars whose first element of cost exceeds the car limit only because of modifications made to enable an individual with a disability to use the car for a taxable purpose (eg in a disabled taxpayer's courier business).

The car limit applies after the discount provisions (¶17-210) have applied and after the cost of the car has been reduced by any GST input tax credits (TD 2006/40). If a car is held by two or more entities, the car limit is applied to the cost of the car and not to the cost of each entity's interest in the car.

Special rules apply when the car is disposed of (¶17-640).

[FITR ¶87-435]

¶17-210 Trade-ins on cars

An anti-avoidance measure counters avoidance of the car limit where an asset (including a car) is traded in on the purchase of a car (ITAA97 s 40-225).

The measure applies if: (i) it is reasonable to conclude that a car was able to be purchased at a discount and that the discount was referable to the taxpayer or another entity selling another asset for less than its market value; (ii) an amount was deducted for the other asset; and (iii) the pre-discount price exceeds the car limit for the financial year in which the taxpayer used the new car for any purpose. In such a case, the amount of the discount is added to the discounted purchase price of the new car. The measure does not apply to cars that are modified for disabled persons. Special rules apply when the car is disposed of (¶17-640).

[FITR ¶87-430]

¶17-220 Luxury car leases

Luxury car leases (including subleases), other than genuine short-term hire arrangements and hire purchase agreements, are treated as sale (by the lessor to the lessee) and loan transactions. The lessee (and not the lessor) is treated as the owner of the car until the lease ends or the lessee enters a sublease (ITAA97 Div 242; ¶17-020). This treatment applies where the cost of a car (whether new or secondhand) is more than the car limit applying for the income year in which the lease commenced, ensuring that the limit applies equally to *leased* luxury cars and purchased or otherwise financed cars.

The market value of the car at the start of the lease (or a specified amount in the case of a sublease) is taken to be the first element of cost for the car for depreciation purposes (¶17-100; s 242-20). Such market value, less any amount actually paid by the lessee to the lessor is also taken to be the amount that the lessee has borrowed from the lessor (s 242-25). Lease payments are divided into notional loan principal and interest components.

Taxation treatment of lessor

The lessor is assessable on the interest component of the lease payment, ie the return on funds lent by the lessor. Such assessable income is calculated by multiplying the outstanding notional loan principal at the start of the lease payment period by the implicit interest rate for the period (s 242-35). The implicit interest rate is the rate under the lease for a payment period (maximum six months), taking into account the total lease payments payable under the lease and any termination payments. The lessor is not entitled to deductions for the decline in value of the car.

Taxation treatment of lessee

The lessee is entitled to: (i) a deduction equal to the interest component which is assessable to the lessor, calculated for each payment period and apportioned to reflect any private use (s 242-45 to 242-55); and (ii) deductions for the decline in value of the car based on the market value of the car, reduced according to the car limit applicable in the income year, and by any private use. The lessee is not entitled to a deduction for the capital component of lease payments.

Lease extension, renewal, termination or expiry

If the lease is extended, renewed or ends, and the sum of the lease payments and any termination amounts paid to the lessor exceeds the sum of the notional principal and interest, the excess is assessable to the lessor and deductible to the lessee. If the sum of the lease payments and any termination amounts paid to the lessor is less than the sum of the notional principal and interest, the difference is deductible to the lessor and assessable to the lessee (s 242-65; 242-70).

When the lease expires or is terminated, and is then extended or renewed, the original loan is treated as having been repaid and the lessor is treated as having made a new loan in the amount of the car's market value at the time of the extension or renewal (s 242-80). The notional loan is treated as a termination amount and the lessee continues to be the owner of the car.

If at the end of the lease (renewal or extension) the lessee acquires the car from the lessor, the transfer and termination payments to acquire the car are ignored for tax purposes and the lessee continues to own the car and therefore the amount paid by the lessee is not assessable to the lessor or deductible to the lessee (s 242-85).

If the lessee's right to use the car ends, and no amount is paid to the lessor by the lessee to acquire the car, the lessee is treated as having sold the car back to the lessor for its market value at the end of the lease (s 242-90).

[FITR ¶229-000]

Effective Life of Depreciating Assets

¶17-270 Effective life of asset

The decline in value of a depreciating asset is calculated on the basis of the effective life of the asset (¶17-490, ¶17-500). Taxpayers can work out their own estimate of the effective life of a depreciating asset or rely on the Commissioner's determination (ITAA97 s 40-95). The Commissioner's determination is contained in TR 2017/2, which replaced TR 2016/1 from 1 July 2017. The choice must be made for the year in which the asset is first used, or installed ready for use, by the taxpayer for any purpose. In some circumstances, no choice can be made and a statutory effective life applies (¶17-280).

The ATO periodically reviews the effective lives of some assets in its published determinations. Details of the assets currently under review are on the ATO website (at www.ato.gov.au/Business/Depreciation-and-capital-expenses-and-allowances/In-detail/Effective-life/Reviews-in-progress).

Taxpayer's estimate of effective life

The effective life adopted by a taxpayer must relate to the total estimated period the asset can be used by *any* entity for the purpose of producing income (assessable, exempt or non-assessable non-exempt), exploration or prospecting, mining site rehabilitation or environmental protection activities, or conducting R&D activities (ITAA97 s 40-105). Therefore the effective life of the asset may include a period of time even if the taxpayer expects to dispose of the asset before its effective income-producing life is over.

In determining effective life, the task is to find the period of time over which the asset can be used by any entity for the specified purposes, having regard to the wear and tear reasonably expected from the taxpayer's circumstances of use and assuming that the asset will be maintained in reasonably good order and condition. A determination is expected to take into account the factors outlined in TR 2017/2.

Where plant is acquired *secondhand* after 11.45 am EST on 21 September 1999, its secondhand condition may be taken into account in estimating its effective life. The effective life of plant acquired before that time had to be determined as if the plant were new at the time the taxpayer first used or installed it for income-producing purposes.

If the taxpayer concludes that the asset is likely to be scrapped, sold for no more than scrap value or abandoned at a specific point in time (earlier than what would otherwise be its effective life), its effective life ends at that earlier time. That conclusion may be on the basis of experience in the particular industry in relation to the scrapping of assets (eg an asset may be scrapped where, because of the need to keep up with technology, it is no longer useful for income-producing purposes). An asset may also be scrapped because the goods it produces have gone out of production or the production process has changed. However, the technical risk arising from conducting R&D activities is ignored in making the assessment (s 40-105).

Where a depreciating asset is acquired for a particular project, a balancing adjustment event occurs for that asset at the completion of the project if the taxpayer stops using the asset, or having it installed ready for use, for any purpose and expects never to use it (TD 2006/33). Note that an asset cannot be treated as scrapped simply because its use is discontinued or the asset is stored (4 CTBR *Case* 31). However, an asset may be treated as destroyed if rendered useless and left in place (*BP Oil*).

The effective life is calculated at the time when the asset is first used by the taxpayer for any purpose or is installed ready for use for any purpose and held in reserve.

Re-estimation of effective life

For assets acquired on or after 1 July 2001, the effective life *must* be recalculated if during the relevant income year the cost of the asset is increased by at least 10%, even though the taxpayer may conclude that the effective life is the same. This rule is intended to ensure that second element costs incurred during the year are deducted over the life of the asset if they relate to future activities over a substantial period.

The recalculated effective life is used for the future write-off of the balance of the amount yet to be deducted.

The following examples illustrate the method of calculating effective life.

▶ Example 1

According to a manufacturer's specifications, a new photocopier is capable of producing one million copies before needing to be replaced. When purchased new, Copy Co expects that, as used in its business, it will produce half a million copies in two years. It is therefore reasonable to conclude that the copier has an effective life of four years, even if Copy Co's intention is to sell the copier after two years to someone else who may use it more or less heavily.

▶ Example 2

The operators of a luxury hotel chain refurbish every five years. Carpets and curtains are scrapped. TVs are sold at auction. If the TVs had continued to be used by the hotel chain instead of being sold, they would have required replacement after another two years. The effective life of the carpets and curtains is five years and the effective life of the TVs is seven years.

▶ Example 3

A company that uses specialist machinery has a policy of continuous plant development and improvement. Experience demands new generation machines every five years and older machines are then obsolete. The effective life of the machines is five years.

▶ Example 4

A mining company purchases mining equipment to use in a remote locality. The expected life of the mine is 10 years at the end of which the equipment will be abandoned, although it is still physically capable of operation. The effective life of the equipment is 10 years. If it was expected that the equipment could reasonably be transferred to, and used at, another mine site, the effective life could not be limited to the life of the first mine.

▶ Example 5

A company purchases machines for use in its business. Environmental legislation will outlaw the use of the particular type of machine throughout Australia within five years. The effective life of the machines could not be more than five years.

Mining, quarrying and prospecting rights or information

A taxpayer self-assesses the effective life of rights or information related to mining, quarrying or prospecting activities where an immediate deduction is unavailable. They do this by estimating the life of the existing or proposed mine, petroleum field, or quarry. Where the right or information relates to more than one mine, field or quarry, a taxpayer uses the activity with the longest estimated life (s 40-95(10)).

The effective life is to be reasonably estimated from the time the taxpayer first uses the rights or information for any purpose. In doing so, the taxpayer must only refer to the time over which the mining, petroleum or quarrying reserves are expected to be extracted using an accepted industry practice (s 40-95(11)). This enables a taxpayer to take a prior owner's use of the rights or information into account in calculating the remaining effective life.

A taxpayer may recalculate the effective life if it is no longer accurate because of changed circumstances related to the existing or proposed mine, field or quarry (s 40-110(3B); 40-110(4)). For example, the asset may be written off at the taxpayer's choice if the exploration is unsuccessful.

If rights or information do not relate to an existing or proposed mine, petroleum field, or quarry, their effective life is 15 years (s 40-95(12)).

Either the prime cost or the diminishing value methods may be used to calculate the decline in value of the rights or information.

The conditions for claiming an immediate deduction for expenditure on rights or information related to mining, quarrying or prospecting activities under s 40-80 are discussed at ¶17-350 and ¶19-010. Included in these conditions is that the rights or information must have been acquired from the government. Alternatively, if the asset is information, the taxpayer must have: (i) acquired a geophysical or geological data package from a recognised mining provider; (ii) created the information, or contributed to the cost of its creation; or (iii) caused, or contributed to the cost of, the information being created by a recognised mining provider. A recognised mining provider is an entity whose predominant business involves providing information to those involved in mining and quarrying operations (s 40-80(1AA)). If the only reason that a taxpayer does not qualify for an immediate deduction is because the rights or information fail to meet any of these particular conditions, then the asset is depreciated over the shorter of 15 years or its effective life (s 40-95(10A)).

However, special rules apply where mining, quarrying or prospecting rights are exchanged for exploration benefits under a farm-in farm out arrangement. Special rules also apply where joint venture parties exchange post-30 June 2001 rights to pursue a single development under an interest realignment arrangement (¶19-010).

A production licence granted under the *Petroleum (Submerged Lands) Act 1967* (Cth) which included both a right to explore and a right to produce petroleum constituted a single depreciating asset, rather than two assets depreciable over different time periods (*Mitsui & Co Ltd*).

Commissioner's determination of effective life

The Commissioner publishes recommended periods of effective life which taxpayers may optionally adopt as a safe harbour estimate for a depreciating asset (ITAA97 s 40-100). The Commissioner's latest determinations of effective life are incorporated in the tables reproduced in Chapter 43 (commencing at ¶43-000; TR 2017/2).

The appropriate determination to be applied to determine the effective life of a depreciating asset is that in force (s 40-95):

- when the taxpayer entered into a contract to acquire the asset
- when the taxpayer otherwise acquired the asset, or
- when the taxpayer started to construct the asset (eg ID 2002/180),

provided the asset started to be used (or was installed ready for use) for any purpose within five years of that time. Otherwise, it is the determination in force when the asset starts being used (or is installed ready for use) for any purpose.

However, if the taxpayer acquired plant or started to construct plant or entered into a contract to acquire plant before 11.45 am on 21 September 1999, the appropriate effective life is that contained in IT 2685. There is no restriction on the period within which the plant must first be used or held ready for use.

There is a ''statutory cap'' on the effective lives of specified assets where the taxpayer has chosen the effective life determined by the Commissioner (¶17-280).

Re-estimation of effective life

If the effective life based on the Commissioner's determination is no longer accurate because of changed circumstances relating to the nature of the use of the asset, the taxpayer *may* recalculate the effective life of the asset (s 40-110). The taxpayer *must* recalculate the effective life if using the Commissioner's determination of effective life and the prime cost method (¶17-490), and the cost of the asset during the income year is increased by at least 10%. The taxpayer may conclude that the effective life is unchanged. For example, the effective life of an asset must be recalculated if the cost of modifications to an asset done during an income year after the year of acquisition increases the total cost of the asset by at least 10%. This is because the cost of improvements may extend the life of the asset.

[FITR ¶87-110 – ¶87-160]

¶17-280 Statutory effective life

Generally, the decline in value of a depreciating asset is based on the effective life of the asset as self-assessed by the taxpayer or as determined by the Commissioner (¶17-270). In the following circumstances, however, a statutory effective life applies for the asset.

Asset acquired from associate

If the taxpayer acquired the depreciating asset from an associate who used the diminishing value method, the effective life of the asset for the taxpayer is the same as that used by the associate (ITAA97 s 40-95(4)). If the associate used the prime cost

method, the taxpayer must use the remaining effective life of the asset. The taxpayer may request the associate to give it the information about the method and effective life it used for the asset, within 60 days (ITAA97 s 40-140). There are special rules if the ''statutory cap'' (see below) applies.

If either in the year of the acquisition or in a later year the cost of the asset increases by at least 10%, the effective life *must* be recalculated (ITAA97 s 40-110(2), (3)).

Holder changes but user is the same or is an associate of former user

This rule deals with the case where the taxpayer acquires the asset from the former holder but the user of the asset (while the taxpayer is the holder of the asset) is the same as, or is an associate of, the user of the asset while the asset was held by the former holder (s 40-95(5)). In this case, if the former holder used the diminishing value method, the taxpayer must use the same effective life that was used by the former holder (eg not an accelerated depreciation rate under the former law: ID 2003/754). If the former holder was using the prime cost method, the taxpayer must use the remaining effective life. If either the former holder did not use an effective life or the taxpayer does not know and cannot readily find out the effective life used by the former holder, the taxpayer must use the effective life determined by the Commissioner. There are special rules if the ''statutory cap'' (see below) applies.

If either in the year of the acquisition or in a later year the cost of the asset increases by at least 10%, the effective life *must* be recalculated (s 40-110(2), (3)).

Intangible depreciating assets

The effective life of an intangible depreciating asset mentioned in the table below is the period applicable to the asset under the table and cannot be recalculated (s 40-95(7)).

Asset	Effective life
Standard patent	20 years
Innovation patent	8 years
Petty patent	6 years
Registered design	15 years
Copyright (other than film copyright)	The shorter of: (a) 25 years from acquisition of copyright; and (b) the period until the copyright ends
A licence (not relating to a copyright or in-house software)	The term of the licence
A licence relating to copyright (except copyright in a film)	The shorter of: (a) 25 years from when the taxpayer became licensee; and (b) the period until the licence ends
In-house software	5 years if first used, or installed ready for use, from 1 July 2015; otherwise 4 years
Spectrum licence	The term of the licence
Datacasting transmitter licence	15 years
Telecommunications site access right	The term of the right

A Bill has been introduced to allow taxpayers to choose to self-assess the effective life of intangible depreciating assets listed in the table above, provided they start holding them from 1 July 2016. Alternatively, they can choose to continue using the existing statutory lives. If implemented, the choice will need to be made for the income year in which an asset's start time occurs (¶41-150). Where the effective lives are self-assessed, the taxpayer may recalculate the effective life in later income years if it is no longer

accurate because of changed circumstances relating to the nature of the asset's use. For intangible assets a taxpayer started to hold before 1 July 2016, the effective lives in the above table continue to apply and cannot be recalculated.

Film copyright (and exclusive licences relating to copyright in a film) acquired on or after 1 July 2004 is specifically excluded from the treatment of ordinary copyright. Deductions may be available for the decline in value of film copyright on the basis of its effective life (self-assessed, or determined by the Commissioner: Chapter 43), using either the prime cost or diminishing value methods (¶17-015).

The effective life of an **indefeasible right to use** a telecommunications cable system is the effective life of the cable over which the right is granted. For expenditure incurred from 12 May 2004, this applies to both domestic and international IRUs (¶17-015). Such effective life can be self-assessed by the taxpayer or determined by the Commissioner.

The effective life of any other intangible depreciating asset (other than mining, petroleum or quarrying rights: ¶17-270) cannot be longer than the term of the asset as extended by any reasonably assured extension or renewal of that term.

Statutory caps on effective life of specified assets

A statutory ''capped'' life applies for specified assets if the taxpayer has chosen the effective life determined by the Commissioner (Chapter 43) and the capped life is shorter than the life determined by the Commissioner (ITAA97 s 40-102). Taxpayers will continue to be able to self-assess the effective life of the asset based on their own circumstances (if they do not wish to adopt the capped life or the life determined by the Commissioner). For details of the statutory caps, see ¶43-105. For example, from 1 July 2012, the effective life of eligible ships is capped at 10 years (ITAA97 s 40-103).

[FITR ¶87-110, ¶87-115, ¶87-160]

Special Rates of Decline in Value

¶17-325 Small business simplified depreciation rules

The simplified regime for calculating capital allowances on depreciating assets is contained in ITAA97 Subdiv 328-D. Small business entities that choose to use this regime are not subject to the provisions of ITAA97 Div 40 (ITAA97 s 328-175). Under these provisions, small business entities have access to an immediate write-off for low value depreciating assets and a simple pooling facility for other depreciating assets (ITAA97 s 328-180). For full details see ¶7-250.

[FITR ¶313-085 – ¶313-095]

¶17-330 Low-cost items: immediate write-offs

An immediate 100% deduction applies for depreciating assets costing $300 or less and used by taxpayers predominantly in deriving non-business assessable income provided: (a) the asset was not part of a set of assets acquired during the year where the total cost of the set exceeded $300; and (b) the total cost of the asset and any identical or substantially identical item that the taxpayer started to hold in that year did not exceed $300 (ITAA97 s 40-80(2)). For the meaning of ''identical'', see ID 2003/80. The deduction is available for the cost of the asset, reduced by any input tax credits which the taxpayer may be entitled to claim. An apportionment is required if the asset is only partly used for taxable purposes. However, no reduction is made for part-year use of an asset. Such expenditure cannot be allocated to a low-value pool (¶17-810).

[FITR ¶87-081]

¶17-350 Exploration or prospecting assets

Immediate deduction for exploration or prospecting assets

An immediate deduction may be available for the cost of depreciating assets that are first ''used'' for exploration or prospecting for either minerals or quarry materials (s 40-80(1); ¶19-010). The materials must be obtainable by mining and quarrying operations.

Exploration rights involving a lease and licence to explore for minerals will be ''used'' if the taxpayer explores for mineral deposits. Developing a mine plan and evaluating core samples obtained by a previous owner would not qualify as using such rights (ID 2010/64). In addition, enjoying exclusive access to land because exploration rights preclude another entity from exploring it does not, without more, qualify as using exploration rights (ID 2010/65).

To qualify for the immediate deduction, the taxpayer's business must involve mining and quarrying operations at the time the taxpayer first uses the asset (or has it installed ready for use). The operations must also be conducted for an income producing purpose. The taxpayer must not first use the asset for petroleum development drilling, or for working a mining property, quarrying property or petroleum field (ID 2010/67).

Further, expenditure on mining, quarrying or prospecting rights or information first held after 7.30 pm EST on 14 May 2013 must have been acquired from an Australian government authority to qualify for an immediate deduction. Alternatively, if the asset is information, the taxpayer must have: (i) acquired a geophysical or geological data package from a recognised mining provider; (ii) created the information, or contributed to the cost of its creation; or (iii) caused, or contributed to the cost of, the information being created by a recognised mining provider. A recognised mining provider is an entity whose predominant business involves providing information to those involved in mining and quarrying operations (s 40-80(1AA)). If the only reason that a taxpayer does not qualify for the immediate deduction is because the rights or information fail to meet any of these particular conditions, then the asset is depreciated over the shorter of 15 years or its effective life. However, in some cases it may be written off at the taxpayer's choice (s 40-95(10A); ¶17-270).

Similar criteria apply to the immediate deductibility of second element exploration or prospecting costs (s 40-80(1AB)). If second element expenditure on improving mining, quarrying or prospecting information satisfies the conditions in the previous paragraph, then it may qualify for an immediate deduction regardless of how the original information was acquired.

For details of the immediate deduction that was available for geothermal depreciating assets that a taxpayer started to hold between 1 July 2012 and 30 June 2014, see the 56th edition of the *Australian Master Tax Guide*.

Deduction over time for exploration or prospecting assets

If an immediate deduction is not available for an exploration or prospecting depreciating asset, then a deduction may be claimed over the asset's effective life using the prime cost or diminishing value method (¶17-270).

Other exploration expenditure

An immediate deduction may be available for capital expenditure incurred on exploring or prospecting for minerals, or quarry materials, unrelated to a depreciating asset. To qualify, the materials must be obtainable by, and the taxpayer's business must involve, mining and quarrying operations (s 40-730; ¶19-040).

The Commissioner's revised views on the deductibility of mining or petroleum exploration expenditure under the general deduction provision (s 8-1; ¶16-010), or under s 40-730, are in TR 2017/1. PCG 2016/17 sets out how the ATO will administer the law and the draft ruling to assure deductions claimed for exploration expenditure.

In addition, certain mining project and related transport expenditure of a capital nature that does not form part of a depreciating asset's cost may be deductible over the estimated life of the project (s 40-830 to 40-885; ¶19-050).

[FITR ¶87-080]

¶17-370 Computer hardware and software

Computer hardware

Computer hardware (eg laptops, screens, backup drives, routers, modems, and scanners) are normally depreciating assets, or parts of depreciating assets. Their cost may be written off as an ordinary capital allowance (Div 40; ¶17-330; ¶17-480), or as a small business capital allowance (Div 328; ¶7-250).

Computer software

Computer software is the digital system comprised of the programs, data and associated documentation, that instructs other parts of a computer, and may include website content. A capital allowance is available for "in-house software" (s 40-30(2)(d)) used for an income producing purpose usually over five years, or as part of a software development or low value pool (Div 40). Alternatively, the small business capital allowance regime may apply (Div 328; ¶7-250). Sometimes, an immediate deduction may instead be available for capital expenditure on in-house software (see below). A Bill has been introduced to allow taxpayers to choose to self-assess the effective life of "in-house software", provided they start holding the asset from 1 July 2016 (Treasury Laws Amendment (2017 Enterprise Incentives No 1) Bill 2017: ¶41-150).

To the extent that software costs are not general deductions (s 8-1; ¶16-010), or are not in-house software, the costs may be recognised in the CGT cost base of a CGT asset (typically, the first or fourth elements; s 110-25). Otherwise, as a last resort, the costs might be recognised as blackhole expenses (s 40-880; ¶16-156).

Deductions for expenditure on intellectual property and related expenditure are discussed at ¶16-727.

"In-house software" defined

"In-house software" is defined as computer software (or a right to use computer software), that a "taxpayer" acquires, develops or commissions and that is "mainly" used by them in performing the functions for which the software was developed (ie not mainly for sale; s 995-1(1)). Also, the expenditure must not be deductible outside the ordinary capital allowance regime (in Div 40; ¶17-480) and the rules for small business taxpayers (in Div 328; ¶7-250) (eg ID 2010/14). For example, if expenditure qualifies for a general deduction, it will not be in-house software; instead it may have the character of maintenance expenditure. Software developed for conjunctive use within a taxpayer's corporate group was in-house software in ID 2014/16.

The definition requires the software to be used by the "taxpayer" in performing the functions for which it was developed. For example, a taxpayer's website might provide access to software that: (i) is installed on a user's device for offline use independent of the taxpayer's business; or (ii) is provided mainly for the user's benefit and not to enable further interactions with the taxpayer. The Commissioner's view is that such software is not in-house software for the taxpayer because it is not used by them to perform the functions for which it was developed. Also, content that is incidental to a website, which does not have value separate from the website, is not in-house software (TR 2016/3).

The use of the word "mainly" in the definition covers dual-purpose situations. For example, if a taxpayer develops software for their own use, but they also license it to other businesses, then the taxpayer's "main" use of the software will be a question of fact in establishing if it is in-house software.

Prime-cost capital allowances

Deductions are available for the decline in value of a depreciating asset that is "in-house software" held for a taxable purpose. The decline in value is calculated using the prime cost method. The effective life is five years if the in-house software is first used, or installed ready for use, from 1 July 2015; otherwise it is four years (¶17-010, ¶17-280).

If in-house software stops being used and the taxpayer expects never to use it again, or if the taxpayer has never used the software and decides never to use it, a balancing adjustment event occurs (¶17-630) and the termination value of the software is zero (¶17-640).

A deduction is available for in-house software expenditure (other than software pool expenditure), if the taxpayer intends to use the software for a taxable purpose, but, before being able to use it (or install it ready for use), they decide never to use or install it (s 40-335). The amount deductible is the total expenditure incurred on the software reduced by any consideration derived for the software (up to the amount of the expenditure), reduced by the non-taxable use proportion. Any recoupments of the expenditure are included in assessable income (¶10-270).

Software development and low-value pool regimes

Taxpayers may include expenditure on developing or commissioning (but not acquiring) in-house software in a software development pool if the software is intended to be used *solely* for a taxable purpose (ie the purpose of producing assessable income, of exploration or prospecting, of mining site rehabilitation or environmental protection activities) (ITAA97 s 40-450). A separate software development pool must be created for each income year in which expenditure on such software is incurred. Amounts allocated to a software development pool are reduced by any available input tax credits, and the pool value is reduced by decreasing adjustments and increased by increasing adjustments (¶34-100) to which the taxpayer is entitled for the acquisition of the asset (ITAA97 s 27-100).

If software development pool expenditure is incurred in the 2015/16 or a later income year, the expenditure is deducted over five years. However, no amount is deducted for the income year the expenditure is incurred (Year 1). Instead, the taxpayer calculates the total amount incurred on developing or commissioning in-house software in Year 1, and deducts 30% of that amount for each of income Years 2, 3 and 4. The remaining 10% is deducted for income Year 5 (s 40-455).

Expenditure incurred before the 2015/16 income year is deducted over four years. No amount is deducted for Year 1. Instead, 40% of the Year 1 total is deducted for each of income Years 2 and 3, with the remaining 20% being deducted for income Year 4.

The deduction is available even if the software is not used or installed until later (or ever). After the pool is created in an income year, all software development expenditure incurred in that year or a later year must be allocated to a software development pool.

Consideration derived in relation to pooled software (eg for the disposal, grant, licence or loss of the software) is assessable, except where roll-over relief is elected (¶17-710; s 40-460). The balancing adjustment provisions (¶17-630) do not apply.

The low-value pool regime (in Subdiv 40-E; ¶17-810) may also apply to a depreciating asset that is in-house software, but not if expenditure has already been recognised in a software development pool.

For the cost setting measures that apply to software development and low-value pools in consolidated groups, see ITAA97 Subdiv 716-G.

SBE capital allowance regime

If the entity incurring in-house software expenditure is a small business entity (SBE) (under Div 328), then they may qualify for an immediate deduction if the software's cost is below the low-cost asset threshold (s 328-180; ¶7-250). If the asset's cost is at or above

- second-hand goods (¶34-260)
- insurance claims (¶34-210)
- CTP insurance schemes (¶34-210), and
- accreditation of alternative medical practitioners (s 21).

[AMGST ¶19-000; GSTG ¶75-000]

¶34-360 Other GST-related measures

"Locking in" the GST rate

Measures intended to lock in the GST rate at 10% are contained in the *A New Tax System (Commonwealth-State Financial Arrangements) Act 1999*. This Act provides that no alteration can be made to the rate unless each state and territory agrees, as well as both Houses of Federal Parliament.

Relationship with other taxes

In general, the GST component of the price of goods or services is not assessable to the supplier (ITAA97 s 17-5: ¶10-000). Similarly, the GST component is not deductible to the purchaser/recipient except to the extent that an input tax credit cannot be claimed (ITAA97 s 27-5: ¶16-860). The cost of assets that you can depreciate is reduced by the amount of any input tax credit entitlement (¶17-080). Periodical payments of net GST made to the ATO by suppliers are not deductible (ITAA97 s 27-15).

Supplies of goods and services to employees as fringe benefits will not be subject to GST if the supply is subject to FBT or is an exempt fringe benefit. However, GST may apply where the employee makes a contribution or payment to the employer towards the cost of the fringe benefit (s 9-75; GSTR 2001/3).

Wine equalisation tax and luxury car tax

The wine equalisation tax and luxury car tax are both designed to cushion the effect that the abolition of sales tax would otherwise have had. The operative provisions for these taxes are contained in the *A New Tax System (Wine Equalisation Tax) Act 1999* and the *A New Tax System (Luxury Car Tax) Act 1999*.

Administration

General machinery provisions for the administration of the taxation laws (including GST) are contained in the TAA.

GST-related offences

Penalties for failing to comply with various GST obligations are contained in the TAA. Guidelines for remission of some of these penalties are set out in several ATO Practice Statements, including PS LA 2012/4 and PS LA 2012/5 (false or misleading statements), PS LA 2007/3 (tax invoices) and PS LA 2007/4 (registration obligations).

GST Regulations

Some important GST rules are contained in the A New Tax System (Goods and Services Tax) Regulations 1999 — eg the detailed requirements for tax invoices (¶34-140) and the definition of input taxed financial supplies (¶34-190).

Australian Business Numbers

In general, an entity's GST registration number is its Australian Business Number (ABN). Rules governing the use of ABNs are contained in the *A New Tax System (Australian Business Number) Act 1999*.

Chapter 35 Fringe Benefits Tax

Introduction

¶35-000 Outline of fringe benefits tax

Fringe benefits tax (FBT) is a tax payable by employers on the value of certain benefits that have been provided to their employees or to associates of those employees in respect of their employment, known as "fringe benefits".

The principal legislation dealing with FBT is the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) and its regulations. Section references in this chapter are to the FBTAA unless otherwise indicated. Other legislation affecting fringe benefits comprises the *Fringe Benefits Tax Act 1986* (FBTA) and the *Fringe Benefits Tax (Application to the Commonwealth) Act 1986*. The ATO publishes *Fringe benefits tax: a guide for employers* (NAT 1054).

Employers are generally required to pay FBT in four instalments but FBT is assessed on an annual basis. The FBT year runs from 1 April to 31 March and so references to a "year" in relation to FBT mean a year ending on 31 March. The system of FBT is based on self-assessment by employers. The statutory due date for lodgment of FBT returns and payment of any FBT liability is 21 May following the end of the FBT year. However, for taxpayers who are on a tax agent's lodgment programme, concessions apply (¶35-030).

FBT is imposed on the fringe benefits taxable amount which is the employer's aggregate fringe benefits amount for the year grossed-up (¶35-025). If certain conditions are satisfied, employers exempted from the record-keeping requirements are able to calculate the FBT payable based on the aggregate fringe benefits amount of an earlier year and not the aggregate fringe benefits amount of the current year (¶35-692).

FBT rate

For the year ended 31 March 2017, the FBT rate is 49%. For the year that commenced 1 April 2017, the FBT rate is 47%.

Interaction with other taxes

Income tax

A benefit that is taxable under the FBTAA (or specifically exempted under that Act, except for certain car expense payment benefits) is free from income tax. The scheme of ITAA36, ITAA97 and the FBTAA is that monetary remuneration, including most allowances, is subject to income tax in the employee's hands, and that non-cash benefits (and certain living-away-from-home allowances) are subject to FBT, which is payable by the employer, and are not subject to income tax.

However, an employer is required to record on an employee's payment summary the taxable value of certain fringe benefits provided during the year (¶35-055).

Employers can claim an income tax deduction for the cost of providing fringe benefits (¶16-520) and for any FBT incurred (¶16-858). The deduction for the cost of providing the fringe benefits is available even though no deduction would have been

allowed had the employee incurred the expenditure (eg entertainment, club fees, expenditure on leisure facilities and boats, HELP and similar payments (¶2-380), travel expenses of accompanying relatives). Further, an employer is assessable to income tax on amounts of FBT reimbursed or amounts received to reduce the taxable value of fringe benefits provided.

Based on TR 95/24, for the income tax year ending 30 June 2017, most employers can deduct:

- their actual FBT liability for the FBT year ended 31 March 2017
- *less* the FBT instalment referable to the June 2016 FBT quarter
- *plus* the FBT instalment referable to the June 2017 FBT quarter.

Where an FBT assessment is issued or amended for an earlier FBT year, FBT is incurred at the end of the earlier FBT year rather than in the year in which the assessment is raised (TD 2004/20).

The taxable value of fringe benefits is reduced by the amount of a payment that is non-deductible because of the personal services income rules (¶30-620, ¶30-630; s 61G).

GST

Although the provision of services by an employee would normally be treated as the consideration for the supply of a fringe benefit, no GST arises unless the employee makes a contribution for the benefit (*A New Tax System (Goods and Services Tax) Act 1999* (GST Act), s 9-75(3); GSTR 2001/3). If no contribution is made, no GST is charged. If the employee makes a ''recipient's payment'' towards a car fringe benefit or a ''recipients contribution'' towards another benefit, the employer must remit 1/11th of the contribution as GST in respect of the supply of the fringe benefit. No GST is charged if the provision of the fringe benefit is a GST-free (¶34-165) or input-taxed (¶34-170) supply.

Where the taxable value of a benefit includes the ''cost'' of providing the benefit, this means the GST-inclusive cost (TR 2001/2).

Interaction with foreign employment income rules

Where resident taxpayers derive foreign earnings (¶10-860), there is the potential for double taxation as FBT is levied on employers whereas most foreign jurisdictions tax such benefits to the employee. A non-resident employer can be subject to PAYG withholding (¶26-100) and FBT in respect of Australian resident employees working overseas (TD 2011/1). A non-resident employer who pays an Australian resident for work performed overseas is subject to withholding obligations if the non-resident employer has a sufficient connection with Australia, ie if the non-resident carries on an enterprise or income-producing activities in Australia and has a physical presence in Australia. If there is a withholding obligation, FBT obligations will arise in relation to benefits provided to that employee. However, if there is no withholding obligation, amounts paid to the employee by the non-resident employer will not be ''salary and wages'' and no FBT obligations can arise for the non-resident employer in relation to benefits provided to that employee.

[FTR ¶800-000, ¶833-825]

¶35-025 Fringe benefits taxable amount — gross-up rules

An employer's fringe benefits taxable amount is calculated by ''grossing-up'' the taxable values of fringe benefits provided during the FBT year. The gross-up has the effect that FBT is calculated as if the employer provided fringe benefits with a taxable value that included the FBT paid by the employer.

An employer's fringe benefits taxable amount is calculated using two gross-up methods: one for benefits for which the employer is entitled to GST input tax credits on the acquisition price, and the other for benefits for which there is no entitlement to GST

input tax credits. The reason for the two gross-up calculations is to distinguish between persons and benefits receiving different treatment under the GST legislation (TR 2001/2). The employer is then allowed a deduction for the FBT.

The effect of the gross-up rules in s 5B(1A) to (1D) is that the fringe benefits taxable amount is calculated as follows:

$$\text{s 5B(1B) amounts} + \text{s 5B(1C) amount} + \text{aggregate non-exempt amount}$$

The s 5B(1B) and (1C) amounts are calculated by applying the relevant gross-up formulae to the ''type 1'' or ''type 2'' aggregate fringe benefits amounts of the employer, calculated using method statements in s 5C(3) and (4). Type 1 and type 2 aggregate fringe benefits amounts are determined according to whether or not GST input tax credits are available on acquisitions of goods or services acquired to provide the benefits.

- *Type 1 aggregate fringe benefits amounts* broadly represent the sum of the individual fringe benefits amounts and the excluded fringe benefits (¶35-055) that are provided to the employer's employees and that are ''GST-creditable benefits'', ie the provider of the benefit is entitled to GST input tax credits at the time the benefit was acquired.
- *Type 2 aggregate fringe benefits amounts* are all other fringe benefits.

The gross-up of type 1 aggregate fringe benefits amounts under s 5B(1B) essentially applies where the provider of the benefit is entitled to GST input tax credits on the acquisition of the thing it provides as a fringe benefit. The gross-up of type 2 aggregate fringe benefits amounts under s 5B(1C) applies where the provider is not entitled to GST input tax credits (eg because the provider is not registered for GST or because the thing supplied is GST-free or input taxed).

GST-creditable benefit

The first category of GST-creditable benefit is one that relates to the acquisition or importation of a thing, which is essentially anything that can be supplied or imported (s 149A).

The second type of GST-creditable benefit is one where the person who provided the benefit was entitled to an input tax credit (¶34-010) for that benefit by the operation of GST Act Div 111. It also applies to GST group arrangements and ensures that a benefit may also be a GST-creditable benefit where another member of the GST group, rather than the person who is providing the benefit, is entitled to input tax credits.

Division 111 of the GST Act is concerned with entitlements to input tax credits for reimbursing employees, agents, officers or partners for expenses they incur in connection with the carrying on of an employer's enterprise (¶34-100). The entitlement extends to charitable bodies and government schools reimbursing their volunteers.

GSTR 2001/3 explains the circumstances under which supplies of fringe benefits are subject to GST. That ruling explains the entitlement to input tax credits for acquisitions and importations related to the provision of fringe benefits.

Gross-up formulae

Type 1 benefits

If an employer is entitled to input tax credits in respect of the value of fringe benefits at the time the benefits were provided (type 1 benefits), then the total value of the fringe benefits is grossed up to a tax-inclusive value using the formula:

$$\frac{\text{FBT rate} + \text{GST rate}}{(1 - \text{FBT rate}) \times (1 + \text{GST rate}) \times \text{FBT rate}}$$

This formula is aimed at recouping any input tax credits arising from the provision of fringe benefits by an employer or associate, or under an arrangement between the employer and a third party. For the FBT year ended 31 March 2017, the rates are 49% and 10%, resulting in a gross-up rate of 2.1463. For the FBT year that commenced on 1 April 2017, the rates are 47% and 10%, resulting in a gross-up rate of 2.0802.

Type 2 benefits

These benefits comprise:

- those that are wholly GST-free
- those that represented goods or services not acquired by the employer (such as goods manufactured by the employer)
- those provided by an employer that is a small business employer who has opted not to register for GST
- those benefits provided by an employer whose activities are input taxed.

In the above cases, the gross-up formula is:

$$\frac{1}{(1 - \text{FBT rate})}$$

This formula results in a gross-up rate of 1.9608 for the FBT year ended 31 March 2017 and a gross-up rate of 1.8868 for the FBT year that commenced on 1 April 2017.

An "employer's fringe benefits taxable amount" (s 5B) represents the total of the type 1 and type 2 aggregate fringe benefits amounts calculated using the above formulae plus any aggregate non-exempt amount.

Aggregate non-exempt amount

An employer's aggregate non-exempt amount is calculated according to s 5B(1E) to (1L). Only employers that are qualifying public or non-profit hospitals, public ambulance services, health promotion charities or public benevolent bodies and that provide benefits exempted by s 57A (¶35-100) have aggregate non-exempt amounts. Such an employer's aggregate non-exempt amount is the sum of the grossed-up value of an employee's individual fringe benefits amounts and most excluded fringe benefits (¶35-055) provided to the employee that exceeds the relevant threshold. This sum is basically all fringe benefits other than entertainment facility leasing expenses and meal entertainment (except if provided as part of a salary packaging arrangement) and car parking. The relevant thresholds are:

- $17,667, if the employee is engaged in duties connected with qualifying public or non-profit hospitals or public ambulance services ($17,000 for FBT years commencing 1 April 2017 and later), or
- $31,177, if the employee is engaged in duties connected with a public benevolent institution or a health promotion charity that is not covered by the $17,667 threshold, eg an institution that is not a public hospital ($30,000 for the FBT year commencing 1 April 2017 and later) (¶35-100).

For the FBT year ended 31 March 2017, salary packaged meal entertainment and entertainment facility leasing expenses are no longer considered to be excluded fringe benefits. In order to provide a $5,000 threshold before such benefits become taxable, the aggregate non-exempt amount is reduced by the lesser of $5,000 and the total grossed-up taxable value of salary packaged meal entertainment and entertainment facility leasing expense benefits.

For an illustration of the application of the rules, see CR 2005/82. Where the employer's status changes during the FBT year from being an endorsed public benevolent institution to a hospital that is not endorsed, the employer remains entitled to the $31,177 capped exemption for each employee who was employed both before and after this change while being provided with benefits throughout the FBT year (ID 2009/159).

▶ Example

During the FBT year ended 31 March 2017, an employer provides its employees with these fringe benefits:

- employee A received a television with a taxable value of $2,000 and an overseas holiday with a taxable value of $7,000
- employee B received a $3,000 reimbursement of his children's school fees.

The employer is registered for GST and input tax credits are available on the acquisition of the television. None of the benefits are exempted by s 57A, so there is no aggregate non-exempt amount. The employer's fringe benefits taxable amount is calculated as follows.

Step 1: calculate the type 1 aggregate fringe benefits amount

Add each employee's individual fringe benefits amount for benefits where the employer was entitled to input tax credits for GST paid.

employee A	=	$2,000 for the television
employee B	=	$0 (tuition fees are GST-free)
	=	$2,000

Step 2: calculate the type 2 aggregate fringe benefits amount

Add each employee's individual fringe benefits amount for benefits where the employer did not pay GST or input tax credits were not allowed.

employee A	=	$7,000 (no GST on overseas holiday)
employee B	=	$3,000 (tuition fees are GST-free)
	=	$10,000

Step 3: calculate the s 5B(1B) amount

Multiply the type 1 aggregate fringe benefits amount by the relevant gross-up formula (ie by the rate of 2.1463), ie $2,000 × 2.1463 = $4,292.60

Step 4: calculate the s 5B(1C) amount

Multiply the type 2 aggregate fringe benefits amount by the relevant gross-up formula (ie by the rate of 1.9608), ie $10,000 × 1.9608 = $19,608

Step 5: calculate the fringe benefits taxable amount

Add together the s 5B(1B) and (1C) amounts:

$4,292.60 + $19,608 = $23,900.60

The employer's FBT liability for the year is:

$23,900 × 49% = $11,711

The amount of $11,711 is deductible to the employer (ITAA97 s 8-1).

[FTR ¶832-471, ¶833-825]

¶35-030 FBT annual returns and assessments

FBT is collected via a self-assessment system. Each year an employer who has provided fringe benefits to its employees is required to:

(1) obtain declarations and make elections

For type 1 benefits

(2) identify the employee's individual fringe benefits amounts that are GST-creditable benefits for the year of tax in respect of the employment of the employee (¶35-025)

(3) add up the taxable value of every "excluded fringe benefit" (¶35-055) for the year (other than an amortised fringe benefit under s 65CA: ¶35-650) that is a GST-creditable benefit (¶34-010) relating to an employee and the employer

(4) total items (2) and (3). This represents the employer's type 1 aggregate fringe benefits amount

(5) calculate that part of the "employer's fringe benefits taxable amount" that comprises type 1 benefits (ie multiply item (4) by 2.1463 for the FBT year ended 31 March 2017)

For type 2 benefits

(6) identify all other employee's individual fringe benefits amounts for the year of tax in respect of the employment of the employee

(7) add up the taxable value of every other excluded fringe benefit for the year (other than an amortised fringe benefit) relating to an employee and the employer

(8) total items (6) and (7). This represents the employer's type 2 aggregate fringe benefits amount if there are no amortised or reducible (s 65CC: ¶35-650) fringe benefits

(9) calculate the amortised amount for the year of each amortised fringe benefit relating to an employee and the employer

(10) total items (8) and (9)

(11) calculate the reduction amount for the year of tax of each reducible fringe benefit relating to an employee and the employer

(12) deduct item (11) from item (10). This represents the employer's type 2 aggregate fringe benefits amount (s 5C(4))

(13) calculate that part of the "employer's fringe benefits taxable amount" that comprises type 2 benefits (ie multiply item (12) by 1.9608 for the FBT year ended 31 March 2017)

FBT payable

(14) total items (5) and (13)

(15) calculate the FBT payable on the "employer's fringe benefits taxable amount" (ie multiply item (14) by 49% for the FBT year ended 31 March 2017: ¶42-380)

(16) deduct the FBT rebate if applicable (¶35-642), and

(17) prepare and lodge an annual FBT return (unless the taxable amount of fringe benefits is nil: s 68) and pay any tax due or obtain a refund after allowing for instalments of FBT paid during the year.

The 2017 FBT return form is available from the ATO at Fringe benefits tax (FBT) return 2017 (www.ato.gov.au/uploadedFiles/Content/SME/downloads/n1067-01-2017_js37922_w.pdf). A single return must be lodged for each employer. An employer with decentralised operations cannot divide its FBT responsibilities among different branches. The consolidation regime (¶8-000) does not apply to an employer's FBT obligations and each entity within a consolidated group must comply with its own FBT obligations.

The ATO recommends that employers register once they have established that they have to pay FBT. To register for FBT, employers complete an *Application for registration — fringe benefits tax* (NAT 1055) and send it to the ATO. There is no legal requirement to register.

Although there is no requirement to lodge an FBT return if the fringe benefits taxable amount for the year is nil, employers that are registered for FBT but do not need to lodge an FBT return are asked by the ATO to lodge with the ATO a *Notice of non-lodgment of FBT return* (NAT 3094).

Alternative assessments

Alternative assessments may be issued to the same taxpayer (for different income years) or to different taxpayers (in respect of the same year of income) pursuant to more than one tax Act in respect of the same income, benefit or transaction (eg an income tax assessment and an FBT assessment in respect of the same income or benefit). The Commissioner would not normally institute proceedings to recover the aggregate amount of the tax owing in relation to both the primary and the alternative assessments, unless he considers that the tax payable under the alternative assessment is at risk (PS LA 2006/7).

Deemed assessment

The lodging of a return gives rise to a deemed assessment of the employer's liability for FBT (s 72). That assessment is deemed to have been made by the Commissioner and served on the employer at the time when the return is lodged. If a return is not lodged, the Commissioner can make an assessment of the fringe benefits taxable amount and the amount of tax for which, in the Commissioner's opinion, the employer would have been liable (s 73). Alternatively, the Commissioner can require any person to lodge a return for a particular year (s 69).

Amendment of assessment

An assessment may be amended where the employer requests an adjustment, or where an audit or subsequent check by the Commissioner reveals undisclosed or undervalued benefits. An application for amendment must be made in the approved form (s 74(6A)). A refund or reduction of the FBT liability as a result of an amended assessment is an assessable recoupment (TD 2004/21).

An assessment may be amended within three years of the lodgment of a return. Where there has not been full and true disclosure and there has been an avoidance of tax, the assessment may be amended within six years of the lodgment of the return. Where, in the Commissioner's opinion, there has been tax fraud or evasion, an amendment may be made at any time (s 74(3); *Case 17/2006*).

Lodgment dates

For employers *not* on a tax agent lodgment programme, the annual return form must be lodged by 21 May (or such later date as the Commissioner allows). Self-assessed deferral requests for FBT returns are no longer available but taxpayers can lodge a "Request for additional time to lodge" where there are exceptional or unforeseen circumstances that prevent lodgment by the due date.

For employers on a tax agent lodgment programme the ATO provides a lodgment-only deferral to 25 June for electronic lodgments only. Paper returns are still required by 21 May.

To continue to be eligible for the lodgment program due date, the tax agent must lodge 85% or more of the FBT returns from his/her client list by the due date.

Tax agents

Generally, only a registered tax agent can charge a fee for preparing FBT returns or objections on behalf of another person (*Tax Agent Services Act 2009*, Div 50). The prohibition on charging fees for tax services does not extend to solicitors or barristers acting in a professional capacity in preparing an objection, in tax litigation or proceedings, and in advising on tax matters. Only a registered tax agent or registered BAS agent can provide a BAS service (¶32-000), which would include preparing FBT information on a BAS.

[FTR ¶823-290, ¶823-490, ¶823-590, ¶824-050, ¶830-100]

¶35-050 Payment of FBT

An employer's FBT liability is due and payable on 21 May following the FBT year ended on 31 March if the employer is not on a tax agent's lodgment programme (s 90). If the employer is on a tax agent's lodgment programme, the due date is 28 May.

If the previous year's FBT liability was $3,000 or more, the employer is required to pay the tax in quarterly instalments (s 101 to 113). The instalments are notified in each quarter's BAS or IAS with a final payment being due, if necessary, with the lodgment of the annual FBT return.

Instalments are based on either: (a) the employer's "notional tax amount" — generally, the amount of the employer's tax for the most recent year of tax for which the Commissioner has made an assessment (s 110) (this amount is modified where the FBT rate has changed); or (b) if the employer chooses, the employer's estimate of its current year's FBT liability (s 112).

GIC is payable if the estimate and consequent instalments are too low (¶29-510).

For deferred BAS payers (¶24-240), the instalments of tax are due as follows (s 103(2)):

- first instalment — 28 July
- second instalment — 28 October
- third instalment — 28 February
- fourth instalment — 28 April, and
- balance — to be paid on lodgment of the annual FBT return, ie on or before 21/28 May (s 90).

For employers other than deferred BAS payers, the instalments of tax are due as follows (s 103(1)):

- first instalment — 21 July
- second instalment — 21 October
- third instalment — 21 January
- fourth instalment — 21 April, and
- balance — to be paid on lodgment of the annual FBT return, ie on or before 21/28 May (s 90).

Due dates on weekends

Where a due date for payment of a tax debt or lodgment of an approved form falls on a Saturday, a Sunday or a public holiday, the payment or lodgment may be made on the next business day without incurring a penalty or GIC.

No instalments if FBT less than $3,000

Instalments do not have to be paid by employers whose FBT liability in the previous year was less than $3,000 (s 111). Such employers need only pay on an annual basis.

[FTR ¶827-405, ¶828-040]

¶35-055 Reporting of benefits on payment summaries

Employers are required to record on payment summaries the grossed-up taxable value of certain fringe benefits (other than excluded fringe benefits) provided to employees during the FBT year, where the taxable value of the benefits provided to an employee exceeds $2,000 (a grossed-up value of $3,921 for the FBT year ended 31 March 2017) (s 135M to 135Q). Special rules apply where the employer is exempt from FBT.

The "reportable fringe benefits amount" (ie the individual's grossed-up fringe benefits amount) is used to determine a taxpayer's entitlement to certain income-tested tax concessions and liability to income-tested surcharges for the year.

Employers can elect to notify the Commissioner of reportable fringe benefits amounts using single touch payroll reporting (¶26-630). Where this is done, the employer is not required to issue a payment summary covering the reportable fringe benefits amount.

Excluded fringe benefits

These "excluded fringe benefits" are not included in the reporting requirements (s 5E(3)):

- car parking fringe benefits (¶35-252). Certain motor vehicle parking expense payment benefits are exempt under s 58G and therefore are not fringe benefits and not subject to the reporting requirements
- fringe benefits attributable to entertainment facility leasing expenses (¶35-617)
- entertainment by way of food or drink, and accommodation, travel or reimbursement of expenses in relation to that entertainment (¶35-617). However, for the 2016/17 FBT year and later years, salary packaged meal entertainment benefits and entertainment facility leasing expense benefits are included in the reporting requirements
- an expense payment, property or residual fringe benefit arising in relation to the provision of remote area residential fuel where the taxable value of the fringe benefit is reduced under s 59 (¶35-650)
- a remote area housing loan whose taxable value is reduced under s 60 (¶35-650)
- fringe benefits that relate to occasional travel to a major population centre in Australia provided to employees and family members not resident in or adjacent to an "eligible urban area" (as defined in s 140). For a list of such centres, see the Australian Bureau of Statistics, *Year Book Australia* for 2009/10 (*NTLG FBT minutes*, 12 May 2011). Regular trips will not qualify (ID 2009/24)
- fringe benefits that relate to freight costs for food provided to employees not resident in or adjacent to an eligible urban area
- amortised and reducible fringe benefits (s 65CA; 65CC: ¶35-650)
- benefits provided to address security concerns relating to the personal safety of an employee, or an associate, arising from the employee's employment, where a threat assessment was made by a relevant industry body or government body or other competent person
- the following fringe benefits prescribed by regulation:
  (a) the provision of parking facilities to an employee who is entitled to the use of a disabled persons' car parking space and who is the driver of, or a passenger in, the car and who displays a valid disabled persons' car parking permit on the car (reg 4)

(b) emergency and essential health care costs incurred by Australian resident employees, or their associates who are also Australian residents, while the employee is serving overseas (provided the costs are not covered by Medicare) (reg 5)

(c) benefits provided to Australian Defence Force members relating to the removal and storage of household effects resulting from a Department of Defence direction to change residence (reg 6)

(d) use by a police officer of a car that is garaged at the employee's place of residence to enable the employee's quick response to crime-related incidents where the car is fitted with a police radio, warning lights and sirens (reg 7)

(e) benefits associated with the removal or storage of household effects of police officers who move at the direction of the police force (reg 7)

(f) benefits provided to police officers in relation to housing attached to a police station, remote area housing rent, and costs incidental to the purchase of a new dwelling where the officer was required to move in order to perform the duties of the employment (reg 7)

(g) pooled or shared private use by employees of their employer's car, ie a vehicle provided for the private use of two or more employees resulting in a car benefit for more than one employee (reg 8). The exclusion does not apply to the use of a motor vehicle that is not a car, such as a utility designed to carry a load of one tonne. However, the private use of a car is an excluded fringe benefit for an employee where a second employee's private use of the same car is an exempt benefit (ID 2008/21). It is sufficient for record-keeping purposes if the employee preparing the odometer records also confirms that, during the FBT year, the car was used by more than one employee for either private purposes or was parked overnight at the employee's home in accordance with the employer's written policy; the records should also provide the names of the two employees concerned (*NTLG meeting*, 12 November 2009), and

(h) living-away-from-home (LAFH) allowances and benefits, including certain expense payment benefits and residual benefits, for Commonwealth employees required to live away from their normal residence to undertake their official duties of employment (reg 9).

Determining employee's share

Employers are required to determine the taxable value of all fringe benefits, other than excluded benefits, provided to each employee (''individual fringe benefits amount''). Where one fringe benefit is provided for two or more employees, the employer must allocate the taxable value in a way that reasonably reflects the amount of benefit received by each employee (s 5F).

Reportable fringe benefits amount

Where the individual fringe benefits amount for an employee exceeds $2,000 for the FBT year ending 31 March, that amount, after being grossed-up (¶35-025), is the reportable fringe benefits amount to be included by the employer on the employee's payment summary for that income year ending 30 June. The factor used for gross-up purposes is the FBT gross-up factor used for type 2 benefits (¶35-025), irrespective of whether GST has been included in the benefits (s 135P(2)).

If, as a result of an FBT assessment being amended, there is an understatement of up to $195 in a payment summary, the employer is nonetheless considered to have satisfied the reporting requirements, provided the understatement was not deliberate (Chapter 5.9 of the ATO's fringe benefits tax guide for employers).

[FTR ¶800-270 – ¶800-290, ¶832-110 – ¶832-160]

¶35-057 Salary packaging and salary sacrifice arrangements

''Salary packaging'' is the structuring of an employee's total remuneration so that it provides the most value to the employee in relation to its cost to the employer. Two common ways of structuring a salary package are:

(1) on a gross salary plus benefits basis, eg the package might be expressed as $80,000 salary, plus compulsory superannuation and a fully-maintained car of a certain class, and

(2) on a total remuneration cost basis, eg the package may be expressed in terms of the total cost to the employer, being $130,000. The employee can select a mix of salary and permitted benefits so that the total cost to the employer, including FBT on the benefits, is $130,000.

The latter method allows employees to give up part of their salary entitlement in return for desired benefits that are not assessable to the employee, but are taxable or exempt fringe benefits. Where such ''salary sacrifice'' arrangements (SSAs) are effective (¶31-120), a taxpayer (in particular a taxpayer paying tax at the highest marginal rate) may be able to reduce his/her tax bill. The tax benefit arises where the fringe benefit provided by the employer is taxed concessionally under the FBT regime. As a result, although the amount of salary that has been sacrificed equals the cost to the employer of providing the benefit (and therefore is a neutral transaction from the employer's point of view, subject to any additional administration costs that, in any event, the employee could be required to pay), the cost of the benefit to the employee is less than if the employee used after-tax salary to obtain the same benefit.

Generally, the principal benefits are cars (providing greatest advantages for employees on a high marginal tax rate), FBT-exempt portable computers (¶35-645) and FBT-exempt superannuation contributions (¶13-710, ¶35-070). Where the employer is FBT-exempt, a wide range of salary sacrifice benefits are tax-effective within specified limits (¶35-100). This is also generally the case for high marginal rate employees where the employer is eligible for an FBT rebate (¶35-100, ¶35-642).

The provision of child care facilities on the employer's business premises is an exempt fringe benefit and therefore also provides salary sacrifice opportunities (¶35-580). The provision of a low interest loan by an employer to an employee may be beneficial if the loan is used for investment purposes (to the extent that the loan is used for investment purposes, the ''otherwise deductible'' rule reduces the amount of FBT payable: ¶35-680). Alternatively, a loan provided for private purposes at the benchmark interest rate may be beneficial where it provides better terms or greater access to funds than the employee could have otherwise obtained (¶35-290).

[FTR ¶832-730]

General Criteria for Fringe Benefits

¶35-060 Outline of fringe benefits

A taxable fringe benefit will arise where:

- a benefit is provided to an employee, an associate of an employee, or some other person at the direction of an employee or an associate of an employee
- the benefit is provided by the employee's employer, by an associate of the employer, or by a third party under an arrangement with the employer or with an associate of the employer, and
- the benefit is provided in respect of the employment of the employee (s 136(1)).

The tax extends to benefits that are provided to prospective or former employees in connection with their prospective or past employment.

Connection with Australia

FBT applies to benefits provided in relation to an employee who is a resident of Australia, except where the relevant salary or wage of the employee is exempt from income tax, and to a non-resident employee whose salary or wage from the employment has an Australian source (definition of ''employee'' in s 136(1); ID 2007/25). Where an employee is a non-resident for part of the year, benefits provided during the year will be taxable in proportion to the period of residence. Whether FBT is included as a tax to which a particular DTA applies depends on how ''Australian tax'' is defined in the agreement. For example, the New Zealand DTA, the United Kingdom DTA and the Timor Sea Treaty between Australia and East Timor include references to FBT. For the application of FBT to benefits provided to a non-resident employee from New Zealand or the United Kingdom, see ID 2005/166.

FBT applies irrespective of whether the acts, omissions, and so on giving rise to a liability under the Act occurred inside or outside Australia (s 163(1)).

[FTR ¶832-451]

¶35-070 Benefit must be provided

A ''benefit'' includes any right, privilege, service or facility. Some benefits are expressly *excluded* as fringe benefits and do not give rise to any FBT liability. The main exclusions are:

- exempt benefits (¶35-645)
- salary or wages
- most superannuation fund contributions (see below)
- payments from certain superannuation funds
- benefits under employee share schemes or trusts, including in respect of individuals engaged in foreign service, and including certain stapled securities acquired under such schemes and indeterminate rights (¶10-085; ID 2010/142)
- payments on termination of employment
- capital payments for enforceable contracts in restraint of trade
- capital payments for personal injury
- payments deemed to be dividends for income tax purposes and loans that comply with the deemed dividend provisions in ITAA36 Div 7A (¶4-200, eg ID 2011/33)
- payments to an associated person to the extent that they are not considered by the Commissioner to be deductible
- amounts that have been subject to family trust distribution tax (¶6-268)
- certain distribution entitlements of individual venture capital managers (s 136(1)).

The following are salary and wages (rather than fringe benefits):

- an allowance paid to employees in place of medical benefits insurance (*Tubemakers of Australia*)
- payments made to employees for the cost of fares to and from work, regardless of whether public transport was used (*Roads and Traffic Authority of NSW*: ¶35-330)
- retention payments made to a person in consideration of the person providing services for 12 months and paid in addition to normal periodic salary (*Dean*).

Benefits provided under an ''effective'' salary sacrifice arrangement are not salary and wages and, conversely, benefits provided under ''ineffective'' arrangements are salary and wages and not subject to FBT (TR 2001/10: ¶31-120). Costs incurred by an employer in administering such arrangements do not give rise to a fringe benefit (ID 2001/333). Where a person is being paid parental leave pay by an employer in

accordance with the *Paid Parental Leave Act 2010*, the employee can salary sacrifice his/her parental leave pay for non-cash remuneration as parental leave pay is salary and wages as defined for FBT purposes when paid by the person's employer.

A benefit is not ''provided'' if it is obtained through the employee's fraudulent activity that is not condoned by the employer (ID 2003/458).

Superannuation contributions

Employer superannuation contributions are not fringe benefits if they are contributions for an *employee* to:

- a complying superannuation fund or a fund that the contributor reasonably believed was complying (¶13-100)
- a non-resident superannuation fund where the employee for whom the benefit is provided is a temporary resident of Australia (generally an employee with a temporary visa), or
- an RSA under the *Retirement Savings Accounts Act 1997* (¶13-470).

Employer superannuation contributions not falling under any of those exclusions may constitute a fringe benefit. In particular, superannuation contributions on behalf of *associates* of employees (eg a spouse) are subject to FBT (s 136(1), definition of ''fringe benefit'').

Payments by an employer of a superannuation fund's expenses (that are treated as a superannuation contribution) are not a fringe benefit (MT 2005/1).

[FTR ¶832-244, ¶832-455, ¶832-465]

¶35-080 Benefit provided to employee

To be a fringe benefit, a benefit must be provided to an employee of the employer concerned (s 136(1)). Additionally, a fringe benefit arises where a benefit is provided to an associate of the employee, or to a third party under an arrangement between the employer or an associate of the employer, and an employee or an associate of the employee (s 148(2): ¶35-110).

The test of whether there is an employment relationship is — if the benefit had been provided in cash form, would it have been salary or wages for PAYG purposes? In addition, past and prospective employees are treated as employees, so that benefits provided to such people or to their associates are subject to FBT if those benefits meet the other criteria. However, benefits provided to relatives of deceased employees (eg travel benefits provided to a widow or widower of a Member of Parliament) are not subject to FBT (TR 1999/10) nor is the payment of funeral expenses of a deceased employee (ID 2006/159). An ''employee'' is a person who is entitled to receive ''salary or wages'', ie payments to employees, company directors and office holders, as well as other specified payments that are subject to PAYG (TR 2005/16).

Where an employee directs the employer to pay part of the agreed salary to a third party (such as a bank by way of loan repayment) the amount remains part of the employee's salary (*Wood*; *Case 1/97*).

A person who is provided only with non-cash benefits instead of salary or wages is treated as an employee if, had any benefit been in the form of cash, that cash would have been salary or wages and that person would have been an employee (s 137).

Contributions made by an employer to an industry welfare trust (CR 2004/76) and contributions of apprentice levies to a redundancy fund (CR 2004/97) do not give rise to a fringe benefit. See also CR 2004/113 (payments for worker income protection and portable sick leave insurance policies) and ID 2002/848 (employee share plan).

A low-interest loan by an insurance agency to its agents does not give rise to a fringe benefit because insurance agents are not employees (TR 93/38). Local government councillors are not treated as employees unless the council resolves that its members are subject to PAYG withholding (definition of ''salary or wages''; TAA Sch 1 s 12-45 and 446-1).

Requirement for a particular employee to be identified: employee benefits trusts

A particular employee (rather than a number of employees) must be identified in connection with the benefit. Therefore a payment made into an Employee Incentive Trust in relation to three employees was not a fringe benefit and was not deductible (*Essenbourne*; see also *Spotlight Stores*; *Cameron Brae*; *Benstead Services*; ¶16-010, ¶35-110). The Full Federal Court declined to consider the issue in *Pridecraft* (on appeal from *Spotlight Stores*). The required connection with a particular employee was present in *Walstern* where the trustee of a foreign superannuation fund allocated the contribution to a particular employee.

This approach is confirmed in TR 2017/D5 which states that a contribution to an employee remuneration trust (ERT) will be a fringe benefit where the trustee is an associate of an employee and the contribution is a benefit provided in respect of the employment of a particular employee, or two or more employees, provided the identity of each of the employees who will take a share of the benefit is known with sufficient particularity. Accordingly, both the employee, and the share of the benefit the employee will take, must be known at the time of the contribution. ''In respect of employment'' requires a sufficient or material, rather than a causal, connection or relationship between the benefit and the employment. A contribution is *not* a fringe benefit to the extent that it is remuneration of an employee, assessable as salary or wages or if it is a deemed dividend under ITAA36 Div 7A.

In *Caelli Constructions*, an employer's contributions to a redundancy fund on behalf of employees were subject to FBT as property fringe benefits. The fund's trust deed fixed the weekly amount of the contributions to be made by employers for each worker, and provided for how the contributions were to be applied. Further, the trust deed provided that the amount standing to the credit of a particular worker's account was available for distribution to the worker if the employment ceased.

In *Indooroopilly Children Services*, the proposed issue of shares by a franchisor to the trustee of an employee share plan for the benefit of its franchisees' employees was not considered to give rise to a fringe benefit. The Commissioner had taken the view in former TR 1999/5 (now withdrawn) that a payment by an employer to the trustee of a trust or a non-complying superannuation fund set up to provide benefits to employees gave rise to a property fringe benefit. However, as a result of the decision in *Indooroopilly*, the Commissioner accepted that: (a) it is necessary to identify a particular employee in respect of whose employment a benefit is provided before a fringe benefit can exist; and (b) a benefit provided to a common associate of a number of employees, eg the trustee of an employee benefit trust, can be a fringe benefit if the identity of employees is known when the benefit is provided (ATO *Decision Impact Statement*; ID 2007/194). Thus employer contributions to a social club do not constitute a fringe benefit as they do not relate to a particular employee (ID 2007/208).

The issue of bonus units to employees as part of an employee benefit trust arrangement is a fringe benefit at the time of issue or transfer, provided the issue of the bonus unit does not create a right to receive salary or wages (TR 2010/6). A right to receive salary or wages or bonus income is not a fringe benefit.

[FTR ¶832-385, ¶832-459]

¶35-090 Employer liable for FBT

It is the employer whose employee (or the associate of the employee) receives the benefit who is liable for FBT (s 66). This is so whether the employer is a sole trader, partnership, trustee, corporation, unincorporated body, government or government body (s 165; 166).

Where an employer disposes of a business and the new owner continues to provide fringe benefits to persons who were employed by the former owner, the new owner is liable for FBT in respect of those benefits.

A payment made by an employee in reimbursement of an FBT liability does not constitute an employee contribution capable of reducing the taxable value of a benefit (s 136A). However, the employer is assessable on such reimbursements.

The Commonwealth, states and territories can devolve the administration and payment of FBT to nominated bodies (s 135R to 135X). The application of the FBT regime to certain Commonwealth agencies is discussed in ID 2007/200.

[FTR ¶822-130, ¶833-410, ¶833-540, ¶833-560]

¶35-100 FBT exempt employers

There are specific exemptions for these employers:

- *religious institutions* for benefits provided to a minister or full-time member of a religious order in respect of that person's religious work (s 57; ID 2001/332). Benefits provided to a religious practitioner for the performance of pastoral or related duties are exempt benefits, regardless of whether the religious practitioner is a common law employee of the religious institution
- *international bodies* that are exempt generally from taxation (s 55)
- *foreign government representatives* that are exempt under the *Consular Privileges and Immunities Act 1972* or the *Diplomatic Privileges and Immunities Act 1967* (s 56)
- *public benevolent institutions* (¶16-950) (and certain hospitals) (s 57A). The exemption does not extend to benefits provided by a state department of health to an employee whose duties are not exclusively performed in connection with a public hospital (ID 2003/40). In *SIM Australia (as trustee for SIMAID Trust)*, a trust failed to qualify as a PBI because, despite being public and benevolent, it was not an institution. Benefits provided for certain live-in carers may also be exempt (s 58) (¶35-380).

There are a number of exemptions for particular classes of benefit (¶35-130). There are also specific exemptions for certain miscellaneous benefits (¶35-645) and there is an FBT rebate available to certain non-profit employers (¶35-642).

Public benevolent institutions, hospitals and health promotion charities

The s 57A exemption applies where the employer is:

- a public benevolent institution (PBI). For the meaning of ''public benevolent institution'', see TR 2003/5 and ¶16-950
- a government body, and the employee performs his or her duties in a public hospital or a hospital carried on by a rebatable non-profit society or association
- a public hospital or a hospital carried on by a rebatable non-profit society or association (see further TD 2015/12)
- a public ambulance service, or
- a health promotion charity (as discussed in TR 2004/8), ie a charitable institution whose principal activity is promoting the prevention or control of disease in humans. See TR 2011/4 for a discussion of the meaning of ''charitable institution''.

A cycling association was not entitled to be endorsed as a health promotion charity because the prevention and control of disease in human beings was not its principal activity (*Bicycle Victoria Inc*).

Benefits that are exempt under s 57A are limited in the amount of concessional treatment they attract.

In particular, for health promotion charities and public benevolent institutions that are not public hospitals, the exemption is limited to certain excluded fringe benefits (meal entertainment, car parking and entertainment facility leasing expenses) and $31,177 of each employee's individual grossed-up non-exempt amount (this amount will be $30,000 for the FBT years commencing 1 April 2017 and later). Where the s 57A employer is a public hospital or a hospital carried on by a non-profit society or association, or the employer is a government body and the employee works exclusively for a public hospital or a non-profit hospital, or a public ambulance service, the cap is $17,667 (this will be $17,000 for the FBT years commencing 1 April 2017 and later) (¶35-025). The cap applies even if the employee was employed for part of the year only. For example, see CR 2007/15 to CR 2007/17.

Benefits provided by public benevolent institutions and health promotion charities only attract concessional treatment if they are endorsed by the Commissioner under s 123C to 123E. The endorsement process is discussed at ¶10-610.

New laws limit the concessional treatment of salary packaged entertainment benefits from 1 April 2016. These introduce a cap on the total amount of salary packaged entertainment benefits that certain employees can be provided by exempt employers (covered by s 57A) and rebatable employers (covered by s 65J) that are subject to a reduced amount of FBT. Salary packaged entertainment benefits are now included in the standard threshold. Further, if the total value of fringe benefits exceeds the standard threshold in a particular year, the threshold is raised by the lesser of:

- $5,000, and
- the total grossed up taxable value of salary packaged entertainment benefits.

[FTR ¶819-490 – ¶819-790]

¶35-110 Benefit provided to associates of employers and employees

Generally, a benefit provided by an associate of an employer or to an associate of an employee is subject to FBT in the same manner as if the employer had provided it or the employee had received it. In addition, a benefit provided by a third party under an arrangement with the employer *or with an associate of the employer* will be caught, as will a benefit provided to a third party at the request of the employee *or of an associate of the employee* (s 148).

A fringe benefit may arise where a benefit is provided by a *third party*, if the employer or associate knew or ought reasonably to have known that it was doing so:

- because there was an arrangement between the employer or an associate of the employer and the arranger, or
- because the employer participated in or facilitated the provision of the benefit.

For example, a fringe benefit arises where a franchisor issues shares to a trust for the benefit of franchisee employees, whether the franchisees provide specific information to the trustee in relation to each of the beneficiaries (eg position held and length of service) or whether the information is available to the franchisor as a result of the pay-roll function that it performs under licence agreements between the franchisor and franchisees (ID 2005/195).

A benefit that is effectively only one benefit, although provided to more than one person (such as an employee and an associate of an employee), will only give rise to one liability (s 138).

"Associate" has the meaning provided in ITAA36 s 318, which covers a broad range of entities that are associates of natural persons, companies, partnerships and trustees. The term includes relatives, partners, trustees and beneficiaries, and related companies, as well as other people such as de facto spouses and same-sex partners (s 136(1); 159; eg ID 2006/196). The trustees of employee benefit trusts or non-complying superannuation funds (whether resident or non-resident) established to provide benefits to employees are associates of the employees notwithstanding that no employee is a beneficiary or member when the benefit is provided (*Caelli Constructions*; *Decision Impact Statement* on *Indooroopilly Children Services*). If a partnership is reconstituted, the old partnership is an associate of the new.

The deeming rule in s 148(2) applies where a benefit is provided to a person other than an employee or an associate of the employee under an arrangement between the provider, the employer or an associate of the employer and the employee or an associate of the employee. In this situation, the recipient of the benefit is deemed to be an associate of the employee.

The deeming rule does not apply if the employee would be entitled to a deduction under ITAA97 Div 30 (¶16-942) had the employee, rather than the provider, provided the benefit to the recipient (s 148(2A)).

[FTR ¶832-461]

¶35-120 Benefit must have nexus with employment

For a benefit to be a fringe benefit, it must be provided "in respect of" the employment of an employee — even if provided to an associate of the employee or to a third party at the request of the employee or an associate (s 136(1); 148).

A benefit is provided "in respect of" employment if it is provided by reason of the employment, or in relation to the employment — whether directly or indirectly. This includes a benefit provided for more than one reason, eg because of employment or a family relationship (*Curtain World*).

MT 2016 sets out these examples of where there would *not* be a fringe benefit: (a) where accommodation and meals are provided in the family home to children of a primary producer who work on the family farm; (b) where board is provided in the family home to a son who is apprenticed to his father as a motor mechanic; (c) where birthday presents are given by parents to their children who work in a family small business; (d) where a wedding gift is given to a child by the parents where earlier the child had worked in the family business; and (e) where parents give a child an interest-free or low-interest loan to purchase a matrimonial home.

Flight rewards received under a consumer loyalty programme are generally not subject to FBT as they result from a personal contractual relationship. An FBT liability may arise, however, where:

- the person with the personal contract is also an employer and provides the flight reward to an employee (who is a family member) in respect of the employment, or
- in respect of the employment, a flight reward is provided to an employee or the employee's associate under an arrangement that results from business expenditure (TR 1999/6).

Rewards received under a consumer loyalty programme that result from points accrued from business expenditure may be subject to FBT if there is a sufficient and material connection with employment (eg the employee uses his/her own credit card to pay reimbursed employer's expenses so that reward points arise for the employee) (PS LA 2004/4 (GA); ¶10-030).

In the case of a benefit provided to a shareholder who is also an employee, there is potential for the benefit to either be a fringe benefit or a dividend. In the case of a private company, ITAA36 s 109ZB provides that ITAA36 Div 7A applies to a loan and the forgiveness of debt, even if the loan or debt forgiveness was provided to the individual in

his/her capacity as an employee or in respect of the employment of the person (¶4-200). For other benefits, ITAA Div 7A does not apply to benefits provided to shareholders in their capacity as an employee. For other such benefits, and for companies to which ITAA36 Div 7A does not apply, the benefit will generally be a fringe benefit if the company claims an income tax deduction for it (MT 2019). Otherwise, it will generally be regarded as being provided to a shareholder as such and not as being a fringe benefit. To be a fringe benefit, there must be a *sufficient* or *material*, rather than merely a *causal*, connection between the benefit and the employment (*J&G Knowles*; see also *Starrim*; *Case 28/97*).

▶ Planning point

As the tax consequences for the company and recipient are different, the manner in which a benefit is paid requires consideration. For the company, the tax consequences are more beneficial if the amount is non-deductible and not subject to FBT. For the recipient, however, the tax consequences will depend on whether the benefit received is a dividend (assessable) or non-assessable amount.

Benefits provided by a company to its director/shareholder in repayment of a loan were not provided ''in respect of'' the employment as they related to the shareholders' entitlement as creditors of the taxpayer (*Slade Bloodstock*). See also ID 2001/253, ID 2003/316, ID 2003/688, ID 2003/690, ID 2003/692 and ID 2003/836. In CR 2007/112, the required connection with employment was absent where the payer had no PAYG withholding obligation in relation to any payments to the recipients for services provided. The provision of a share to satisfy the exercise of a right granted under an employee share scheme comes as a consequence of the employee exercising the rights previously obtained under the scheme, and not in respect of employment (ID 2010/219).

Benefits provided to an employee/partner through an administration/service entity are not considered to have been provided in respect of employment (TD 95/57) (¶31-180).

Benefits provided to genuine volunteer workers will not, in most cases, give rise to a fringe benefit (ATO: *Volunteers and tax* NAT 4612).

[FTR ¶832-463]

Types of Benefits and Employee Contributions

¶35-130 Types of benefits

Any benefit that is a ''fringe benefit'' will give rise to a liability for FBT on the part of the relevant employer. A benefit that is an exempt benefit is not a fringe benefit (s 136(1): ¶35-645). The amount of FBT payable depends on the *taxable value* of the benefit. FBT is payable on the grossed-up taxable value of a benefit (¶35-025). The taxable value of a fringe benefit is usually reduced by the amount of any payment by the recipient or employee towards the fringe benefit (¶35-135) and by the amount that would be deductible if the employee incurred the expense (¶35-680).

The legislation contains a number of different valuation rules for calculating the taxable value of different categories of fringe benefit. There are 12 categories of benefit: (1) car benefits (¶35-150); (2) car parking benefits (¶35-252); (3) debt waiver benefits (¶35-310); (4) loan benefits (¶35-270); (5) expense payment benefits (¶35-330); (6) housing benefits (¶35-380); (7) living-away-from-home allowance benefits (LAFHA) (¶35-490); (8) board benefits (¶35-630); (9) entertainment benefits provided by tax-exempt bodies (¶35-617); (10) meal entertainment benefits (¶35-617); (11) property benefits (¶35-490); and (12) residual benefits (¶35-570).

[FTR ¶800-000]

¶35-135 Employee contributions to benefits

Generally, any employee contribution towards the cost of providing a fringe benefit will reduce the taxable value of the fringe benefit. For example, rent paid by an employee in receipt of a housing fringe benefit will be deducted from the market or statutory value

of the benefit used to calculate the taxable value. Journal entries in an employer's accounts reflecting a set-off between the employer and employee can be such a payment, subject to certain conditions (MT 2050). See also ID 2012/88 where interest was not paid ''in respect of the provision of'' an expense payment fringe benefit and therefore was not a recipients contribution.

▶ Example

An employee is provided with a motor vehicle and makes payments to an employer of $30 per week for the cost of fuel charged to the employer's fleet card. These payments would reduce the employer's FBT liability for running costs of that employee's car.

Any consideration received by an employer in reimbursement of an FBT liability does not, however, constitute an employee contribution capable of reducing the taxable value of the fringe benefit (s 136A).

A contribution by an employee towards the cost of a car fringe benefit is known as a ''recipient's payment'' (¶35-190). An employee contribution towards a housing fringe benefit is known as ''recipients rent''. A contribution by an employee towards the cost of most other fringe benefits is known as a ''recipients contribution''.

Employee contributions will generally be assessable income to the employer.

The taxable value of a fringe benefit is reduced by the full amount of the contribution, irrespective of whether the contribution includes an amount to compensate the employer for any GST liability that may arise from the employee contribution. GST is usually payable by the employer on a ''recipient's payment'' made by the employee towards the cost of a car fringe benefit, and a ''recipients contribution'' made by the employee towards the cost of other benefits, but not on recipient's rent paid in relation to a housing fringe benefit (¶35-000). See GSTR 2001/3.

[FTR ¶801-930, ¶802-150, ¶832-870]

Car Benefits

¶35-150 Conditions giving rise to a car benefit

A car benefit arises on any day where an employer's car is used by an employee for private purposes or is available for such use. Even if the car is not actually owned or leased by the employer or an associate, there will still be a car benefit if it is used or is available for use for private purposes by an employee under an arrangement between the employer or an associate of the employer and a third party who actually owns or leases the car. The existence of a car benefit is determined on a daily basis.

There must be a "car"

A car benefit only arises from the provision of a ''car'', defined as any motor-powered road vehicle (including a four-wheel drive vehicle) (except a motor cycle or similar vehicle) designed to carry a load of less than one tonne and fewer than nine passengers.

The designed load of a vehicle is determined on the same basis as that applied for determining the vehicles that are subject to CGT (¶11-640; MT 2024). A car that has been destroyed as a result of a natural disaster ceases to be a ''car'' from the date of the natural disaster (ID 2011/28).

A car does not include a motor cycle or a four-wheeled motor cycle of the sort used on farms. Provision of a motor vehicle that is not a car will not give rise to a car benefit, but may give rise to a residual benefit if it is used by an employee.

Private use of an unregistered car (one that cannot be driven legally on a public road) will be an exempt benefit where the car is unregistered at all times during the year when it is held by the provider of the benefit and where it is held principally for use in business operations (s 8(3); 162N).