2008-2009

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAX LAWS AMENDMENT (2009 MEASURES No. 4) BILL 2009

EXPLANATORY MEMORANDUM

(Circulated by the authority of the
Treasurer, the Hon Wayne Swan MP)

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

Abbreviation	***Definition***
ABR	Australian Business Register
ATO	Australian Taxation Office
CFC	controlled foreign company
CGT	capital gains tax
Commissioner	Commissioner of Taxation
DGRs	deductible gift recipients
FBT	fringe benefits tax
FHSA trust	First Home Saver Account trust
FIFs	foreign investment funds
GST	goods and services tax
ITAA 1936	*Income Tax Assessment Act 1936*
ITAA 1997	*Income Tax Assessment Act 1997*
LIA 1995	*Life Insurance Act 1995*
LPR	legal personal representative
MEC group	multiple entry consolidated group
PHIA 2007	*Private Health Insurance Act 2007*
PPFs	prescribed private funds
R&D	research and development
TAA 1953	*Taxation Administration Act 1953*
TIES	Tax Issues Entry System

General outline and financial impact

Lift the expenditure cap for eligibility to the Research and Development Tax Offset

Schedule 1 to this Bill increases the research and development (R&D) expenditure cap for eligibility to the R&D Tax Offset from $1 million to $2 million.

Date of effect: This amendment applies from 1 July 2009.

Proposal announced: This measure was announced in the Treasurer's Media Release No. 062 of 12 May 2009.

Financial impact: This measure is estimated to have the following revenue impact over the forward estimates period:

2008-09	***2009-10***	***2010-11***	***2011-12***	***2012-13***
Nil	–$120m	$55m	Nil	Nil

Compliance cost impact: Low.

Prescribed private funds

Schedule 2 to this Bill amends the *Income Tax Assessment Act 1997*, the *Taxation Administration Act 1953* and the *A New Tax System (Australian Business Number) Act 1999* to improve the integrity of prescribed private funds (PPFs). The amendments among other things:

- rename PPFs as private ancillary funds;
- move the full administration of those funds under the authority of the Commissioner of Taxation (Commissioner);
- give the Treasurer the power to make legislative guidelines about the establishment and maintenance of private ancillary funds; and
- give the Commissioner the power to impose administrative penalties on trustees that fail to comply with the guidelines and to remove or suspend trustees of non-complying funds.

Date of effect: These amendments will apply from 1 October 2009.

Proposal announced: These amendments were announced in the 2008-09 Budget by the Treasurer in Media Release No. 052 of 13 May 2008.

Financial impact: Nil.

Compliance cost impact: Low.

Demutualisation of friendly societies

Schedule 3 to this Bill amends the *Income Tax Assessment Act 1997* to provide relief from capital gains tax to members and insured entities of friendly societies that have a life insurance business and/or a private health insurance business and the friendly society demutualises to a for-profit entity.

Date of effect: These amendments apply to demutualisations that occur on or after 1 July 2008. This will ensure that friendly societies that demutualise on or after this date but prior to the amendments receiving Royal Assent may qualify for this relief.

Proposal announced: These amendments were announced in the then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs' Media Release No. 086 of 24 October 2008.

Financial impact: These amendments are expected to have a small but unquantifiable revenue impact.

Compliance cost impact: Low. This comprises a low implementation impact and a low decrease in ongoing compliance costs relative to the affected group.

Consolidation: Application of losses with nil available fraction

Schedule 4 to this Bill amends the *Income Tax Assessment Act 1997* to ensure losses transferred to the head company of a consolidated group or a multiple entry consolidated group by a joining entity that is insolvent at the joining time can be used by the head company in certain circumstances.

Date of effect: 1 July 2002 — this measure is beneficial to taxpayers.

Proposal announced: This measure was announced jointly by the Treasurer and the then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs in Media Release No. 053 of 13 May 2008.

Financial impact: This measure will have an unquantifiable (but minimal) cost to revenue over the forward estimates.

Compliance cost impact: Low.

Minor amendments

Schedule 5 to this Bill makes technical corrections and other minor amendments to the taxation laws. These amendments are part of the Government's commitment to the care and maintenance of the tax system.

Date of effect: These amendments commence from Royal Assent unless otherwise stated in this explanatory memorandum.

Proposal announced: These amendments were all foreshadowed by release in draft form on the Treasury website on 20 May 2009.

Financial impact: The amendments proposed by items 329 to 336 to the capital gains tax (CGT) small business concessions are expected to result in an unquantifiable but small cost to revenue.

The amendments proposed by items 337 and 338 to the CGT provisions as they apply to foreign residents are expected to result in an unquantifiable potential gain to revenue.

The other minor amendments are expected to have a nil to minimal revenue impact.

Compliance cost impact: Nil to low.

Chapter 1
Lift the expenditure cap for eligibility to the Research and Development Tax Offset

Outline of chapter

1.1 Schedule 1 to this Bill amends the tax law to increase the research and development (R&D) expenditure cap for eligibility to the R&D Tax Offset from $1 million to $2 million.

1.2 All references to legislative provisions in this chapter are references to the *Income Tax Assessment Act 1936* (ITAA 1936) unless otherwise stated.

Context of amendments

1.3 The R&D Tax Concession contained in the ITAA 1936 provides a concessional tax deduction to companies that incur expenditure in undertaking eligible R&D activities. Certain companies can choose to receive a tax offset (R&D Tax Offset) rather than a deduction.

1.4 As part of the 2009-10 Budget, the Government announced that it will replace the existing R&D Tax Concession with a new R&D tax incentive, with effect from 1 July 2010. For additional details refer to the Treasurer's Media Release No. 062 of 12 May 2009.

1.5 The Government announced that as an interim measure, it would increase the R&D expenditure cap for eligibility to the existing R&D Tax Offset from $1 million to $2 million, with effect from 1 July 2009.

Summary of new law

1.6 This amendment increases the R&D expenditure cap for eligibility to the R&D Tax Offset from $1 million to $2 million.

Detailed explanation of new law

1.7 Section 73B of the ITAA 1936 provides a tax deduction to companies that incur expenditure in undertaking eligible R&D activities. In many cases the deduction is equal to 125 per cent of expenditure.

1.8 Under section 73I, certain companies, as set out in section 73J, that incur expenditure on eligible R&D can choose a tax offset instead of a deduction. The R&D Tax Offset is equal to 30 cents in every dollar that the company would have been able to deduct if it had chosen to claim a deduction. For a deduction of 125 per cent, this would equate to an offset of 37.5 per cent of expenditure.

1.9 The R&D Tax Offset is refundable, allowing these companies to 'cash out' the R&D Tax Concession. This means it is most attractive to companies that are in a tax loss position, who cannot immediately benefit from an additional tax deduction.

1.10 To be eligible for the R&D Tax Offset, paragraph 73J(1)(c) requires that the R&D group (as defined in section 73K) of which the company claiming the Offset is a part have an 'aggregate research and development expenditure amount' that is not more than $1 million (this imposes a 'hard cap' on expenditure).

1.11 This measure increases the R&D expenditure cap for eligibility to the existing R&D Tax Offset from $1 million to $2 million, with effect from 1 July 2009. ***[Schedule 1, item 1, paragraph 73J(1)(c)]***

1.12 Lifting the expenditure cap provides a further boost to small pre-profit companies in research intensive industries, ahead of the introduction of the new R&D tax incentive in 2010-11, and mitigates the incentive for firms to keep their R&D spending under the current expenditure cap.

Example 1.1

Barksdale Technologies Ltd is a company that satisfies the conditions in section 73J, with the exception of paragraph 73J(1)(c). The company is not part of a broader R&D group. In 2009-10, the company incurs expenditure of $1.5 million on eligible R&D activities.

Without this amendment, Barksdale Technologies would be unable to elect to claim the R&D Tax Offset, as it has not met the existing condition in paragraph 73J(1)(c). That is, the company's R&D aggregate expenditure exceeds the hard cap on expenditure of $1 million.

Following this amendment, Barksdale Technologies is able to elect to claim the R&D Tax Offset because its R&D aggregate expenditure is below the new hard cap on expenditure of $2 million.

Application and transitional provisions

1.13 This amendment commences from the date this Bill receives Royal Assent and applies to years of income starting on or after 1 July 2009.

1.14 It is expected that the provision will be repealed as part of the introduction of the new R&D tax incentive in 2010-11.

1.15 Schedule 1 does not contain any transitional provisions.

Chapter 2
Prescribed private funds

Outline of chapter

2.1 Schedule 2 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997), the *Taxation Administration Act 1953* (TAA 1953) and the *A New Tax System (Australian Business Number) Act 1999* to improve the integrity of prescribed private funds (PPFs). The amendments among other things:

- rename PPFs as private ancillary funds;
- move the full administration of those funds under the authority of the Commissioner of Taxation (Commissioner);
- give the Treasurer the power to make legislative guidelines about the establishment and maintenance of private ancillary funds; and
- give the Commissioner the power to impose administrative penalties on trustees that fail to comply with the guidelines and to remove or suspend trustees of non-complying funds.

Context of amendments

History

2.2 PPFs came about as a response to a report on philanthropy in Australia by the Business and Community Partnerships Working Group on Taxation Reform dated 26 March 1999.

2.3 PPFs are a form of ancillary trust fund designed to encourage private philanthropy by providing private groups, such as businesses, families and individuals, with greater flexibility to start their own trust funds for philanthropic purposes.

2.4 Donations to PPFs are tax deductible. PPFs are limited to making distributions to other deductible gift recipients (DGRs) that either

have been endorsed by the Commissioner, or are listed by name in the income tax law as a DGR.

2.5 A PPF may also be entitled to an income tax exemption if it is also endorsed as a charity or as an income tax exempt fund.

2.6 A PPF is one of two types of ancillary trust fund that can qualify for DGR status and income tax exempt status. The other type is a public ancillary fund, which is distinct from a PPF in that it must establish a public fund. Public ancillary funds are a common structure for community and fundraising foundations. Both types of ancillary fund act only as intermediaries between donors and organisations that can receive tax deductible donations.

2.7 The current PPF guidelines outline the process to be followed, and requirements to be met, in order to establish a PPF, including the requirement to establish a trust in accordance with a model trust deed. The current guidelines are unlegislated and therefore have no legal status in their own right.

Areas for improvement in the current arrangements for PPFs

2.8 The current PPF guidelines outline the requirements for PPFs in some detail, but not necessarily the objectives of those requirements. Furthermore, in cases of PPFs misusing their funds (for example, providing benefits to the donor) there is currently an ‘all or nothing’ penalty system. The Commissioner is generally limited to advising the Treasurer to declare that a particular organisation is no longer a PPF. De-listing of a PPF does not affect the deductions that have already been claimed, nor enable the protection of the PPF’s philanthropic funds into the future.

2.9 The Government announced in the 2008-09 Budget a measure to improve PPF integrity which will be achieved by:

- amending the PPF guidelines to, among other things, ensure regular valuation of assets at market rates and increase the size of compulsory distributions;
- legislating the PPF guidelines; and
- giving the Australian Taxation Office (ATO) greater regulatory powers.

2.10 At present, the Governor-General is responsible for prescribing funds as PPFs and the Treasurer is responsible for declaring a fund to no longer be a PPF.

2.11 The amendments included in Schedule 2 to this Bill implement the Government's Budget announcement to give legislative force to the PPF guidelines and to give the ATO greater regulatory powers.

2.12 The remaining elements of the Government's Budget announcement will be implemented by way of amendments to the PPF guidelines which will be made by way of a legislative instrument.

2.13 The Government released a discussion paper in November 2008 seeking public input into the implementation of the new integrity arrangements. One hundred and thirty eight submissions were received in response to the paper.

2.14 Many respondents to the discussion paper were encouraged by the Government's interest in the philanthropic sector, and in particular the proposals to simplify arrangements for PPFs, and give the ATO greater regulatory powers. However, the majority of respondents also cautioned against increasing the minimum distribution rate for PPFs to a point where PPFs are unable to exist in perpetuity. The matter of a minimum distribution rate will be considered by the Government along with other matters before the new guidelines are finalised.

2.15 An exposure draft of Schedule 2 to this Bill was released on 14 May 2009. Fourteen submissions were received. There was general support for the changes proposed in this Schedule. However, a number of refinements were made as a result of minor concerns about transitional arrangements and the scope of the administrative penalty regime.

Summary of new law

2.16 The amendments bring the full administration of the PPF regime under the authority of the Commissioner. This means that PPFs would no longer be 'prescribed' in the relevant legal sense but instead be endorsed by the Commissioner. This would have the effect of giving the ATO full regulatory control over PPFs and allow the ATO to take more timely action to protect the capital of a PPF.

2.17 As PPFs will no longer be prescribed, they have been renamed private ancillary funds.

2.18 The amendments give the Treasurer the power to make guidelines about the establishment and maintenance of private ancillary funds. Those guidelines are enforced through the imposition of administrative penalties.

2.19 The Commissioner will also have the power to suspend or remove trustees of private ancillary funds that breach the guidelines or other relevant Australian laws. The Commissioner's decisions are reviewable by the Administrative Appeals Tribunal and the Federal Court of Australia.

2.20 In order to provide the Commissioner with the necessary regulatory powers to protect the charitable funds of private ancillary funds it is necessary to require that all of the trustees of private ancillary funds are corporate trustees.

2.21 The amendments also facilitate changes to the Australian Business Register (ABR) so that the register can expressly identify private ancillary funds and the provision in the ITAA 1997 under which a DGR is entitled to be endorsed.

2.22 The amendments also introduce new secrecy disclosure rules. The Commissioner will be able to disclose to State and Territory Attorneys-General breaches by charities of state laws relating to trusts and charities.

Comparison of key features of new law and current law

New law	*Current law*
The Commissioner will be responsible for determining whether a trust fund is a private ancillary fund (according to a legislative definition) and determining whether that fund is entitled to be endorsed as a DGR. The Commissioner's decision is reviewable by the Administrative Appeals Tribunal and the Courts.	The Governor-General is responsible for prescribing trust funds as PPFs. The Treasurer is responsible for removing prescribed PPFs. Once a trust fund is prescribed as a PPF it is automatically a DGR. These decisions are made by reference to non-binding guidelines. There are no formal mechanisms to appeal these decisions.
The Treasurer will have the power to make binding guidelines about the establishment and maintenance of private ancillary funds. The guidelines are a legislative instrument and are subject to review by the Parliament.	The existing PPF guidelines are not binding in nature. The Government makes reference to the guidelines in determining whether to prescribe or remove a PPF. The guidelines are not subject to review by the Parliament.

New law	***Current law***
The guidelines are enforced through the imposition of administrative penalties.	No equivalent. The only remedy to enforce the existing guidelines is to prospectively remove the PPF status of a non-complying trust fund.
The Commissioner will have the power to suspend or remove the corporate trustees of private ancillary funds that consistently breach the guidelines or other relevant Australian laws.	No equivalent.
For constitutional reasons, all of the trustees of private ancillary funds must be corporate trustees.	Trustees of existing PPFs can be either individuals or corporations.
The ABR will expressly identify whether an entity is a private ancillary fund.	No equivalent.
The ABR will expressly identify under what provision an entity is entitled to be endorsed as a DGR.	The ABR currently only includes a statement as to whether an entity is a DGR or not.
The Commissioner will be able to disclose information to State and Territory Attorneys-General where he or she identifies a breach by a charity or private ancillary fund of a state or territory law relating to trusts or charities.	The Commissioner is unable to disclose information to State and Territory Attorneys-General relating to charities.

Detailed explanation of new law

Full administration by the Commissioner

2.23 The Commissioner will have full administration of private ancillary funds. The Governor-General and Treasurer will no longer have a role in determining whether a particular trust fund is entitled to be a PPF. ***[Schedule 2, items 4 and 22, item 2 in the table in subsection 30-15(2) of the ITAA 1997 and Subdivision 426-D in Schedule 1 to the TAA 1953]***

2.24 A definition of 'private ancillary fund' (new term for PPF) is being included in the ITAA 1997 and TAA 1953. A trust fund that meets the definition will be entitled to be endorsed as a DGR (subject to the general requirements that apply to all entities seeking endorsement as a DGR). ***[Schedule 2, items 4 and 22, item 2 in the table in subsection 30-15(2) of the ITAA 1997 and section 426-105 in Schedule 1 to the TAA 1953]***

2.25 The Commissioner will be responsible for considering whether a trust fund meets the definition of a 'private ancillary fund' and whether that fund is then entitled to be endorsed as a DGR. ***[Schedule 2, items 5, 6 and 7, paragraph (c) of the cell in item 2 in the table in subsection 30-15(2), paragraph 30-17(1)(b) and subsection 30-125(1) of the ITAA 1997]***

2.26 The Commissioner will maintain his or her current role in assessing a trust fund's entitlement for endorsement as an income tax exempt entity.

2.27 A trust is a ***private ancillary fund*** if:

- all the trustees of the trust are constitutional corporations; and
- all the trustees have agreed to comply with the guidelines made by the Treasurer.

2.28 PPFs were not previously required to have corporate trustees. However, for Constitutional reasons, it has been necessary to impose this new requirement on private ancillary funds in order to provide the Commissioner with additional regulatory powers.

2.29 A constitutional corporation is a corporation covered by section 51(xx) of the *Constitution*. A corporation established and operated solely as a trustee of a private ancillary fund would be considered a constitutional corporation. Professional trustee corporations would also be considered constitutional corporations.

2.30 Imposing a requirement for private ancillary funds to have a corporate trustee also ensures that directors meet a minimum standard of behaviour. The *Corporations Act 2001* details the circumstances under which an individual will be automatically disqualified from managing corporations. These include where the person has:

- a conviction on indictment of an offence in relation to decisions that affect the business of a corporation or its financial standing;
- an offence involving a contravention of the *Corporations Act 2001* punishable by imprisonment for 12 months or more;
- an offence involving dishonesty punishable by more than three months imprisonment;

- conviction for an offence against the law of a foreign country punishable by more than 12 months imprisonment; or
- is an undischarged bankrupt.

[Schedule 2, item 22, section 426-105 in Schedule 1 to the TAA 1953]

2.31 In order for a trust fund to become a private ancillary fund, the trustee(s) will need to agree to be bound by the guidelines. The trustee(s) will indicate their agreement to be bound in a form approved by the Commissioner. ***[Schedule 2, item 22, section 426-105 in Schedule 1 to the TAA 1953]***

2.32 A private ancillary fund will be entitled to be endorsed as a DGR provided they have an Australian Business Number, meet the existing conditions applying to both types of ancillary funds and comply with the guidelines. ***[Schedule 2, item 7, subsection 30-125(1) of the ITAA 1997]***

2.33 If the Commissioner refuses to endorse a prospective private ancillary fund as a DGR, the fund can request a review of the decision by the Commissioner, Administrative Appeals Tribunal or appeal the decision to a Court under section 426-35 in Schedule 1 to the TAA 1953.

Private ancillary fund guidelines

2.34 The Treasurer will be able to make binding guidelines about the establishment and maintenance of a private ancillary fund. ***[Schedule 2, items 15 and 22, subsection 995-1(1) of the ITAA 1997 and section 426-110 in Schedule 1 to the TAA 1953]***

2.35 Compliance with the guidelines is a requirement for a private ancillary fund's continued endorsement as a DGR. ***[Schedule 2, item 7, subsection 30-125(1) of the ITAA 1997]***

2.36 The guidelines are a legislative instrument and are therefore subject to disallowance by either House of Parliament.

2.37 The guidelines may specify requirements about the purpose, structure and governing rules of a private ancillary fund. The guidelines may also specify matters about the ongoing governance and permitted and prohibited activities of the fund.

2.38 It is envisaged that the guidelines will specify matters such as the role and purpose of private ancillary funds; the class of entities that the fund may donate to; that the fund be not-for-profit in character; the individuals that may be directors of the fund's trustee; the minimum distribution requirements of the fund; the permitted investment strategies of the fund; and any ongoing audit requirements.

2.39 The guidelines will ensure that private ancillary funds have appropriate governance arrangements, are properly accountable and act in a manner consistent with an entity holding philanthropic funds for a broad public benefit.

Income tax returns

2.40 Under the existing non-binding guidelines, PPFs agree to provide the ATO with an annual information statement. There is currently no consequence for failing to comply with this requirement.

2.41 The Government does not intend to introduce new reporting laws for private ancillary funds. Instead, commencing from the 2009-10 income year, private ancillary funds will be required to lodge an annual income tax return. The income tax return for private ancillary funds will be similar to the current annual information statement.

2.42 Private ancillary funds that fail to lodge their income tax return by the relevant due date will be subject to the general penalty regime that applies to all taxpayers who do provide their income tax return to the Commissioner by the due date.

Administrative penalties

2.43 Administrative penalties will be imposed on trustees and the directors of trustees that hold a private ancillary fund out as being endorsed; entitled to be endorsed; or entitled to remain endorsed; as a DGR. ***[Schedule 2, item 22, subsections 426-120(1) and (2) in Schedule 1 to the TAA 1953]***

2.44 The administrative penalties will largely result from a private ancillary fund failing to comply with the guidelines. This is because a condition of a private ancillary fund's endorsement as a DGR is that it must comply with the guidelines.

2.45 While the TAA 1953 imposes the penalty, the guidelines will determine the amount of the penalty. The amount of the penalty has been left to be determined by the guidelines so that any administrative penalty can be appropriately tailored to the nature and size of the breach taking account of the trustee's level of culpability and the particular requirement that the private ancillary fund has not complied with. ***[Schedule 2, item 22, subsection 426-120(3) in Schedule 1 to the TAA 1953]***

2.46 The trustees of a private ancillary fund are jointly and severally liable to any administrative penalty.

2.47 As corporate trustees of private ancillary funds usually have little capital, it is necessary to also impose the penalty on the directors (where any of the penalty cannot reasonably be recovered from a trustee) to effectively ensure that a private ancillary fund complies with the guidelines. Exposure to this liability promotes a minimum level of accountability amongst directors for decisions that affect the private ancillary fund.

2.48 In determining whether a penalty can reasonably be recovered from a trustee regard should be had to the administrative practicality of recovering the penalty from the trustee, the amount of time the penalty has remained unpaid and the likelihood of successfully recovering the penalty from the trustee. The Commissioner must take reasonable steps to recover the penalty from the trustee before concluding that the penalty can not reasonably be recovered.

2.49 A director that did not take part in the management of the trustee at the time the private ancillary fund breached its obligations may in certain circumstances avoid an administrative penalty.

2.50 The circumstances that the director must demonstrate are that the director was not aware of the breach and it would not have been reasonable to expect them to have been aware of the breach; or the director took all reasonable steps to ensure that the breach did not occur; or there were no such steps that the director could have taken. ***[Schedule 2, item 22, subsections 426-120(5) to (8) in Schedule 1 to the TAA 1953]***

2.51 Directors of trustees that are registered trustee companies are not liable to these administrative penalties, as registered trustee companies have an appropriate level of prudential supervision and regulation to cover their liabilities. Registered trustee companies are those companies that are governed by the relevant state trustee companies Acts.

2.52 The administrative penalty must not be reimbursed from the fund. ***[Schedule 2, item 22, subsection 426-120(4) in Schedule 1 to the TAA 1953]***

2.53 Directors should be aware of the process for making decisions, as governed by the *Corporations Act 2001*.

2.54 Further, the Commissioner has the discretion to remit all or a part of the penalty under the normal machinery provisions for penalties.

Suspension or removal of trustees

The Commissioner's powers

2.55 The Commissioner will have the power to remove or suspend a trustee of a private ancillary fund that breaches the guidelines or any other Australian law. ***[Schedule 2, item 22, section 426-125 in Schedule 1 to the TAA 1953]***

2.56 It is expected that the Commissioner would only take such action in situations that involve serious non-compliance by a private ancillary fund.

2.57 Whether the Commissioner decides to merely suspend a trustee or to remove them permanently will depend upon the nature of a breach, the circumstances of the trustee and the history of compliance.

2.58 The Commissioner is being provided with these powers in order to protect the assets of the private ancillary fund and the ongoing integrity of the tax law.

2.59 If the Commissioner chooses to suspend a trustee, it will be for a period that the Commissioner determines by reference to the circumstances. The Commissioner may also modify the suspension period as he or she considers necessary. ***[Schedule 2, item 22, subsections 426-125(2), (4) and (6) in Schedule 1 to the TAA 1953]***

2.60 If the Commissioner suspends or removes a trustee, he or she must give the trustee a written notice advising them of the decision, explaining the reasons why the decision was taken and in the cases of suspension, setting out the period of suspension. The trustee may seek a review of the decision by the Administrative Appeals Tribunal or a court following the process outlined in Part IVC of the TAA 1953 (taxation objections, reviews and appeals). ***[Schedule 2, item 22, subsections 426-125(3), (5), (7) and (8) in Schedule 1 to the TAA 1953]***

If a trustee is suspended or removed

2.61 When a trustee is suspended or removed, the Commissioner must appoint an acting trustee to undertake the duties of trustee until the suspension period has ended or a replacement trustee is appointed (as the case may be). ***[Schedule 2, item 22, subsections 426-130(1) and (2) in Schedule 1 to the TAA 1953]***

2.62 An acting trustee may be an individual, body corporate or a Government authority. The Commissioner may also appoint him or herself as acting trustee. The acting trustee must have agreed to comply with the private ancillary fund guidelines. The Commissioner cannot

appoint an acting trustee who is not a constitutional corporation for a period exceeding 6 months. ***[Schedule 2, item 22, subsection 426-130(3) to (5) in Schedule 1 to the TAA 1953]***

2.63 The Commissioner may determine the terms and conditions upon which an acting trustee is appointed. The terms and conditions determined by the Commissioner are valid despite any limitation in an Australian law or the governing rules of the private ancillary fund. ***[Schedule 2, item 22, section 426-135 in Schedule 1 to the TAA 1953]***

2.64 The Commissioner may also give directions to an acting trustee to do or not to do certain things. The acting trustee commits an offence if they contravene a direction. ***[Schedule 2, item 22, section 426-160 in Schedule 1 to the TAA 1953]***

2.65 The Commissioner may terminate the appointment of an acting trustee at any time. If the Commissioner were to do so, he or she would be required to appoint a new acting trustee. ***[Schedule 2, item 22, section 426-140 in Schedule 1 to the TAA 1953]***

2.66 An acting trustee may resign as acting trustee. However, the acting trustee must do so in writing given to the Commissioner. The resignation is not effective until seven days after the Commissioner receives the written resignation. ***[Schedule 2, item 22, section 426-145 in Schedule 1 to the TAA 1953]***

2.67 When the Commissioner appoints an acting trustee, the Commissioner must make an order transferring the property of the private ancillary fund from the former or suspended trustee to the acting trustee. The order has the legal effect of immediately transferring that property subject to certain limitations. ***[Schedule 2, item 22, subsections 426-150(1) and (3) in Schedule 1 to the TAA 1953]***

2.68 The property covered by the order is both legal and equitable property.

2.69 The Commissioner must also make a subsequent order transferring the property when the appointment of an acting trustee ends. The subsequent property transfer order may be to a new acting trustee, to the previously suspended trustee or to a newly appointed trustee as appropriate. ***[Schedule 2, item 22, subsection 426-150(2) in Schedule 1 to the TAA 1953]***

2.70 The Commissioner's order to transfer property does not immediately transfer property if the property is of a kind whose transfer is registrable under an Australian law. Instead, the property is transferred only after the registration process has been completed. ***[Schedule 2, item 22, subsection 426-150(4) in Schedule 1 to the TAA 1953]***

2.71 A former trustee has a number of obligations to comply with following their suspension, removal or the ending of their appointment. A former trustee must:

- provide the acting or new trustee with all books relating to the fund's affairs that is in their custody, possession or control;
- provide notice to the acting or new trustee identifying all the property of the fund (as much as they possibly can); and
- provide notice to the acting or new trustee explaining how that property was accounted for.

[Schedule 2, item 22, subsections 426-165(1) to (3) in Schedule 1 to the TAA 1953]

2.72 The acting or new trustee may also require the former trustee to assist with the transfer of the property of the private ancillary fund. The acting or new trustee must do so by mandating that the former trustee take certain actions necessary for the transfer of a specific item of property to the acting or new trustee. ***[Schedule 2, item 22, subsection 426-165(4) in Schedule 1 to the TAA 1953]***

2.73 A former trustee will commit an offence if they do not comply with these obligations. ***[Schedule 2, item 22, subsection 426-165(5) in Schedule 1 to the TAA 1953]***

2.74 Former trustees are strictly liable for their actions relating to books, identification of property and transfer of property (that is, liable regardless of fault). This liability has been established to compel former trustees which have already been removed on the grounds of misconduct to deal fairly with the trust's property during the handover period. ***[Schedule 2, item 22, subsection 426-165(6) in Schedule 1 to the TAA 1953]***

Changes to the Australian Business Register

2.75 For each private ancillary fund, the ABR must include a statement on the ABR indicating that the fund is a private ancillary fund. ***[Schedule 2, items 1 and 22, paragraph 26(3)(ga) of the A New Tax System (Australian Business Number) Act 1999 and section 426-115 in Schedule 1 to the TAA 1953]***

2.76 These additional requirements will improve the integrity and transparency of private ancillary funds.

2.77 For each DGR, the ABR must identify the item in the table in subsection 30-15(2) of the ITAA 1997 under which an entity qualifies as a DGR. Consistent with the endorsement requirements, this requirement is

limited to DGRs covered by items 1, 2 and 4 in the table in subsection 30-15(2). ***[Schedule 2, item 9, subsection 30-229(2) of the ITAA 1997]***

2.78 These changes to the ABR will assist ancillary funds determine which DGRs they can donate monies to. By way of background, for tax integrity reasons, ancillary funds are forbidden from donating to one another. However, the ABR currently does not distinguish between different types of DGRs so it can often be difficult for an ancillary fund to confirm the eligibility of a DGR to receive donations from them. These changes to the ABR seek to reduce these difficulties by distinguishing DGRs on the ABR by type.

Disclosure of information to the states and territories

2.79 The Commissioner will be authorised to disclose information to State and Territory Attorneys-General that relates to the non-compliance of a charity or a private ancillary fund with an Australian law.

2.80 The disclosure must be for the purposes of relevant State and Territory Attorneys-General administering a state or territory law governing trusts or charities. ***[Schedule 2, items 3 and 17, subsection 16(4) of the ITAA 1936 and subsection 3C(4) of the TAA 1953]***

2.81 The States and Territories have the primary responsibility for trust law and charities law. State and Territory Attorneys-General are the ‘protectors’ of charities. Traditionally, they have had the sole responsibility for ensuring that trustees of charitable trusts act in accordance with a trust’s governing rules and relevant state law. The Attorneys-General are also the only authority with standing to take legal action in protection of a charitable trust.

2.82 In order to assist the State and Territory Attorneys-General perform their role, it is appropriate that the Commissioner be able to provide them with information concerning non-compliance that the ATO has identified as part of its compliance activities. Collaboration between ATO and State and Territory Attorneys-General should improve the integrity of charities and the protection of philanthropic funds.

Application and transitional provisions

General application

2.83 The amendments generally apply from 1 October 2009. ***[Clause 2]***

Transitional rules for existing PPFs

2.84 Existing PPFs will become private ancillary funds on 1 October 2009. The Commissioner will be taken to have endorsed all those PPFs that become private ancillary funds as DGRs on 1 October 2009. In order to comply with the new definition of private ancillary fund, all existing PPFs will also be taken to have agreed to comply with the guidelines from 1 October 2009. This mechanism will ensure a smooth transition of existing PPFs into the new regime. ***[Schedule 2, items 27, 29 and 30]***

PPFs with non-corporate trustees

2.85 Private ancillary funds (that were PPFs before 1 October 2009) will not be required to replace their non-corporate trustees with corporate trustees. Mandating the replacement of trustees will create unnecessary compliance costs for existing trustees. ***[Schedule 2, item 28]***

2.86 Those private ancillary funds that continue to have non-corporate trustees will not be subject to the Commissioner’s new powers to suspend or remove trustees. It is for constitutional reasons that the new powers cannot be extended to these existing PPFs.

2.87 In cases of serious non-compliance by private ancillary funds with non-corporate trustees, the Commissioner will have the ability to refer the matter to the relevant State or Territory Attorney–General for action.

2.88 If at any point after 1 October 2009, a private ancillary fund with non-corporate trustees replaces all its non-corporate trustees with corporate trustees, the private ancillary fund will become subject to the Commissioner’s new powers.

2.89 Under the existing integrity arrangements, PPFs and other ancillary funds are prevented from distributing to one another. However, in order to assist PPFs move fully into the new regime, private ancillary funds with non-corporate trustees will be permitted to transfer all of their property to another private ancillary fund with trustees that have only corporate trustees. This transitional arrangement will give transitional private ancillary funds the option of restructuring their trustee arrangements by establishing a new private ancillary fund to hold the assets of the old fund. ***[Schedule 2, item 31]***

2.90 Transitional private ancillary funds that wish to restructure (either by establishing a new private ancillary fund, or replacing their existing trustees) should make themselves familiar with the state and territory laws on replacing trustees or transferring assets between trusts.

PPFs that have been approved by the Treasurer but not prescribed by 1 October 2009

2.91 Under existing arrangements, there is often a delay between the time the Treasurer agrees to recommend to the Governor-General that a trust fund be prescribed as a PPF and date the fund is prescribed. The date a fund is prescribed is usually backdated to the day the Treasurer agrees to recommend prescription. Both the prospective funds and the Commissioner would usually act on the advice of the Treasurer until the procedural formalities for prescription are completed.

2.92 With the transfer of responsibility for these funds to the Commissioner, there is likely to be a number of funds that are yet to be prescribed. For reasons of certainty and simplicity, the Treasurer will be given the power to make a declaration after 1 October 2009 listing those funds that have been approved but not yet prescribed. The declaration will have the effect of deeming those listed funds to have been prescribed from the date set out in the determination. ***[Schedule 2, item 26]***

Progressive changes to the ABR

2.93 The Australian Business Registrar will be given until 1 January 2010 to update the ABR with the additional DGR endorsement category details. The changes to the ABR are commencing at a later time to give the Registrar sufficient time to make the necessary systems changes in support the new requirements. ***[Schedule 2, items 23 and 24, subsection 30-229(2A) of the ITAA 1997 and subsection 426-115(1) in Schedule 1 to the TAA 1953]***

Consequential amendments

2.94 Use of the term 'prescribed private fund' is amended to now refer to 'private ancillary fund'. ***[Schedule 2, items 4 and 10, section 30-15 and paragraph 31-10(1)(b) of the ITAA 1997]***

2.95 References to 'prescribed private fund' are being repealed and replaced with a reference to the definition of private ancillary fund. ***[Schedule 2, items 2, 11, 13 to 16, subsection 6(1) of the ITAA 1936, paragraph 31-10(2)(b) and subsection 995-1(1) of the ITAA 1997, and subsection 2(1) of the TAA 1953]***

2.96 Table of tax related liabilities in other legislation in the TAA 1953 is amended to refer to the new penalties. ***[Schedule 2, item 18, item 140 in the table in subsection 250-10(2) in Schedule 1 to the TAA 1953]***

Chapter 3
Demutualisation of friendly societies

Outline of chapter

3.1 Schedule 3 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to provide relief from capital gains tax (CGT) to members and insured entities of friendly societies that have a life insurance business and/or a private health insurance business and the friendly society demutualises to a for-profit entity.

3.2 All references to legislative provisions in this chapter are references to the ITAA 1997 unless otherwise stated.

Context of amendments

3.3 Friendly societies may provide life insurance, private health insurance, aged care and other services to their members or other entities. These amendments will provide CGT relief for members or insured entities of a friendly society with a life insurance and/or a private health insurance business that demutualises to a for-profit entity. The CGT relief is broadly equivalent to that which is available when a stand-alone life insurer or private health insurer demutualises.

3.4 Demutualisation is the process by which participants of a mutual fund (such as a friendly society) give up their rights to participate in the fund. In effect, this involves the participants giving up the right to benefit in the future from any accumulated mutual surplus that has been (or may be) built in the fund. Upon demutualisation there is effectively a distribution of any accumulated mutual surplus to the participants. Ordinarily, this triggers a CGT taxing point.

3.5 Division 9AA of the *Income Tax Assessment Act 1936* (ITAA 1936) provides that any capital gains or capital losses that arise on these transactions for members and policyholders of life insurers and general insurers that demutualise are disregarded. In addition, Division 9AA of the ITAA 1936 provides a cost base for shares issued to policyholders and members of demutualising life insurers that is based on the life insurer's *embedded value*. Division 9AA of the ITAA 1936 also provides a cost base for shares issued to policyholders and members of a

demutualising general insurer that is based on the general insurer's *net tangible assets*.

3.6 Division 315 of the ITAA 1997 provides that any capital gains or capital losses that arise on these transactions for policyholders of a private health insurer that converts, by demutualising, to a for-profit entity are disregarded. Division 315 of the ITAA 1997 provides a cost base for shares issued to policyholders of a demutualising private health insurer that is based on the private health insurer's *market value*.

3.7 Division 9AA of the ITAA 1936 provides relief only when members or policyholders of the insurer receive their share of the distributed accumulated mutual surplus in the form of shares in the demutualised insurer or an entity that ends up wholly owning the demutualised insurer. Division 9AA of the ITAA 1936 also requires the demutualised insurer or the holding company to become a listed company, generally within two years of demutualising.

3.8 In addition, Division 9AA of the ITAA 1936 may not be available for friendly societies that have a life insurance business held in a wholly owned subsidiary.

3.9 These amendments will therefore provide relief for demutualising friendly societies in a broader range of situations. Specifically, relief will be available when the friendly society demutualises to a for-profit entity regardless of whether the society distributes its accumulated mutual surplus in the form of shares or an amount of money (or both). Further, there will be no requirement that the demutualised friendly society become a listed entity.

3.10 This is similar to the scope of the relief available for demutualising private health insurers contained in Division 315 of the ITAA 1997.

Summary of new law

3.11 Schedule 3 amends the ITAA 1997 by inserting Division 316 into Part 3-32. This Division disregards various capital gains and capital losses that may arise when a friendly society demutualises to a for-profit entity.

3.12 Specifically, Subdivision 316-B disregards capital gains and capital losses that arise to members and insured entities of the friendly society under its demutualisation, except when the member or insured entity receives an amount of money.

3.13 In cases where the member or insured entity receives an amount of money, these amendments modify the cost base rules applying to the relevant asset (an *interest affected by demutualisation*) so that the member or insured entity may realise a capital gain or capital loss. This modification ensures that members and insured entities that receive money are treated equivalently under CGT to members and insured entities that receive an allocation of shares and immediately dispose of them. These rules are contained in Subdivision 316-B and Subdivision 316-C.

3.14 Subdivision 316-C also sets out the rules for calculating the cost base of shares and rights to acquire shares that are issued under the friendly society's demutualisation to its members and insured entities.

3.15 Subdivision 316-D disregards capital gains and capital losses and sets out other CGT consequences that arise when shares or rights to acquire shares are subsequently transferred to members and insured entities of the friendly society after the demutualisation.

3.16 Subdivision 316-E sets out special rules for successors of a deceased member or deceased insured entity that receive shares or rights to acquire shares that would have otherwise been issued to the member or insured entity under the demutualisation.

3.17 The non-CGT consequences of the friendly society's demutualisation are set out in Subdivision 316-F. This includes a reduction to the demutualising friendly society's franking account.

Comparison of key features of new law and current law

New law	***Current law***
Capital gains and capital losses arising to members and insured entities when their friendly society demutualises to a for-profit entity will be disregarded except when the member or insured entity receives an amount of money under the demutualisation.	Members and policyholders of life insurers and policyholders of private health insurers may be able to disregard capital gains and capital losses that arise when their insurer demutualises. However, these current provisions do not provide consistent outcomes for friendly societies that have a life insurance business and a private health insurance business.

New law	***Current law***
Members and insured entities that receive an amount of money under their friendly society's demutualisation will calculate their capital gain or capital loss by reference to a modified cost base that is based on: • the market value of the friendly society's health insurance business (if it has one); and • the embedded value of any other business.	Except where the provisions relating to demutualising private health insurers apply, entities that give up rights in return for an amount of money will typically realise a capital gain or capital loss on the rights equal to the capital proceeds received less the cost base of the rights. The cost base of these rights would typically be minimal.
The cost base of shares and rights to acquire shares that are issued to members and insured entities under their friendly society's demutualisation will be based on: • the market value of the friendly society's health insurance business (if it has one); and • the embedded value of any other business.	The cost base of shares issued to members and policyholders of life insurers that demutualise is based on the life insurer's embedded value. The cost base of shares or rights to acquire shares issued to policyholders of private health insurers that demutualise is based on the private health insurer's market value.
Capital gains and capital losses arising on some transactions related to the friendly society's demutualisation will also be disregarded.	Capital gains and capital losses arising on related transactions may trigger CGT consequences.
No other tax consequences will arise to members and insured entities from them receiving shares, rights or an amount of money under a friendly society's demutualisation.	Distributions for a company may, in certain circumstances: • be treated as a dividend; or • trigger CGT consequences.
Legal personal representatives and beneficiaries of a deceased member or insured entity that receive shares or rights to acquire shares because of the member or entity's death will receive the same cost base for the shares or rights that the deceased member or entity would have received. In addition, any capital gains or capital losses arising from the shares or rights passing to a beneficiary of the estate will be disregarded.	As these shares or rights are not held by the deceased member or insured entity at the time of their death, no CGT roll-over is available when the shares or rights pass to a beneficiary of their estate.

New law	*Current law*
Shares or rights to acquire shares issued under a friendly society's demutualisation may be held on trust and transferred to, or sold on behalf of, members and insured entities without CGT consequences for the trustee.	A trustee dealing with assets in a trust will typically incur CGT consequences.

Detailed explanation of new law

3.18 A friendly society is defined in section 995 of the ITAA 1997 as being:

- a body that is a friendly society for the purposes of the *Life Insurance Act 1995* (LIA 1995);
- a body that is registered or incorporated as a friendly society under a State law or a Territory law;
- a body that is permitted, by a State law or a Territory law, to assume or use the expression friendly society; or
- a body that, immediately before the date that is the transfer date for the purposes of the *Financial Sector Reform (Amendments and Transitional Provisions) Act (No. 1) 1999*, was registered or incorporated as a friendly society under a State law or a Territory law.

Eligible demutualisations

3.19 The demutualising friendly society must satisfy the following requirements for this relief to be available.

3.20 Prior to demutualising, the friendly society must carry on either a health insurance business or a life insurance business. A friendly society that carries on both a health insurance business and a life insurance business also qualifies for the relief. These businesses may be carried on through a wholly owned subsidiary of the friendly society. ***[Schedule 3, item 1, paragraph 316-5(a)]***

3.21 The entity that carries on the health insurance business (either the friendly society or a wholly owned subsidiary) must be a private health insurer within the meaning of the *Private Health Insurance Act 2007* (PHIA 2007) ***[Schedule 3, item 1, subparagraph 316-5(a)(i)].***

- A friendly society that carries on only a health insurance business may qualify for this relief and is therefore excluded from the demutualisation relief contained in Division 315 of the ITAA 1997 ***[Schedule 3, item 22].***

3.22 The entity that carries on the life insurance business (either the friendly society or a wholly owned subsidiary) must be registered under section 21 of the LIA 1995 ***[Schedule 3, item 1, subparagraph 316-5(a)(ii)].***

- A friendly society that carries on a life insurance business may qualify for this relief and is therefore excluded from the demutualisation relief contained in Division 9AA of the ITAA 1936 ***[Schedule 3, item 2].***

3.23 A friendly society that carries on neither a health insurance business nor a life insurance business will not qualify for this relief. However, such a friendly society may qualify for the demutualisation relief contained in Division 9AA of the ITAA 1936 (if the friendly society is a general insurer) or Schedule 2H to the ITAA 1936.

3.24 It is also a requirement of this relief that the friendly society must not have capital divided into shares that are held by its members prior to demutualising. ***[Schedule 3, item 1, paragraph 316-5(b)]***

3.25 After demutualising, the friendly society must be carried on for the object of securing a profit or pecuniary gain for its members. ***[Schedule 3, item 1, paragraph 316-5(c)]***

Example 3.1

Friendliest Friendly Society Ltd (Friendliest Friendly) is a company limited by guarantee and a body that is permitted by a State law to use the expression friendly society. Among its other businesses, Friendliest Friendly provides life insurance to its members. Consequently Friendliest Friendly is registered under section 21 of the LIA 1995.

Friendliest Friendly proposes to demutualise to a for-profit entity. Should it demutualise, Friendliest Friendly qualifies for this relief.

Example 3.2

Affable Society Ltd (Affable Society) is registered as a friendly society under a State law and is a company limited by guarantee. It has two wholly owned subsidiaries — one of which carries on a private health insurance business and the other which carries on a life insurance business.

- The subsidiary that carries on the private health insurance business is a private health insurer within the meaning of the PHIA 2007.
- The subsidiary that carries on the life insurance business is registered under section 21 of the LIA 1995.

Affable Society proposes to demutualise to a for-profit entity and, as part of a broader merger arrangement with a for-profit private health insurer Healthy Health Ltd (Healthy Health), become wholly owned by Healthy Health.

Should it demutualise, Affable Society qualifies for this relief.

Example 3.3

Benevolent Company Ltd (Benevolent Company) is a company limited by guarantee and a body that is a friendly society for the purposes of the LIA 1995. It carries on a life insurance business and is registered under section 21 of the LIA 1995.

Benevolent Company proposes to demutualise and become a for-profit entity.

Should it demutualise, Benevolent Company qualifies for this relief.

3.26 A friendly society may demutualise in any of the following ways.

- The society may issue shares to its members where the shares entitle the members to a share of the profit or capital of the friendly society.
- The society may distribute amounts to its members in their capacity as members (whether or not the amounts are paid from profits).
- The society may amend its constitution to expressly provide for the distribution of profits to its members in their capacity as members.

Relief for members and insured entities of the friendly society

3.27 Most capital gains and capital losses arising under the friendly society's demutualisation to entities that are either members of the society or insured through the society or a wholly owned subsidiary of the society will be disregarded.

- An exception to this rule applies when the member or insured entity receives an amount of money under the demutualisation. The consequences of this transaction are set out in paragraphs 3.35 to 3.41.

3.28 It will be a question of fact as to whether a specific transaction (and therefore a capital gain or capital loss) arises under the friendly society's demutualisation. Transactions are likely to vary between demutualising friendly societies. In determining whether a transaction arises under a friendly society's demutualisation, regard may be given to the friendly society's demutualisation scheme approved by its members.

3.29 However, transactions that occur after the distribution of the friendly society's accumulated mutual surplus will not be transactions that occur under the friendly society's demutualisation. This will be the case even if the transactions occur as part of a broader scheme for reorganising the friendly society's affairs. Nonetheless, a friendly society may distribute its accumulated mutual surplus in more than one transaction and in this case each of these transactions would occur under the friendly society's demutualisation. However, if a friendly society distributes its accumulated mutual surplus in the form of shares for example, then there will be cost base implications for the shares if they are not all issued at the same time. Further information about these cost base rules is set out in paragraph 3.49.

Example 3.4

Further to Example 3.3.

Following approval from its members, Benevolent Company demutualises to a not-for-profit entity on 27 October 2008 and distributes its accumulated mutual surplus to its members in the form of money.

Under the terms of Benevolent Company's demutualisation, the accumulated mutual surplus will be distributed as follows:

- 90 per cent of the total accumulated mutual surplus to be distributed will initially be distributed to members that have agreed to receive their share of the accumulated mutual surplus and the remaining 10 per cent will be retained for other members that may make a future claim for their share of the surplus.

- After six months, the residual amount of the accumulated mutual surplus will then be distributed to all members that had previously received a share of the distributed accumulated mutual surplus (whether it was from the initial 90 per cent distribution or the remaining 10 per cent distribution).

The distribution of each of these amounts will be transactions that occur under Benevolent Company's demutualisation.

3.30 Entities that are insured through the friendly society or a wholly owned subsidiary (insured entities) may include, for example:

- policyholders and other insured persons within the meaning of the PHIA 2007 — where the friendly society or a wholly owned subsidiary carries on a health insurance business; and
- owners or holders of life insurance policies within the meaning of the ITAA 1997 — where the friendly society or a wholly owned subsidiary carries on a life insurance business. This may also include owners or holders of funeral policies, income bonds, sickness policies and scholarship plans within the meaning of the ITAA 1997.

[Schedule 3, item 1, subparagraph 316-55(1)(a)(ii)]

3.31 In some cases, depending on the terms of the friendly society's demutualisation, entities that were formerly members of the society or were formerly insured by the society or a wholly owned subsidiary may be entitled to receive a share of the society's accumulated mutual surplus.

- For convenience, references to members or insured entities also include entities that were former members of the society or were formerly insured by the society or a wholly owned subsidiary.

Example 3.5

Further to Example 3.1.

Friendliest Friendly announces its intention to demutualise.

Mary is a member of Friendliest Friendly at the time of this announcement and at the time its members subsequently approve its demutualisation. Mary is entitled to receive an allocation of 1,500 shares in Friendliest Friendly under the terms of its demutualisation.

However, Mary is no longer a member at the time the Friendliest Friendly demutualises and issues her with 1,500 shares. Mary is therefore a former member of Friendliest Friendly.

3.32 If a member or insured entity dies during a demutualisation process, similar CGT relief may also be available for their successor (such as a legal personal representative (LPR)) and beneficiaries of their estate. Further information about the CGT consequences for the LPR and beneficiaries in these circumstances is set out in paragraphs 3.86 to 3.96.

Disregard capital gains and capital losses

3.33 Except when a member or insured entity of the friendly society receives an amount of money under its demutualisation, capital gains and capital losses arising to the entity will be disregarded from CGT events that happen under the society's demutualisation to an interest of the member or insured entity that is *affected by demutualisation*. ***[Schedule 3, item 1, paragraph 316-55(1)(a)]***

3.34 An ***interest affected by demutualisation*** may include:

- an interest that the entity has (or had) in the friendly society as the owner or holder of an insurance policy with the society or a wholly owned subsidiary that is a life insurer or health insurer;
- a membership interest that the entity has (or had) in the friendly society;
- a right or interest of another kind that the entity has (or had) in the friendly society; or
- a right or interest of another kind that arises to the entity under the demutualisation.
  - However, an interest in a lost policy holders trust is excluded from being an '*interest affected by demutualisation*'. Instead a separate regime exists for dealing with these interests. Further information about the lost policy holders trust regime is set out in paragraphs 3.66 to 3.85.

[Schedule 3, item 1, paragraph 316-55(1)(b)]

Example 3.6

Further to Examples 3.1 and 3.5.

Philip is a member of Friendliest Friendly and under the terms of its constitution has a number of rights including the right to receive notice of Friendliest Friendly's Annual General Meeting, the right to attend and be heard at that meeting and the right to require Friendliest Friendly to manage its assets in a certain way and to operate on a not-for-profit basis.

Under the terms of Friendliest Friendly's demutualisation scheme, Philip acquires the right to receive 5,000 shares.

These rights make up Philip's interests that are affected by Friendliest Friendly's demutualisation. These rights are satisfied when Friendliest Friendly distributes its accumulated mutual surplus and Philip receives his 5,000 shares.

As Philip did not receive an amount of money under Friendliest Friendly's demutualisation, he disregards any capital gains or capital losses that arise from the satisfaction of these rights.

Example 3.7

Further to Example 3.5.

Mary has the right to receive 1,500 shares under Friendliest Friendly's demutualisation. Mary subsequently receives these shares when Friendliest Friendly distributes its accumulated mutual surplus and so her right to receive the shares ends.

This right is an interest affected by Friendliest Friendly's demutualisation. As it arises under Friendliest Friendly's demutualisation Mary disregards any capital gains or capital losses arising to her from the satisfaction of her right to the 1,500 shares.

Capital gains and capital losses realised on an amount of money

3.35 From a policy perspective, a member or insured entity that receives an amount of money under their friendly society's demutualisation should receive a consistent CGT outcome relative to a member or insured entity that receives an allocation of shares. This can be achieved by ensuring that the CGT outcome for such a member or insured entity is equivalent to that for a member or insured entity that receives an allocation of shares and immediately disposes of them.

- In this context it is important to note that Division 9AA of the ITAA 1936 and Division 315 of the ITAA 1997 do not

distinguish between members and policyholders of the demutualising entity that have continuously held an interest in the demutualising entity since before 20 September 1985 and those that have not for the purposes of providing a modified cost base for issued shares.

3.36 A member or insured entity that receives an amount of money under their friendly society's demutualisation for the cancellation or variation of their *interests affected by demutualisation* does not disregard any capital gains or capital losses arising in relation to the receipt of money. ***[Schedule 3, item 1, paragraphs 316-60(1)(a), (b), and (d), paragraph 316-60(3)(a) and subparagraph 316-60(1)(c)(i)]***

3.37 Instead the member or insured entity calculates whether they realise a capital gain or capital loss on the basis that their *interest affected by demutualisation* has a modified cost base or reduced cost base. ***[Schedule 3, item 1, subsection 316-60(2)]***

3.38 The member or insured entity then works out the cost base or reduced cost base of their *interest affected by the demutualisation* by multiplying the capital proceeds they receive by the friendly society's *valuation factor* ***[Schedule 3, item 1, paragraph 316-60(2)(b)].***

- Further information about calculating the friendly society's *valuation factor* is set out in paragraphs 3.53 to 3.65.
- The friendly society may inform its members or insured entities what its *valuation factor* is.

Example 3.8

Further to Examples 3.3 and 3.4.

David has been a continuous member of Benevolent Company since 2005 and under its demutualisation receives $2,000 in satisfaction of the rights he has against Benevolent Company. These rights are David's interests affected by Benevolent Company's demutualisation.

Benevolent Company has a *valuation factor* of 0.9.

- Examples 3.14 and 3.15 provide information about how a friendly society may calculate its *valuation factor*.

David calculates whether he makes a capital gain or capital loss from the receipt of the $2,000 on the basis that his *interests affected by demutualisation* have a modified cost base or reduced cost base.

David calculates his cost base for these interests by multiplying the $2,000 capital proceeds he receives by Benevolent Company's *valuation factor* of 0.9.

David's *interests affected by demutualisation* have a cost base of $1,800.

- This is calculated as follows:
  - $2,000 capital proceeds multiplied by a 0.9 *valuation factor*.

David therefore realises a capital gain of $200 on his interests.

- This is calculated as follows:
  - $2,000 capital proceeds less a $1,800 cost base.

3.39 The following rules will ensure that members and insured entities that receive an amount of money under the demutualisation receive an equivalent CGT outcome to members and insured entities that receive shares.

- A capital gain realised by a member or insured entity from the receipt of an amount of money under their friendly society's demutualisation will not be a '*discount capital gain*' ***[Schedule 3, item 15].***
- A capital gain or capital loss realised by a member or insured entity from the receipt of an amount of money under their friendly society's demutualisation will not be disregarded even where the member or insured entity has held their *interest affected by demutualisation* since before 20 September 1985 ***[Schedule 3, item 1, paragraph 316-60(3)(b)].***

Members or insured entities that receive both non-monetary capital proceeds and money

3.40 A member or insured entity may receive their share of the friendly society's accumulated mutual surplus in the form of money and in the form of non-monetary proceeds, such as shares or rights to acquire shares.

3.41 In these situations the member or insured entity will realise a capital gain or capital loss only in relation to the capital proceeds received in the form of money. In calculating this capital gain or capital loss, the member or insured entity excludes the market value of any property other than money they receive under the demutualisation from their capital proceeds. ***[Schedule 3, item 1, subsection 316-60(2)]***

Example 3.9

Further to Example 3.2.

Affable Society announces its intention to demutualise and offers its members the choice of receiving their share of its accumulated mutual surplus in the form of:

- an amount of money;
- shares in Healthy Health; or
- a combination of money and shares in Healthy Health.

Niomi is a member of Affable Society and elects to receive 100 per cent of her share of the accumulated mutual surplus in the form of money. She subsequently receives $1,000 from Affable Society when it demutualises. This payment is made in satisfaction of a number of rights (*interests affected by demutualisation*) Niomi has against Affable Society.

Affable Society has a *valuation factor* of 0.85.

Niomi calculates whether she makes a capital gain or capital loss on the basis that these *interests affected by demutualisation* have a modified cost base or reduced cost base.

Niomi calculates her cost base by multiplying the $1,000 capital proceeds she receives by Affable Society's *valuation factor* of 0.85.

Niomi's *interests affected by demutualisation* have a cost base of $850.

- This is calculated as follows:
  - $1,000 capital proceeds multiplied by a 0.85 *valuation factor*.

Niomi realises a capital gain of $150.

- This is calculated as follows:
  - $1,000 capital proceeds less a $850 cost base.

Example 3.10

Further to Examples 3.2 and 3.9.

Rob is also a member of Affable Society and elects to receive 50 per cent of his share of the accumulated mutual surplus in the form of money and 50 per cent in the form of shares in Healthy Health. He

subsequently receives $500 from Affable Society and 250 shares in Healthy Health (each worth $2) when Affable Society demutualises.

Rob calculates whether he makes a capital gain or capital loss from this transaction on the basis that his *interests affected by demutualisation* have a modified cost base or reduced cost base.

Rob calculates his cost base by multiplying the $500 capital proceeds (excluding the market value of the 250 shares he receives in Healthy Health) he receives by Affable Society's *valuation factor* of 0.85.

Rob's *interests affected by demutualisation* have a cost base of $425.

- This is calculated as follows:
  - $500 capital proceeds multiplied by a 0.85 valuation factor.

Rob realises a capital gain of $75.

- This is calculated as follows:
  - $500 capital proceeds less a $425 cost base.

Example 3.13 explains how Rob calculates the cost base of his shares in Healthy Health.

Relief for the demutualising friendly society

3.42 Capital gains or capital losses that arise to the friendly society under its demutualisation will be disregarded. ***[Schedule 3, item 1, section 316-75]***

Relief for other entities

3.43 Capital gains or capital losses that arise under the friendly society's demutualisation to other entities will be disregarded when the following three requirements are satisfied. ***[Schedule 3, item 1, section 316-80]***

3.44 First, the entity must be established solely for the purpose of participating in the friendly society's demutualisation. It will be a question of fact whether an entity meets this requirement. However, in determining this, regard should be given to the terms of the friendly society's demutualisation and whether, for example, its demutualisation scheme provides for the creation of the entity. ***[Schedule 3, item 1, paragraph 316-80(a)]***

3.45 Second, the entity must not be a lost policy holders trust. ***[Schedule 3, item 1, paragraph 316-80(a)]***

- These amendments create a separate framework for a lost policy holders trust. This framework is described in paragraphs 3.66 to 3.85.

3.46 Third, the capital gains or capital losses realised by the entity must be connected to the allocation or distribution of the friendly society's accumulated mutual surplus and arise either prior to, or at the time, the surplus is allocated or distributed. Similar to the first requirement, it will be a question of fact whether these requirements are satisfied. ***[Schedule 3, item 1, paragraph 316-80(b)]***

Shares and rights issued to members and insured entities under the demutualisation

3.47 As noted above, a friendly society may distribute its accumulated mutual surplus in the form of shares in the demutualised friendly society or another company or in the form of rights to acquire such shares.

- These rights to acquire shares are separate to the rights that make up a member's or insured entity's *interest affected by demutualisation* and which end or are satisfied under the demutualisation.

Acquisition time of shares or rights to acquire shares

3.48 Members and insured entities that receive shares or rights to acquire shares under their friendly society's demutualisation will be taken, for CGT purposes, to have acquired each of the shares or rights at their issue time. ***[Schedule 3, item 1, subsection 316-105(3)]***

Example 3.11

Further to Examples 3.6 and 3.7.

Friendliest Friendly demutualises and issues shares to its members, including Philip and Mary, on 7 November 2008.

Philip is taken to have acquired each of the 5,000 shares issued to him on 7 November 2008. Similarly, Mary is taken to have acquired each of the 1,500 shares issued to her on 7 November 2008.

Cost base of shares or rights to acquire shares

3.49 Members and insured entities of the friendly society that receive shares or rights to acquire shares under the society's demutualisation will receive a modified cost base for those shares or rights when the following

requirements are satisfied ***[Schedule 3, item 1, subsections 316-105(1) and 316-115(1)].***

- First, the shares or rights must be issued under the demutualisation and in connection with the member or insured entity's *interest affected by demutualisation* being varied or cancelled ***[Schedule 3, item 1, paragraphs 316-110(1)(b) and 316-110(1)(c)].***
- Second, the shares or rights must be issued simultaneously to:
  - all members and insured entities that are entitled to receive shares and rights to acquire shares under the demutualisation;
  - all successors that are entitled to receive shares or rights because of the death of a member or insured entity; and
  - the trustee of a lost policy holders trust.

  [Schedule 3, item 1, subsection 316-110(3) and section 316-115]
- Third, if shares are issued, the shares must be issued in the demutualised friendly society or in a company that wholly owns the demutualised friendly society ***[Schedule 3, item 1, subparagraphs 316-110(1)(a)(i) and (iii)].***
- Alternatively, if rights to acquire shares are issued, then the rights must allow only for shares in the demutualised friendly society or a company that wholly owns the friendly society to be acquired ***[Schedule 3, item 1, subparagraphs 316-110(1)(a)(ii) and (iv)].***
  - In addition, the rights must have an exercise price of nil ***[Schedule 3, item 1, subsection 316-110(2)].***

3.50 The first element of the cost base or reduced cost base of each of these shares or rights to acquire shares is calculated by multiplying the market value of the share or right at the time it is issued by the friendly society's *valuation factor* ***[Schedule 3, item 1, subsections 316-105(1) and (2)].***

- Further information about calculating the friendly society's *valuation factor* is set out in paragraphs 3.53 to 3.65.

Example 3.12

Further to Example 3.11.

Each of the shares issued in Friendliest Friendly has a market value of $3.00 at the time of their issue.

Friendliest Friendly has a *valuation factor* of 0.95.

The first element of the cost base or reduced cost base of each of the 5,000 shares in Friendliest Friendly issued to Philip is $2.85.

- This is calculated as follows:
  - $3.00 market value multiplied by a 0.95 *valuation factor*.

Mary calculates the first element of the cost base or reduced cost base of each of the 1,500 shares issued to her similarly.

Example 3.13

Further to Example 3.10.

The first element of the cost base or reduced cost base of each of the 250 shares in Healthy Health issued to Rob is $1.70.

- This is calculated as follows:
  - $2.00 market value multiplied by a 0.85 *valuation factor*.

Should Rob immediately sell his shares he would realise a capital gain of $0.30 per share, assuming he incurs no other costs in relation to the shares.

- This is calculated as follows:
  - $2.00 capital proceeds (current market value of each of the shares) less a $1.70 cost base (as calculated above).

Rob’s total capital gain from the 250 shares is $75.

- This is calculated as follows:
  - $0.30 capital gain per share multiplied by 250 shares.

3.51 The first element of the cost base or reduced cost base of shares or rights to acquire shares that are issued to the trustee of a lost policy holders trust is also calculated in the same way ***[Schedule 3, item 1, subsection 316-115(3)].***

- Further information about a lost policy holders trust is set out in paragraphs 3.66 to 3.85.

3.52 The first element of the cost base or reduced cost base of shares or rights to acquire shares that are issued to the LPR of a deceased member or insured entity is also calculated in the same way ***[Schedule 3, item 1, subsection 316-115(2)].***

- Further information about other CGT consequences of shares or rights to acquire shares issued to a deceased member or insured entity's LPR is set out in paragraphs 3.86 to 3.96.

Friendly society's valuation factor

3.53 The friendly society's *valuation factor* is derived as follows:

$$\frac{\text{Market value of the friendly society's health insurance business (if any)} + \text{Embedded value of the friendly society's other business}}{\text{Total capital proceeds received under the demutualisation by members, insured entities, successors to deceased members and insured entities and the trustee of the lost policy holders trust to interests affected by demutualisation (except those interests that arise under the demutualisation)}}$$

[Schedule 3, item 1, subsection 316-65(1)]

3.54 The formula's numerator represents the value of the friendly society and the denominator represents the friendly society's accumulated mutual surplus.

- The two components that make up the formula's numerator reflect the differing treatment of life insurers and private health insurers under the existing income tax law. Division 9AA of the ITAA 1936 and Division 315 of the ITAA 1997 respectively calculate the cost base of shares issued to members and policyholders of life insurers and policyholders of private health insurers.
- The formula's denominator reflects the total value of the friendly society's accumulated mutual surplus distributed to:
  - members and insured entities of the society;

– successors of deceased members and insured entities; and

– the trustee of a lost policy holders trust.

[Schedule 3, item 1, section 316-65]

3.55 Each of the components of the valuation formula is discussed in further detail below.

Market value of any health insurance business

3.56 In calculating the market value of a health insurance business carried on by the friendly society (either directly or through a wholly owned subsidiary) regard may be given to the consideration paid to the society or a subsidiary of the society for the disposal or control of that business. ***[Schedule 3, item 1, subsection 316-65(1)]***

3.57 If such consideration is paid to the friendly society or a subsidiary of the society and the amount to be paid is fixed under the terms of a binding agreement then the market value of the health insurance business may be calculated by reference to the time that the binding agreement for the disposal or control of the business is made and the value of the consideration.

3.58 Alternatively, if the consideration paid to the friendly society or a subsidiary of the society is dependent on subsequent events occurring after a binding bid is made, then the market value of the health insurance business may be calculated by reference to the time that the payment is made and the value of the consideration.

Example 3.14

Further to Example 3.2.

Healthy Health entered into a binding agreement with Affable Society as part of a broader arrangement to pay Affable Society $50 million for control of Affable Society's private health insurance.

Several months later Healthy Health makes this $50 million payment to Affable Society after its members agree to its demutualisation. At the time Healthy Health makes this payment, the market value of Affable Society and its private health insurance business has slightly declined.

For the purposes of the *valuation factor* calculation, Affable Society's private health insurance business has a market value of $50 million.

Embedded value of any other businesses

3.59 The embedded value of the friendly society's other business is calculated on the assumption that the friendly society or a wholly owned subsidiary does not carry on a health insurance business. ***[Schedule 3, item 1, subsection 316-65(1)]***

3.60 The embedded value is derived from the sum of the friendly society's *existing business value* and its *adjusted net worth*. These amounts need to be calculated on either:

- the demutualisation resolution day — if an accounting period of the friendly society ends on that day ***[Schedule 3, item 1, subsection 316-70(1) and paragraph 316-70(3)(a)]***; or
- the last day of the most recent accounting period of the friendly society prior to the demutualisation resolution day ***[Schedule 3, item 1, subsection 316-70(1) and paragraph 316-70(3)(b)].***
  - However, if the embedded value is calculated on the last day of the friendly society's most recent accounting period prior to the demutualisation resolution day, the friendly society's *existing business value* and *adjusted net worth* need to be adjusted to take account of any significant changes to these amounts up until the demutualisation resolution day ***[Schedule 3, item 1, subsection 316-70(5)].***

In this context, the reference to a friendly society's accounting period refers to its financial year accounting period rather than any other accounting period that the friendly society may have for management reporting purposes.

3.61 Consistent with Division 9AA of the ITAA 1936, the friendly society's demutualisation resolution day is either the day:

- on which the resolution to proceed with the demutualisation is passed by the society's members or insured entities; or
- if the friendly society, or a subsidiary of the friendly society, has a life insurance business and all of that business is transferred to another company under the demutualisation under a scheme confirmed by the Federal Court of Australia — the day that the transfer takes place.

  – However, if the transfer takes place over more than one day, then the last day that the transfer takes place will be the friendly society's demutualisation resolution day.

[Schedule 3, item 1, subsection 316-70(4)]

3.62 The embedded value calculation needs to be calculated according to Australian actuarial practice by an actuary who:

- is a Fellow or Accredited Member of the Institute of Actuaries of Australia; and
- is not an employee of the friendly society, a subsidiary of the society that carries on a life insurance or health insurance business or an entity that wholly acquires the friendly society under the demutualisation ***[Schedule 3, item 1, subsection 316-70(2)***.

3.63 There are also two assumptions that need to be made in calculating the friendly society's *existing business value* and *adjusted net worth*. These are:

- that the friendly society and any subsidiaries with a life insurance or health insurance business will continue to conduct their businesses in the same way as previously conducted as if the demutualisation did not occur (*the continued business assumption*) ***[Schedule 3, item 1, subsection 316-70(6)]***; and
- that the friendly society and any subsidiaries will incur the same amount and type of expenditure (adjusted for inflation) as incurred prior to the demutualisation (*the expenditure assumption*) ***[Schedule 3, item 1, subsection 316-70(7)].***

Total capital proceeds

3.64 Capital proceeds received by members, insured entities, successors of deceased members and insured entities and the trustee of the lost policy holders trust under the demutualisation in satisfaction of rights or interests that arise under the demutualisation are excluded from the *valuation factor*'s denominator. This ensures that only capital proceeds received under the demutualisation in relation to the existing rights and interests of members or insured entities to participate mutually in the friendly society are included in the denominator.

- Including any capital proceeds for rights or interests that arise under the demutualisation may lead to a double

counting of some capital proceeds. This will arise for example, if some of the capital proceeds received in relation to a member's or insured entity's rights to participate mutually in the friendly society are rights that arise under the demutualisation. In this case, the value of the right that arises under the demutualisation is included in the capital proceeds the member or insured entity receives from their rights to participate mutually, and so should not be included again.

[Schedule 3, item 1, subsection 316-65(1)]

3.65 Any reduction to the capital proceeds a member, insured entity or a successor of a deceased member or insured entity makes because they receive both money and non-monetary capital proceeds under the demutualisation is ignored when calculating the total capital proceeds received for the purposes of the valuation formula. This ensures that the value of all capital proceeds received under the demutualisation is included in the *valuation factor*'s denominator whether the proceeds take the form of assets or an amount of money. ***[Schedule 3, item 1, subsection 316-65(2)]***

Example 3.15

Further to Examples 3.13 and 3.14.

Under Affable Society's demutualisation, $70 million is distributed to its members (and their successors) and 15 million shares in Healthy Health (each worth $2) are issued to its members, their successors and the trustee of the Affable Lost Trust (a lost policy holders trust).

The total capital proceeds received by these entities is $100 million.

- This is calculated as follows:
  - $70 million in cash plus $30 million (15 million shares each with a market value of $2).

The embedded value of Affable Society's non-health insurance business is $35 million.

Affable Society has a *valuation factor* of 0.85.

- This is calculated as follows:
  - The numerator of Affable Society's *valuation factor* is $85 million. This comprises of a $50 million market value of Affable Society's private health insurance business plus a $35 million embedded value of its other business.

– The denominator of the *valuation factor* is equal to $100 million.

– That is, $\frac{\$50 \text{ million} + \$35 \text{ million}}{\$100 \text{ million}}$

Lost policy holders trust

3.66 Division 315 of the ITAA 1997 provides a legislative framework for shares or rights to acquire shares to be held on trust for policyholders of demutualising health insurers that are entitled to receive the shares or rights but do not receive them directly. The framework allows these shares or rights to be held on trust and transferred to the policyholder without CGT consequences for the trustee. The framework also ensures that the policyholder receives the shares or rights with the same CGT attributes as if they had received the shares or rights to acquire shares directly.

3.67 These amendments provide a similar framework for shares or rights to acquire shares to be held on trust and then transferred to members and insured entities of a demutualising friendly society. As these amendments provide a different CGT outcome for distributions of money compared to Division 315 of the ITAA 1997, this framework also facilitates payments of money from the lost policy holders trust to members and insured entities.

- These members and insured entities (referred to as beneficiaries of the lost policy holders trust) could include unverified or overseas members or unverified or overseas insured entities. A beneficiary of the lost policy holders trust could also include an LPR or beneficiary in the estate of a deceased member or insured entity that was a beneficiary of the lost policy holders trust. ***[Schedule 3, item 1, subsection 316-155(4)]***

Requirements for these rules to apply

3.68 These rules will only apply when the following conditions are satisfied:

- the friendly society's demutualisation scheme that is approved by a court provides for the lost policy holders trust ***[Schedule 3, item 1, subsections 316-155(1) and (2)]***;

- the trust exists solely for the purpose of holding shares or rights to acquire shares on behalf of entities that are beneficiaries of the trust; or holding money payable in

satisfaction of the variation or cancellation of *interests affected by demutualisation* ***[Schedule 3, item 1, subsection 316-155(3)]***; and

- shares or rights to acquire shares are issued or money is paid to the trustee of the lost policy holders trust under the friendly society's demutualisation ***[Schedule 3, item 1, subsection 316-155(5)].***

Example 3.16

Further to Examples 3.1 and 3.11.

After its members agreed to the demutualisation, Friendliest Friendly's demutualisation scheme was subsequently approved by a court. This scheme provided for a trust, Friendly Trust, which has the sole purpose of holding shares on behalf of unverified members and members registered at an overseas address. Friendly Trust's deed provides that the Trust will cease after three years.

Under Friendliest Friendly's demutualisation, the trustee of Friendly Trust receives 50,000 shares in Friendliest Friendly.

The lost policy holder trust rules would apply to Friendly Trust.

Trustee of the lost policy holders trust

Acquisition time of shares or rights to acquire shares

3.69 The trustee of the lost policy holders trust that receives shares or rights to acquire shares will be taken, for CGT purposes, to have acquired the shares or rights at their issue time. ***[Schedule 3, item 1, subsections 316-105(3) and 316-115(3)]***

Cost base of shares or rights to acquire shares

3.70 The first element of the cost base or reduced cost base of the shares or rights issued to the trustee of the lost policy holders trust under the friendly society's demutualisation is calculated in the same way as if the shares or rights to acquire shares had been issued to the member or insured entity (or their LPR or beneficiary of their estate if the member or insured entity dies before receiving the shares or rights) directly. ***[Schedule 3, item 1, subsections 316-105(1) and (2) and 316-115(3)]***

- These rules are set out in paragraphs 3.49 to 3.52.

Example 3.17

Further to Examples 3.12 and 3.16.

The trustee of Friendly Trust acquires 50,000 shares in Friendliest Friendly on 7 November 2008. The first element of the cost base of each of these shares is $2.85.

Transfer of assets to a beneficiary of the lost policy holders trust

3.71 Any capital gains or capital losses arising to the trustee of the lost policy holders trust from the transfer of assets in the lost policy holders trust to a beneficiary of the trust will be disregarded. Similarly, any capital gains or capital losses arising to the trustee from a beneficiary of the lost policy holders trust becoming absolutely entitled to an asset of the trust will be disregarded. ***[Schedule 3, item 1, subsections 316-170(1) and (2)]***

Example 3.18

Further to Example 3.17.

Jess was a member of Friendliest Friendly and under its demutualisation was entitled to receive 500 shares. However, Jess was unaware of Friendliest Friendly's demutualisation and her entitlement to the shares. Six months after Friendliest Friendly demutualised Jess became aware of her entitlement to the 500 shares and contacted the trustee of Friendly Trust. At this time, each of the shares in Friendliest Friendly has a market value of $3.50.

Any capital gains arising to the trustee of Friendly Trust from Jess becoming absolutely entitled to the 500 shares are disregarded.

Example 3.19

Further to Example 3.17.

Ross was also a member of Friendliest Friendly and, although he was unaware of it, he was entitled to receive 1,000 shares under its demutualisation.

Twelve months after demutualising Friendliest Friendly reorganises its affairs and interposes a holding company, Friendly Holding Ltd (Friendly Holding) between itself and its shareholders. Under this scheme, shareholders in Friendliest Friendly exchange two shares in Friendliest Friendly for one share in Friendly Holding. The trustee of Friendly Trust subsequently receives shares in Friendly Holding and, assuming the requirements of Subdivision 124-G of the ITAA 1997 are satisfied, a roll-over of any CGT liability that would have otherwise arisen under the exchange.

Three months later (15 months after Friendliest Friendly demutualised) Ross realised he had an entitlement to shares under Friendliest Friendly's demutualisation and contacted the trustee of Friendly Trust. At this time, each of the shares in Friendly Holding has a market value of $7.50.

Any capital gains arising to the trustee from Ross becoming absolutely entitled to 500 shares in Friendly Holding are disregarded.

3.72 The lost policy holders trust may also provide for the trustee to dispose of shares or rights in the trust held on behalf of a beneficiary and give the net proceeds to the beneficiary, on whose behalf the trustee was holding the assets. This will typically occur when the beneficiary is registered at an overseas address.

Example 3.20

Further to Example 3.17.

Eric was a member of Friendliest Friendly and was entitled to receive 1,000 shares under its demutualisation. Although Eric remains an Australian resident for tax purposes, he was registered with Friendliest Friendly with an overseas address. Instead of directly receiving his 1,000 shares when Friendliest Friendly demutualised, Eric's shares are issued to the trustee of Friendly Trust to sell on his behalf. Two months after Friendliest Friendly demutualises, the trustee of Friendly Trust sells the 1,000 shares for $3.20 each.

Any capital gains arising to the trustee from this transaction are disregarded.

Other dealings with assets

3.73 Any capital gains arising from the trustee dealing with the assets in the lost policy holders trust in any other way will, broadly, be assessed to the trustee under section 99A of the ITAA 1936. ***[Schedule 3, item 1, section 316-175]***

3.74 Specifically, for the purposes of section 97, 98A and 100 of the ITAA 1936, the share of the net income of the trust that is attributable to the capital gains arising from these transactions will not be included in the income of any beneficiaries of the trust ***[Schedule 3, item 1, subsection 316-175(2)].*** In addition, the trustee will not be assessed on this share of net income under section 98 of the ITAA 1936 ***[Schedule 3, item 1, subsection 316-175(3)]***

Beneficiaries of the lost policy holders trust that receive assets or money from the trust

Beneficiaries that receive assets

3.75 Any capital gains or capital losses arising to a beneficiary receiving assets from the lost policy holders trust in satisfaction of their interest in the trust are disregarded. ***[Schedule 3, item 1, section 316-160]***

3.76 The beneficiary will be taken to have acquired each of the assets at the same time as the trustee of the lost policy holders trust acquired them. ***[Schedule 3, item 1, subsections 316-170(1) and (4)]***

3.77 The first element of the cost base or reduced cost base of each of the assets that are transferred to a beneficiary from the lost policy holders trust will be equal to the asset's cost base in the trustee's hands. ***[Schedule 3, item 1, subsections 316-170(1) and (3)]***

3.78 The trustee of the lost policy holders may inform the beneficiary what the first element of the cost base or reduced cost base of any transferred asset will be in the beneficiary's hands. The trustee may also advise the beneficiary of the date that the trustee originally acquired the asset as this date will be the same date that the beneficiary will be taken to have acquired the asset for CGT purposes.

Example 3.21

Further to Example 3.18.

Jess becomes absolutely entitled to 500 shares, which are held in Friendly Trust, in Friendliest Friendly six months after it demutualises. Jess becomes absolutely entitled to the shares in satisfaction of her interest in Friendly Trust.

Any capital gains or capital losses arising to Jess from this transaction are disregarded.

The first element of the cost base or reduced cost base of each of these shares in Jess's hands is $2.85. Jess will be taken to have acquired each of these shares on 7 November 2008.

Example 3.22

Further to Example 3.19.

Ross becomes absolutely entitled to 500 shares in Friendly Holding held in Friendly Trust in satisfaction of his interest in Friendly Trust.

Any capital gains or capital losses arising to Ross from this transaction are disregarded.

The first element of the cost base or reduced cost base of each of these shares in Ross's hands is $5.70. Ross will be taken to have acquired each of these shares on 7 November 2008.

- Ross receives this cost base because the trustee exchanged shares in Friendliest Friendly for shares in Friendly Holding and received a roll-over under Subdivision 124-G of the ITAA 1997.

Example 3.23

Further to Example 3.20.

Eric becomes absolutely entitled to 1,000 shares in Friendliest Friendly in satisfaction of his interest in Friendly Trust. Any capital gains or capital losses arising to Eric from this transaction are disregarded

The first element of the cost base of each of these shares is $2.85.

The trustee of Friendly Trust then sells the shares on behalf of Eric for $3.20. Assuming no other costs are incurred, Eric realises a capital gain of $0.35 on each share sold.

- This is calculated as follows:
  - $3.20 capital proceeds less a $2.85 cost base equals a $0.35 capital gain.

Beneficiaries that receive an amount of money

3.79 A beneficiary whose interest in the lost policy holders trust is satisfied from the receipt of money does not disregard any capital gains or capital losses arising from that receipt. ***[Schedule 3, item 1, subsections 316-165(1) and (3)]***

3.80 Instead the beneficiary calculates whether they realise a capital gain or capital loss on the basis that their interest in the lost policy holders trust has a modified cost base or reduced cost base. ***[Schedule 3, item 1, subsection 316-165(2)]***

3.81 The beneficiary works out the cost base or reduced cost base of their interest in the lost policy holders trust by multiplying the capital proceeds they receive from the trust by the friendly society's *valuation factor* ***[Schedule 3, item 1, paragraph 316-165(2)(b)].***

- Further information about calculating the friendly society's *valuation factor* is set out in paragraphs 3.53 to 3.65.

3.82 The trustee of the lost policy holders trust may inform the beneficiary what the friendly society's *valuation factor* is.

Beneficiaries that receive assets and an amount of money

3.83 A beneficiary's interest in the lost policy holders trust may be satisfied from the receipt of money and non-monetary proceeds.

3.84 In these situations the beneficiary will realise a capital gain or capital loss only in relation to the capital proceeds received in the form of money. In calculating this capital gain or capital loss, the member or insured entity excludes the market value of any property other than money they receive from their capital proceeds. ***[Schedule 3, item 1, paragraph 316-165(2)(a)]***

Expiry of a beneficiary's interest in the lost policy holders trust

3.85 Capital gains or capital losses arising from the expiry of a beneficiary's interest in the lost policy holders trust are disregarded. ***[Schedule 3, item 1, section 316-160]***

Example 3.24

Further to Example 3.17.

Brendan was a member of Friendliest Friendly and under its demutualisation was entitled to receive 2,000 shares. However, Brendan was unaware of the demutualisation and his entitlement to shares.

Brendan is still unaware of his entitlement to shares three years later when Friendly Trust is wound up and his interest in the trust expires.

Any capital gains or capital losses arising to Brendan from the expiry of his interest in Friendly Trust are disregarded.

Shares, rights to acquire shares or money paid to an LPR

3.86 If a friendly society distributes its accumulated mutual surplus in the form of shares or rights to acquire shares and a member or insured entity of the friendly society dies during the demutualisation before receiving their shares or rights, those shares or rights will typically be issued to their LPR. The LPR can then pass the shares or rights to acquire shares to a beneficiary of the deceased member or insured entity's estate.

3.87 Similarly if a friendly society distributes its accumulated mutual surplus in the form of money and a member or insured entity of the

friendly society dies during the demutualisation before receiving the money, then the money will typically be paid to their LPR.

Disregard capital gains and capital losses

3.88 Except where the LPR receives an amount of money under the friendly society's demutualisation, capital gains or capital losses arising to the LPR will be disregarded from CGT events that happen under the demutualisation to an interest of the deceased member or insured entity that is *affected by demutualisation*. ***[Schedule 3, item 1, subsection 316-55(2)]***

Capital gains and capital losses realised on an amount of money

3.89 An LPR that receives an amount of money under a friendly society's demutualisation in relation to a deceased member or insured entity's *interest affected by demutualisation* does not disregard any capital gains or capital losses arising in relation to the receipt of money. ***[Schedule 3, item 1, paragraphs 316-60(1)(a), (b) and (d) and subparagraph 316-60(c)(ii)]***

3.90 Instead the LPR calculates whether they realise a capital gain or capital loss on the basis that the deceased member or insured entity's *interests affected by demutualisation* have a modified cost base or reduced cost base. The LPR works out the cost base or reduced cost base of the deceased member or insured entity's interest affected by demutualisation by multiplying the capital proceeds they receive by the friendly society's *valuation factor*. ***[Schedule 3, item 1, paragraph 316-60(2)(b)]***

LPRs that receive both non-monetary capital proceeds and money

3.91 Where an LPR receives non-monetary proceeds and money, the LPR will realise a capital gain or capital loss only in relation to the capital proceeds received in the form of money. In calculating this capital gain or capital loss, the LPR excludes the market value of any property other than money they receive from their capital proceeds. ***[Schedule 3, item 1, subsection 316-60(2)]***

Shares or rights to acquire shares issued to an LPR

Consequences for the LPR

3.92 An LPR that receives shares or rights to acquire shares under the demutualisation will receive the same first element of the cost base or reduced cost base that the deceased member or insured entity would have received. ***[Schedule 3, item 1, subsections 316-115(2) and 316-200(1)]***

Example 3.25

Further to Examples 3.11 and 3.12.

Hamish was a member of Friendliest Friendly society at the time it announced its intention to demutualise and at the time its members approved the demutualisation. Under Friendliest Friendly's demutualisation Hamish was entitled to receive 3,000 shares in satisfaction of the rights he had against Friendliest Friendly. Unfortunately, Hamish died two days before Friendliest Friendly's demutualisation and so the 3,000 shares were issued to Darren, his LPR.

Any capital gains or capital losses arising to Darren from receiving the 3,000 shares in Friendliest Friendly are disregarded.

The first element of the cost base of each of the 3,000 shares issued to Darren is $2.85. This is the same first element of the cost base that Hamish would have received for the shares had he remained alive.

3.93 Any capital gain or capital loss arising to the LPR from each of the shares or rights passing to a beneficiary of the deceased member or insured entity's estate will be disregarded. ***[Schedule 3, item 1, subsection 316-200(2)]***

Example 3.26

Further to Example 3.25.

Five months after Hamish's death, Darren transfers the 3,000 shares to Shaun, Hamish's beneficiary. Each of the shares has a market value of $3.45 at the time of the transfer.

Any capital gains arising to Darren from the transfer of the 3,000 shares in Friendliest Friendly to Shaun are disregarded.

Consequences for the beneficiary

3.94 A beneficiary of the deceased member or insured entity's estate that receives these shares or rights will be taken for CGT purposes to have acquired each of the shares or rights at the same time as the LPR acquired them. ***[Schedule 3, item 1, subsection 316-200(4)]***

3.95 The first element of the cost base or reduced cost base of each of the shares or rights that pass to a beneficiary of the deceased member or insured entity's estate will be equal to the share or right's cost base in the hands of the LPR. ***[Schedule 3, item 1, subsection 316-200(3)]***

Example 3.27

Further to Example 3.26.

Shaun receives the 3,000 shares in Friendliest Friendly. For CGT purposes Shaun is taken to have acquired each of the shares at the time they were issued to Darren (7 November 2008) rather than at the time he receives the shares from Darren.

Assuming Darren incurred no additional costs from the shares being transferred to Shaun, the first element of the cost base of each of the shares that Darren receives is $2.85.

Interest in a lost policy holders trust

Consequences for the LPR

3.96 Any capital gain or capital loss arising to the LPR from an interest in a lost policy holders trust passing to a beneficiary of the deceased member's or insured entity's estate will be disregarded. ***[Schedule 3, item 1, section 316-205]***

Non-CGT consequences of the demutualisation

General taxation consequences

3.97 A member or insured entity that receives shares or rights to acquire shares under their friendly society's demutualisation will not need to include any amount in their assessable income as a result of receiving these shares or rights ***[Schedule 3, item 1, paragraphs 316-255(1)(a), (2)(a) and (2)(b)].*** Alternatively, a member or insured entity that receives an amount of money under their friendly society's demutualisation will not need to include the amount of that money in their assessable income provided it is received in connection with the variation or cancellation of their *interest affected by demutualisation* ***[Schedule 3, item 1, paragraphs 316-255(1)(b), (2)(a) and(2)(b)].***

Example 3.28

Further to Example 3.8.

Apart from the $200 capital gain he realises, David does not need to include the $2,000 he receives under Benevolent Company's demutualisation in his assessable income.

3.98 Similarly, if an entity receives shares or rights to acquire shares because of the death of a member or insured entity of the friendly society, then that entity will not need to include an amount in their assessable

income as a result of receiving these shares or rights to acquire shares ***[Schedule 3, item 1, paragraphs 316-255(1)(a) and (2)(c)].*** Alternatively, an entity that receives an amount of money because of the death of a member or insured entity of the friendly society will not need to include the amount of money in their assessable income provided it is received in connection with the variation or cancellation of the deceased member or insured entity's *interest affected by demutualisation* ***[Schedule 3, item 1, paragraphs 316-255(1)(b) and (2)(c)].***

3.99 A beneficiary of a lost policy holders trust that receives shares or rights to acquire shares from the lost policy holders trust will not need to include an amount in their assessable income as a result of receiving these shares or rights ***[Schedule 3, item 1, paragraphs 316-255(1)(c) and (2)(d)].*** Alternatively, a beneficiary that receives an amount of money from a lost policy holders trust will not need to include the amount of that money in their assessable income provided it is received in connection with the variation or cancellation of an *interest affected by demutualisation* ***[Schedule 3, item 1, paragraphs 316-255(1)(d) and (2)(d)].***

Franking debits and credits

3.100 If the friendly society or a wholly owned subsidiary has a franking account and that account is in surplus prior to the 'demutualisation resolution day', then a franking debit equal to the value of the surplus arises at the start of the demutualisation resolution day. ***[Schedule 3, item 1, section 316-260]***

- This has the effect of reducing the franking account to zero and is broadly consistent with the treatment in Division 9AA of the ITAA 1936.

3.101 The friendly society's *demutualisation resolution day* is discussed in paragraph 3.61.

3.102 If a franking credit arises in the friendly society or a wholly owned subsidiary's franking account because of a distribution declared prior to the friendly society's demutualisation resolution day, a franking debit equal to the amount of the credit arises in the franking account at the same time as the credit arises. ***[Schedule 3, item 1, section 316-265]***

3.103 A franking credit may arise in the friendly society or a wholly owned subsidiary's franking account on or after the society's demutualisation resolution day if the society or subsidiary paid a pay as you go instalment or income tax on or after that day that is attributable to the period before that day. In these situations, a franking debit equal to the amount of the credit will arise in the franking account at the same time as the credit arises. ***[Schedule 3, item 1, section 316-270]***

3.104 Alternatively, a franking debit may arise in the friendly society or a wholly owned subsidiary's franking account on or after the society's demutualisation resolution day if the society or subsidiary received a refund of income tax that is attributable to the period before that day. In these situations, a franking credit equal to the amount of the debit will arise in the franking account at the same time as the debit arises. ***[Schedule 3, item 1, section 316-275]***

Exception to the share tainting rules

3.105 The share capital account of the friendly society or a company that owns all the shares in the friendly society will not become tainted if an amount is transferred to the account in connection with the friendly society's demutualisation.

- This is consistent with demutualisations that occur under Division 9AA of the ITAA 1936 and Division 315 of the ITAA 1997, to which sections 197-35 and 197-37 of the ITAA 1997 apply respectively.

[Schedule 3, item 19, subsection 197-38(1)]

3.106 This exclusion will only apply to so much of the transferred amount that, together with any amounts that were previously transferred in connection with the demutualisation, does not exceed the sum of the cost bases of shares in the company that are issued to members, insured entities, successors of a deceased member or insured entity or the trustee of a lost policy holders trust. ***[Schedule 3, item 19, subsections 197-38(2) and (3)]***

Application and transitional provisions

3.107 These amendments will apply to demutualisations that occur on or after 1 July 2008. This will ensure that friendly societies that demutualise on or after this date but prior to the amendments receiving Royal Assent may qualify for this relief. ***[Schedule 3, items 4, 23 and 24]***

Consequential amendments

3.108 Consequential amendments will be made to exclude friendly societies with a life and/or health insurance business from the demutualisation relief in Division 9AA of the ITAA 1936 and in Schedule 2H to the ITAA 1936. ***[Schedule 3, items 2 and 3]***

3.109 A consequential amendment will be made to section 11-55 of the ITAA 1997 to direct readers to the non-assessable non-exempt income provisions contained in these amendments. ***[Schedule 3, item 5]***

3.110 A consequential amendment will be made to the table in section 102-30 of the ITAA 1997 that sets out special rules that affect capital gains and capital losses. ***[Schedule 3, item 6]***

3.111 Consequential amendments will be made to the guide material in Subdivision 109-B of the ITAA 1997 to direct readers to the modified acquisition rules contained in these amendments. ***[Schedule 3, items 7 to 10]***

3.112 Consequential amendments will also be made to the guide material in Subdivision 112-B of the ITAA 1997 to direct readers to the modified cost base rules contained in these amendments. ***[Schedule 3, items 11 to 14]***

3.113 A consequential amendment will be made to Note 3 in section 118-1 of the ITAA 1997 to direct readers to the CGT exemptions contained in these amendments. ***[Schedule 3, item 16]***

3.114 A consequential amendment will be made to the anti-overlap rule in subsection 118-20(4) of the ITAA 1997 to ensure that a member or insured entity continues to realise a capital gain or capital loss when they receive an amount of money under the demutualisation that would otherwise be treated as not assessable and not exempt income. ***[Schedule 3, item 17]***

3.115 A consequential amendment will be made to exclude Subdivision 126-E of the ITAA 1997 from applying in relation to a demutualisation that Division 316 applies to. ***[Schedule 3, item 1, section 316-180]***

3.116 A consequential amendment will be made to paragraphs 149-165(1)(b) and 149-170(1)(b) of the ITAA 1997 to ensure that a friendly society that qualifies for this relief and is also a mutual insurance company or mutual affiliate company will continue to qualify for the relief in Subdivision 149-F of the ITAA 1997. ***[Schedule 3, item 18]***

3.117 Consequential amendments will be made to Division 205 of the ITAA 1997 to include the franking debits and franking credits that may arise to a friendly society (or a wholly owned subsidiary) under these amendments. ***[Schedule 3, items 20 and 21]***

3.118 A consequential amendment will be made to exclude friendly societies from Division 315 of the ITAA 1997 where friendly societies are entitled to the relief provided by these amendments. ***[Schedule 3, item 22]***

Chapter 4
Consolidation: Application of losses with nil available fraction

Outline of chapter

4.1 Schedule 4 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to ensure losses transferred to the head company of a consolidated group or a multiple entry consolidated group (MEC group) by a joining entity that is insolvent at the joining time can be used by the head company in certain circumstances.

Context of amendments

4.2 The consolidation regime applies primarily to a group of Australian resident entities wholly owned by an Australian resident company that choose to form a consolidated group. Specific rules provide for the membership of certain resident wholly owned subsidiaries of a foreign holding company (that is, a MEC group). The references in this chapter to a consolidated group include a MEC group.

4.3 Following a choice to consolidate, members of the group are treated as a single entity for their income tax purposes. Subsidiary entities lose their individual income tax identity on entry into a consolidated group and are treated as part of the head company.

4.4 When an entity (the joining entity) becomes a member of a consolidated group (including an entity that becomes the head company of the group) any tax losses and net capital losses of the joining entity are transferred to the head company of the group, provided certain tests are satisfied (Subdivision 707-A).

4.5 Transferred losses are given an available fraction that represents the joining entity's market value in proportion to the market value of the group as a whole (section 707-320). The available fraction limits the rate at which transferred losses can be used by the group. The objective is to ensure that the group cannot use the losses at a substantially faster rate than the joining entity could if it had not joined the group.

4.6 Where the value of a joining entity's liabilities exceeds the value of its assets at the time it joins a consolidated group (that is, where the joining entity has a market value of nil at the joining time), any losses of the entity that are transferred to the head company of the group will have an available fraction of nil. Consequently, assuming that no transitional concessions apply, the losses can never be used by the group.

4.7 Concerns have been raised that inequitable outcomes arise in respect of a transferred loss with a nil available fraction where the loss is wholly or partly attributable to:

- a debt that is forgiven after the joining time, resulting in the head company being subject to the commercial debt forgiveness rules (Division 245 in Schedule 2C to the *Income Tax Assessment Act 1936* (ITAA 1936));
- a debt that is terminated after the joining time, resulting in the head company being subject to the limited recourse debt rules (Division 243); or
- a liability that is taken by an entity which leaves the group, resulting in the head company making a capital gain because capital gains tax (CGT) event L5 (section 104-520) happens.

Summary of new law

4.8 Schedule 4 to this Bill amends the consolidation provisions in the income tax law to ensure losses transferred to the head company of a consolidated group by a joining entity that is insolvent at the joining time can be used by the head company in certain circumstances.

4.9 Therefore, if the transferred losses of a joining entity have an available fraction of nil, the head company can apply the losses to:

- reduce a net forgiven amount under the commercial debt forgiveness rules;
- reduce a capital allowance that is adjusted under the limited recourse debt rules; or
- reduce the capital gain that arises under CGT event L5 when the joining entity subsequently leaves the group.

Comparison of key features of new law and current law

New law	***Current law***
If the transferred losses of a joining entity have an available fraction of nil, the head company can apply the losses to: • reduce a net forgiven amount under the commercial debt forgiveness rules; • reduce a capital allowance that is adjusted under the limited recourse debt rules; or • reduce the capital gain that arises under CGT event L5 when the joining entity subsequently leaves the group.	When an entity (the joining entity) becomes a member of a consolidated group (including an entity that becomes the head company of the group) any tax losses and net capital losses of the joining entity are transferred to the head company of the group, provided certain tests are satisfied. Transferred losses are given an available fraction, worked out based on relative market values, that regulates the rate at which transferred losses can be used by the group. If a joining entity has a market value of nil, any transferred losses of the joining entity will have an available fraction of nil. Consequently, the losses can never be used by the group.

Detailed explanation of new law

4.10 The operation of the commercial debt forgiveness rules, the limited recourse debt rules and CGT event L5 will be modified if:

- an entity (the joining entity) becomes a member of a consolidated group (including an entity that becomes the head company of the group);
- a tax loss or net capital loss was transferred from the joining entity to the head company of the group at the joining time under Subdivision 707-A; and
- the loss is in a bundle of losses for which the available fraction is nil.

[Schedule 4, item 4, subsection 707-415(1)]

4.11 In these circumstances, subject to certain conditions, the head company can choose to apply the loss to, broadly:

- reduce the net forgiven amount under the commercial debt forgiveness rules;
- reduce the capital allowance adjustment under the limited recourse debt rules; or
- reduce the capital gain that arises under CGT event L5 when the joining entity subsequently leaves the group.

[Schedule 4, item 4, subsection 707-415(2)]

4.12 However, the loss can be applied to reduce the net forgiven amount, capital allowance adjustment or capital gain in relation to an income year only to the extent that the loss could be utilised by the head company for the income year on the assumption that the available fraction for the bundle of losses was one. ***[Schedule 4, item 4, subsection 707-415(3)]***

4.13 In addition, a loss can be applied to reduce the net forgiven amount, capital allowance adjustment or capital gain only to the extent that it has not already been applied. ***[Schedule 4, item 4, subsection 707-415(7)]***

Applying the loss under the commercial debt forgiveness rules

4.14 The head company can choose to apply the loss under the commercial debt forgiveness rules if:

- the joining entity owed a debt just before the joining time to an entity that was not a member of the group at that time;
- the loss is wholly or partly attributable to the debt; and
- Subdivision 245-E in Schedule 2C to the ITAA 1936 (which outlines how the total net forgiven amount is applied) applies in relation to the debt (or another debt that is reasonably connected to the debt) because the debt is forgiven after the joining time.

[Schedule 4, item 4, item 1 in the table in subsection 707-415(2)]

4.15 In these circumstances, the head company can choose to apply the loss to reduce the total net forgiven amount mentioned in subsection 245-105(1) for the purposes of applying that total net forgiven amount to:

- reduce deductible revenue losses in accordance with subsection 245-105(5);
- reduce deductible net capital losses in accordance with subsection 245-105(6);
- reduce deductible expenditures in accordance with subsection 245-105(7); and
- reduce relevant cost bases of certain assets in accordance with subsection 245-105(8).

[Schedule 4, item 4, item 1 in the table in subsection 707-415(2)]

4.16 However, the amount of the loss that can be applied to reduce the total net forgiven amount cannot exceed the gross forgiven amount (within the meaning of section 245-75) of the debt to which the loss was attributable. ***[Schedule 1, item 4, subsection 707-415(4)]***

Applying the loss under the limited recourse debt rules

4.17 The head company can choose to apply the loss under the limited recourse debt rules if:

- the joining entity owed a limited recourse debt just before the joining time to an entity that was not a member of the group at that time;
- the limited recourse debt rules apply in relation to the debt; and
- the loss is wholly or partly attributable to a deduction mentioned in paragraph 243-15(1)(c) for an income year ending before the joining time — that is, the loss is wholly or partly attributable to, broadly, a capital allowance deduction in respect of finance expenditure, refinance expenditure or financed property.

[Schedule 4, item 4, item 2 in the table in subsection 707-415(2)]

4.18 In these circumstances, the head company can choose to apply the loss to reduce the deduction mentioned in paragraph 243-15(1)(c) for

the purposes of working out whether the capital allowance deductions are excessive under subsection 243-35(1). ***[Schedule 4, item 4, item 2 in the table in subsection 707-415(2)]***

4.19 However, the amount of the loss that can be applied to reduce the deduction mentioned in paragraph 243-15(1)(c) cannot exceed the amount of the loss that is attributable to the deduction. ***[Schedule 4, item 4, subsection 707-415(5)]***

Applying the loss to reduce the CGT event L5 capital gain

4.20 The head company can choose to apply the loss to reduce the capital gain arising under CGT event L5 if:

- the joining entity ceases to be a subsidiary member of the group after the joining time; and
- the entity's liabilities at the leaving time are the same as, or are reasonably connected to, the liabilities that it had at the joining time.

[Schedule 4, item 4, item 3 in the table in subsection 707-415(2)]

4.21 In these circumstances, the head company can choose to apply the loss to reduce the amount remaining after applying step 4 in the table in subsection 711-20(1) for the purposes of working out whether CGT event L5 happens at the leaving time and, if so, the amount of any capital gain arising under CGT event L5. ***[Schedule 4, item 4, item 3 in the table in subsection 707-415(2)]***

4.22 However, the total amount of losses in the bundle of losses that can be applied to reduce any capital gain arising under CGT event L5 cannot exceed the amount of the capital gain that would be made under CGT event L5 assuming the joining entity ceased to be a member of the consolidated group just after the joining time. ***[Schedule 1, item 4, subsection 707-415(6)]***

Application and transitional provisions

4.23 The measure will apply from 1 July 2002 — that is, from the commencement of the consolidation regime. ***[Schedule 1, item 5]***

4.24 The measure is to apply from 1 July 2002 as it has been sought by, and is beneficial to, taxpayers. In this regard, the measure ensures that losses transferred to the head company of a consolidated group by a

joining entity that is insolvent at the joining time can be used by the head company and therefore are not wasted.

Amendment of assessments

4.25 Generally, the Commissioner of Taxation can amend an assessment of a company, other than a small business entity, within four years from the date of the notice of assessment (section 170 of the ITAA 1936.

4.26 As these amendments apply from 1 July 2002, the period for amending assessments will be extended. That is, the operation of section 170 will be modified so that it does not prevent the amendment of an assessment if:

- the assessment was made before the commencement of Schedule 4;
- the amendment is made within two years after that date; and
- the amendment is made for the purpose of giving effect to the amendments in Schedule 4.

[Section 4]

Consequential amendments

4.27 Consequential amendments will insert notes into the commercial debt forgiveness rules, the limited recourse debt rules and CGT event L5 to refer to the adjustments made by section 707-415. ***[Schedule 4, items 1 to 3, subsections 104-520(3) and 243-35(2) of the ITAA 1997 and subsection 245-105(1) in Schedule 2C to the ITAA 1936]***

Chapter 5
Minor amendments

Outline of chapter

5.1 Schedule 5 to this Bill makes various minor amendments to the taxation laws.

Context of amendments

5.2 The amendments seek to ensure the taxation law operates as intended by correcting technical or drafting defects, removing anomalies and addressing unintended outcomes. The minor amendments are part of the Government's commitment to the care and maintenance of the taxation laws.

5.3 Minor amendment packages now include addressing issues raised through the Tax Issues Entry System (TIES). The TIES website (www.ties.gov.au), which the Australian Taxation Office and Treasury jointly operate, provides a vehicle for tax professionals and the general public to raise issues relating to the care and maintenance of the tax system. The relevant part of the explanatory memorandum identifies TIES issues.

Summary of new law

5.4 The issues these minor amendments deal with include:

- rectifying incorrect terminology;
- correcting grammatical errors;
- repealing inoperative material;
- clarifying ambiguities; and
- ensuring provisions are consistent with the original policy intent.

5.5 Part 1 of this Schedule concerns references to Australian Government Ministers, Departments and Secretaries; Part 2 concerns the repeal of Part IV of the *Taxation Administration Act 1953*; Part 3 has amendments relating to foreign income tax offsets and foreign losses; Part 4 has other amendments; and Part 5 is a transitional provision for item 344 relating to determining technical and further education institutions.

5.6 More significant amendments include:

- putting beyond any doubt that 'taxable Australian real property' in the context of Division 855 of the *Income Tax Assessment Act 1997* (ITAA 1997), relating to the types of assets known as 'taxable Australian property' on which foreign residents pay capital gains tax (CGT), extends to a lease over land, with application to CGT events happening on or after 20 May 2009 (items 337 and 338);

- amending the rules in the income tax law relating to the foreign income tax offset and foreign losses to ensure that:

  – the rules deeming foreign income tax paid by controlled foreign companies (CFCs) and foreign investment funds (FIFs) on attributed amounts apply only to Australian entities;

  – relevant foreign losses converted into tax losses can be deducted in calculating a partnership's net income or loss;

  – previously recouped foreign losses or CFC losses are not eligible to be convertible foreign losses or convertible CFC losses;

  – it is clear beyond any doubt that the deduction limit for convertible foreign losses does not prevent later year tax losses from being deductible in the current year; and

  – there is no possible double counting in relation to convertible foreign losses used by an entity before it joined a consolidated group;

  with application in relation to income years, statutory accounting periods and notional accounting periods starting on or after 1 July 2008 (Part 3, comprising items 258 to 282);

- ensuring that the capital gains tax small business concessions interact appropriately with Division 149 (loss of pre-CGT

status) of the ITAA 1997, with application in relation to payments made by a company or trust on or after the day this Bill receives Royal Assent (this issue having been identified through the TIES system) (items 329 to 336);

- amending the fringe benefits tax (FBT) law to ensure that gifts to deductible gift recipients do not result in an employer having a FBT liability, with application to the FBT year starting on 1 April 2008 and later FBT years (items 304 and 305); and
- ensuring that First Home Saver Account trusts operated by superannuation funds are a 'full self-assessment taxpayer' (as defined) for income tax purposes, with application in relation to the 2009-10 and later income years (items 306 and 307).

5.7 All of the amendments in Schedule 5 commence from the date of Royal Assent unless otherwise stated.

Detailed explanation of new law

Part 1 — References to Ministers, Departments and Secretaries

5.8 Part 1 amends tax legislation to replace the current references to Australian Government Ministers, Secretaries and Departments with streamlined references.

5.9 There are many references in tax legislation to a specific Minister, Department or Secretary of a Department. This means that whenever the title of a Minister or Department changes, there is a need to update these references. In practice, this has rarely resulted in updated references by legislative amendment in the legislation itself. Instead, the practice has been to use substituted reference orders under sections 19B or 19BA of the *Acts Interpretation Act 1901*.

5.10 Substituted reference orders make 'shadow' changes to the references in legislation. They include information relating to the existing reference, what needs to be substituted, the affected provisions, and the date of effect of the substitution. The Governor-General, acting on the advice of the Federal Executive Council, makes the orders.

5.11 Substituted reference orders can be difficult to locate. Even experienced users of tax legislation often do not know that the orders exist. The orders themselves become complex to apply as shadow amendment is made to shadow amendment.

5.12 The revised approach deals with these issues by providing flexible and streamlined references that better accommodate future machinery of government changes. The replacement references refer to the Minister or Department administering a specified Act of Parliament.

5.13 This approach automatically accommodates reallocations of ministerial or departmental responsibility. Administrative Arrangements Orders formally allocate executive responsibility among Ministers and Departments and are published in the *Commonwealth of Australia Gazette*.

5.14 The most current Administrative Arrangements Order can be found at either www.comlaw.gov.au or www.pmc.gov.au. The easiest way to find Administrative Arrangements Orders is to use an internet search engine and to search the term 'Administrative Arrangements Orders'.

5.15 *A New Tax System (Goods and Services Tax Act) 1999* pioneered this approach. It is instructive that the machinery of government changes after the election of the Government in 2007 resulted in many shadow amendments via a substituted references order for all areas of tax legislation except goods and services tax (GST); in fact, GST had none.

5.16 The new arrangements should prove sustainable: the only time that amendments will typically be needed will be following any repeal of the identified Act. The normal process of making consequential amendments as part of the repeal should identify the need for any amendments to the taxation provisions.

Act being amended	*Provision being amended*	*Amendment*
Excise Act 1901	4(1)	Inserts a definition of 'Finance Minister'. ***[Schedule 5, item 1, subsection 4(1)]***
Excise Act 1901	4(1) (definitions)	Replaces the definition of 'Industry Minister' with 'Resources Minister'. ***[Schedule 5, items 2 and 3, subsection 4(1)]***
Excise Act 1901	162B(5) 165A(11) 165A(12)	Replaces references to 'Minister for Finance' with 'Finance Minister'. Also includes the word 'and' at the end of both paragraphs 162B(5)(a) and (b), consistent with modern drafting practice. ***[Schedule 5, items 4, 5, 10 and 11, subsections 162B(5), 165A(11) and (12)]***

Act being amended	*Provision being amended*	*Amendment*
Excise Act 1901	165A(1)(b) 165A(2)(b) 165A(3) 165A(4)	Replaces references to 'Industry Minister' with 'Resources Minister'. ***[Schedule 5, items 6 and 7, paragraphs 165A(1)(b) and (2)(b), items 7 to 9, subsections 165A(3) and (4)]***
Excise Tariff Act 1921	3(1) (definitions)	In the definition of 'intermediate area', replaces the reference to 'Minister for Industry, Science and Resources' with 'Resources Minister'. ***[Schedule 5, item 12, subsection 3(1)]*** Repeals the definition of 'relevant Energy Minister'. ***[Schedule 5, item 12, subsection 3(1)]***
Excise Tariff Act 1921	3A(1)	Replaces the reference to 'Minister for Industry, Science and Resources' with 'Resources Minister'. ***[Schedule 5, item 13, subsection 3A(1)]***
Fringe Benefits Tax (Application to the Commonwealth) Act 1986	3(1)	Inserts definitions of 'Finance Minister' and 'Finance Department'. Also includes the word 'and' at the end of paragraph (a) of the definition of 'responsible Department', consistent with modern drafting practice. ***[Schedule 5, items 14 to 16, subsection 3(1)]***
Fringe Benefits Tax (Application to the Commonwealth) Act 1986	7(1)	Replaces the reference to 'Department of the Special Minister' with 'Finance Minister'. ***[Schedule 5, item 17, subsection 7(1)]*** Replaces the reference to 'Minister for Finance' with 'Finance Minister'. The heading to section 7 is also altered by omitting 'Minister for Finance' and substituting 'Finance Minister'. ***[Schedule 5, item 18, subsection 7(1)]***
Fringe Benefits Tax Assessment Act 1986	47(8)(b)	Replaces the reference to the 'Department of Health, Housing, Local Government and Community Services' with 'Families Department'. ***[Schedule 5, item 19, paragraph 47(8)(b)]***
Fringe Benefits Tax Assessment Act 1986	136(1) (definitions)	Inserts a definition of 'Families Department'. ***[Schedule 5, item 20, subsection 136(1)]***

Act being amended	*Provision being amended*	*Amendment*
Income Tax Assessment Act 1936 (ITAA 1936)	6(1) (definitions)	Inserts definitions of 'Agriculture Secretary'; 'Arts Department'; 'Defence Department', 'Defence Minister' and 'Defence Secretary'; 'Education Department' and 'Education Secretary'; 'Employment Department', 'Employment Minister' and 'Employment Secretary'; 'Families Secretary'; 'Health Department', 'Health Minister' and 'Health Secretary'; 'Housing Secretary'; 'Immigration Department', 'Immigration Minister' and 'Immigration Secretary'; 'Research Department', 'Research Minister' and 'Research Secretary'; 'Trade Department', 'Trade Minister' and 'Trade Secretary'; and 'Veterans' Affairs Department', 'Veterans' Affairs Minister' and 'Veterans' Affairs Secretary'. ***[Schedule 5, items 21 to 43 and 45 to 50, subsection 6(1)]*** Inserts a definition of 'social security law'. ***[Schedule 5, item 44, subsection 6(1)]***
ITAA 1936	16(4)(e)	Repeals this paragraph and replaces it with '… Employment Secretary, or the Families Secretary, for the purpose of the administration of the social security law'. Also includes the word 'or' at the end of paragraphs 16(4)(a) to (d), consistent with modern drafting practice. ***[Schedule 5, items 51 and 52, paragraph 16(4)(e)]***
ITAA 1936	16(4)(ea)	Replaces the reference to 'Secretary to the Department of Employment, Education and Training' with 'Employment Secretary'. ***[Schedule 5, item 53, paragraph 16(4)(ea)]***
ITAA 1936	16(4)(f)	Replaces the reference to 'Secretary to the Department of Health' with 'Health Secretary'. Also includes the word 'or' at the end of paragraphs 16(4)(ea) and 16(4)(eb) (after removing some now unnecessary words), consistent with modern drafting practice. ***[Schedule 5, items 54 to 56, paragraph 16(4)(f)]*** Replaces the reference to 'Minister of State for Health' with 'Health Minister'. ***[Schedule 5, item 57, paragraph 16(4)(f)]***
ITAA 1936	16(4)(fc)	Replaces the reference to 'Secretary of the Department of Family and Community Services' with 'Families Secretary'. Also includes the word 'or' at the end of paragraphs 16(4)(f), (fa) and (fb), consistent with modern drafting practice. ***[Schedule 5, items 58 and 59, paragraph 16(4)(fc)]***

Act being amended	*Provision being amended*	*Amendment*
ITAA 1936	16(4)(h)	Replaces the reference to 'Secretary, Department of Defence' with 'Defence Secretary'. Also includes the word 'or' at the end of paragraphs 16(4)(fc), (fd), (g), (gaa) and (gb), consistent with modern drafting practice. ***[Schedule 5, items 60 and 61, paragraph 16(4)(h)]***
ITAA 1936	16(4)(hb)	Replaces the reference to 'Secretary to the Department of Education and the Secretary to the Department of Social Security' with 'Education Secretary'. Also includes the word 'or' at the end of paragraphs 16(4)(h) and (ha), consistent with modern drafting practice. ***[Schedule 5, items 62 and 63, paragraph 16(4)(hb)]***
ITAA 1936	16(4)(hd)	Replaces the reference to 'Secretary to the Department of Immigration and Ethnic Affairs' with 'Immigration Secretary'. Also includes the word 'or' at the end of paragraphs 16(4)(hb), (hba), (hc), (hca), (hcaa) and (hcb), consistent with modern drafting practice. ***[Schedule 5, items 64 and 65, paragraph 16(4)(hd)]***
ITAA 1936	16(4)(j)	Replaces the reference to 'Secretary to the Department of Housing and Construction' with 'Housing Secretary'. Also includes the word 'or' at the end of paragraph 16(4)(hd), consistent with modern drafting practice. ***[Schedule 5, items 66 to 68, paragraph 16(4)(j)]***
ITAA 1936	16(5B) 16(5C)	Replaces the reference to 'Secretary to the Department of Trade' with 'Trade Secretary'. ***[Schedule 5, items 69 and 70, subsections 16(5B) and (5C)]***
ITAA 1936	23AF(11) to (14) 23AF(18)	Replaces the reference to the 'Minister for Trade' with 'Trade Minister'. Also includes the word 'or' at the end of paragraphs (a) to (d) of the definition of 'eligible project' in subsection 23AF(18). ***[Schedule 5, items 71 to 73, subsections 23AF(11) to (14) and (18)]***
ITAA 1936	73A(6)	Repeals the definition of 'Research Secretary'. ***[Schedule 5, item 74, subsection 73A(6)]***

Act being amended	*Provision being amended*	*Amendment*
ITAA 1936	124K(1) 124K(1A) 124K(1B) 124K(1D) 124ZAA(1) 124ZAA(11) 124ZAB(1) 124ZAB(2)(c) 124ZAB(3) 124ZAB(4) 124ZAB(5) 124ZAB(6)(a) 124ZAB(6A) 124ZAB(7) 124ZAC(1) 124ZAC(2)(c) 124ZAC(3) 124ZAC(5) 124ZAD 124ZADAA(1) 124ZADAB(1) 124ZADAB(2)	Replaces the reference to 'Minister' with 'Arts Minister' and references to 'Secretary to the Minister's Department' and 'Minister's Department' with 'Arts Department'. Also includes the word 'and' in various places, consistent with modern drafting practice. Finally, the heading to section 124ZADAB is altered by omitting 'Minister' and substituting 'Arts Minister'. ***[Schedule 5, items 75 to 101, subsections 124K(1), (1A), (1B), (1D), 124ZAA(1) and (11) and 124ZAB(1), paragraph 124ZAB(2)(c), subsections 124ZAB(3) to (5), paragraph 124ZAB(6)(a), subsections 124ZAB(6A) and (7) and 124ZAC(1), paragraph 124ZAC(2)(c), subsections 124ZAC(3) and (5), section 124ZAD and subsections 124ZADAA(1), 124ZADAB(1) and (2)]***
ITAA 1936	159J(6) (definitions)	Replaces the reference to 'Department of Health' in paragraph (c) of the definition of 'invalid relative' with 'Health Department'. ***[Schedule 5, item 102, subsection 159J(6)]*** Replaces the reference to 'Secretary to the Department of Social Security' in paragraph (c) of the definition of 'invalid relative' with 'Families Secretary'. ***[Schedule 5, item 103, subsection 159J(6)]***
ITAA 1936	202CB(6)	Replaces the reference to 'Secretary to the Department of Social Security' with 'Employment Secretary'. ***[Schedule 5, item 104, subsection 202CB(6)]***

Act being amended	*Provision being amended*	*Amendment*
ITAA 1936	202CB(7) 202CE(8)	Replaces the reference to 'Secretary to the Department of Veterans' Affairs' with 'Veterans' Affairs Secretary'. ***[Schedule 5, items 105 and 107, subsections 202CB(7) and 202CE(8)]***
ITAA 1936	202CE(7)	Replaces the reference to 'Secretary of the Department of Social Security' with 'Employment Secretary'. ***[Schedule 5, item 106, subsection 202CE(7)]***
ITAA 1936	251R(5)(d)	Replaces the reference to 'Secretary of the Department whose Minister administers that Act' with 'Families Secretary'. ***[Schedule 5, item 108, paragraph 251R(5)(d)]***
ITAA 1936	251U(1)(f)	Replaces the reference to 'Minister for Health' with 'Health Minister'. Also includes the word 'or' at the end of paragraphs 251U(1)(a), (b), (c), (ca), (caa), (cb), (cc), (d) and (f), consistent with modern drafting practice. ***[Schedule 5, items 109 to 111, paragraph 251U(1)(f)]***
ITAA 1936	264AA(1)	Replaces the reference to 'Secretary to the Department of Primary Industries and Energy' with 'Agriculture Secretary'. Also the heading to section 264AA is altered by omitting 'Department of Primary Industries and Energy' and substituting 'Agriculture Secretary'. ***[Schedule 5, item 112, subsection 264AA(1)]***
ITAA 1997	25-7 (note)	Replaces the reference to 'Secretary to the Department of Family and Community Services' with 'Families Secretary'. ***[Schedule 5, item 113, section 25-7 (note)]***
ITAA 1997	30-25(1) (item 2.1.7 in the table) 30-30(1)(c) and (d)	Replaces the references to 'Minister for Employment, Education, Training and Youth Affairs' and to 'Minister' with 'Education Minister'. ***[Schedule 5, item 114, item 2.1.7 in the table in subsection 30-25(1) and items 115 and 116, paragraphs 30-30(1)(c) and (d)]***
ITAA 1997	30-75	Replaces the reference to 'Minister' with 'Families Minister'. ***[Schedule 5, item 117, section 30-75]***
ITAA 1997	30-80(1) (item 9.1.2 in the table) 30-85(2)(a) and (b) 30-85 (5)	Replaces references to 'Minister for Foreign Affairs' with 'Foreign Affairs Minister'. ***[Schedule 5, items 118 to 121, item 9.1.2 in the table in subsection 30-80(1), paragraphs 30-85(2)(a) and (b) and subsection 30-85(5)]***

Act being amended	*Provision being amended*	*Amendment*
ITAA 1997	30-210(1) 30-230(5) 30-235(1) 30-240 30-295 30-300(6) and (7) 30-305(1) and (4) 30-310(1) 375-865(2)(b) 376-10(1)(b) and (c) 376-230(1)(a) and (b) 376-240(3)(d)	Replaces references to 'Minister for Communications and the Arts' with 'Arts Minister' and to 'Secretary to the Department of the Department of Communications and the Arts' with 'Arts Secretary'. Also ensures that asterisking protocols for defined terms are followed. ***[Schedule 5, items 122 to 124, 148 and 149, subsections 30-210(1), 30-230(5), 30-235(1) and 30-289(4), section 30-295, subsections 30-300(7), 30-305(1) and (4), 30-310(1) and paragraphs 375-865(2)(b), 376-10(1)(b) and (c), 376-230(1)(a) and (b) and 376-240(3)(d)]***
ITAA 1997	30-287 30-289(4) 30-289A(3) 30-289B(1) and (4) 30-289C(1)	Replaces references to 'Minister or Secretary for Family and Community Services' with 'Families Minister' or 'Families Secretary'. ***[Schedule 5, items 125 to 129, section 30-287, subsections 30-289(4), 30-289A(3), 30-289B(1) and (4), and 30-289C(1)]***
ITAA 1997	30-295 30-300(6) 30-300(7) 30-305(1) 30-305(4) 30-310(1)	Replaces references to 'Minister for Communications and the Arts' with 'Arts Minister' and references to 'Secretary to the Department of Communications and the Arts' with 'Arts Secretary'. ***[Schedule 5, items 130 to 135, section 30-295 and subsections 30-295, 30-300(6) and (7), 30-305 (1) and (4) and 30-310(1)]***
ITAA 1997	34-25(1)	Replaces the reference to 'Secretary to the Department of Industry, Science and Tourism (the Industry Secretary)' with 'Industry Secretary'. ***[Schedule 5, item 136, subsection 34-25(1)]***
ITAA 1997	34-65	Replaces the reference to 'Department of Industry, Science and Tourism' with 'Industry Department'. ***[Schedule 5, item 137, section 34-65]***
ITAA 1997	40-180(2) (item 10 in the table) 40-300(2) (item 11 in the table)	Replaces references to 'Minister for Finance' with 'Finance Minister'. ***[Schedule 5, items 138 and 139, item 10 in the table in subsection 40-180(2), item 11 in the table in subsection 40-300(2)]***
ITAA 1997	40-670(1)(a)	Replaces the reference to 'Secretary of the Department of Agriculture, Fisheries and Forestry' with 'Agriculture Secretary'. ***[Schedule 5, item 140, paragraph 40-670(1)(a)]***

Act being amended	*Provision being amended*	*Amendment*
ITAA 1997	40-670(1)(b)	Replaces the reference to 'that Department' with 'the Agriculture Department'. Replaces the reference to 'that Secretary' with 'the Agriculture Secretary'. ***[Schedule 5, items 141 and 142, paragraphs 40-670(1)(a) and (b)]***
ITAA 1997	51-32(3)	Replaces the reference in paragraph (b) to 'Minister administering section 1 of the *Defence Act 1903*' with 'Defence Minister'. Replaces the words 'that Act' with 'the *Defence Act 1903*'. ***[Schedule 5, items 143 and 144, paragraph 51-32(3)(b), subsection 51-32(3)]***
ITAA 1997	52-131(9) (note)	Updates the note about the location on the internet of the *ABSTUDY Policy Manual* to refer to 2009 rather than 2007 and to replace the reference to the 'Department of Education, Science and Training' with 'Education Department'. ***[Schedule 5, item 145, subsection 52-131(9) (note)]***
ITAA 1997	61-630(3) and (5)	Replaces the references to 'Minister administering the *Student Assistance Act 1973* (the Education Minister)' with 'Education Minister' and ensures the reference is asterisked. ***[Schedule 5, items 146 and 147, subsections 61-630(3) and (5)]***
ITAA 1997	396-5 396-40 396-65(1) and (2) 396-70 (heading) 396-70(1) 396-70(5), (6) and (7) 396-75(1) and (2) 396-80(1), (4) and (5)(b) 396-90(2) 396-100 396-105 396-110	Replaces the references to 'Minister for Transport and Regional Development' with 'Transport Minister', with consequential amendments. ***[Schedule 5, items 150 to 168 and 171 and 172, sections 396-5 and 396-40, subsections 396-65(1) and (2), section 396-70, subsections 396-70(1) and (5) to (7), 396-75(1) and (2), 396-80(1) and (4), paragraph 396-80(5)(b), subsection 396-90(2) and sections 396-100, 396-105 and 396-110]***
ITAA 1997	396-105	Replaces the reference to 'Secretary to the Minister's Department' with 'Transport Secretary' and 'Minister's Department' with 'Transport Department'. ***[Schedule 5, items 169 and 170, section 396-105]***

Act being amended	*Provision being amended*	*Amendment*
ITAA 1997	995-1(1) (Dictionary)	Amends definitions of ‘Arts Minister’ and ‘Arts Secretary’; ‘Climate Change Minister’ and ‘Climate Change Secretary’; ‘Environment Minister’ and ‘Environment Secretary’; ‘Heritage Secretary’; ‘Housing Secretary’; ‘Industry Secretary’; ‘Transport Department’ and ‘Transport Minister’. Inserts definitions of ‘Agriculture Department’, ‘Agriculture Minister’ and ‘Agriculture Secretary’; ‘Arts Department’; ‘Climate Change Department’; ‘Education Department’ and ‘Education Minister’; ‘Environment Department’; ‘Families Department’, ‘Families Minister’ and ‘Families Secretary’; ‘Finance Minister’; ‘Foreign Affairs Minister’; ‘Heritage Department’ and ‘Heritage Minister’; ‘Housing Minister’ and ‘Housing Department’; ‘Industry Department’ and ‘Industry Minister’; and ‘Transport Secretary’. ***[Schedule 5, items 173 to 204, subsection 995-1(1)]***
Income Tax Assessment (Transitional Provisions) Act 1997	30-10 30-15(1) 30-15(1) (note) 30-20	Replaces references to ‘Minister’ with ‘Arts Minister’. ***[Schedule 5, items 205 to 208, section 3-10, subsection 30-15(1) and section 30-20]***
Petroleum Resource Rent Tax Assessment Act 1987	2	Repeals the definition of ‘certifying Minister’. Inserts definitions of ‘Resources Minister’ and ‘Resources Department’. ***[Schedule 5, items 209 to 211, section 2]***
Petroleum Resource Rent Tax Assessment Act 1987	18(2) 18(3) 20(1) 20(2)(b) 20(7) 20(8) 20(12)(a)	Replaces references to ‘certifying Minister’ with ‘Resources Minister’ and makes similar changes. ***[Schedule 5, items 212 to 226, subsections 18(2) and (3) and 20(1), paragraph 20(2)(b), subsections 20(7) and (8), and paragraph 20(12)(a)]***
Petroleum Resource Rent Tax Assessment Act 1987	36B(1)	Replaces the reference to the ‘Minister administering the *Offshore Petroleum and Greenhouse Gas Storage Act 2006*’ with ‘Resources Minister’. ***[Schedule 5, item 227, subsection 36B(1)]***

Act being amended	*Provision being amended*	*Amendment*
Petroleum Resource Rent Tax Assessment Act 1987	36B(2) 36B(3) 36B(5) 108(5)	Replaces references to 'Minister' and 'certifying Minister' with 'Resources Minister' and replaces 'Minister's Department' with 'Resources Department'. ***[Schedule 5, items 228 to 230, subsections 36B(2), (3) and (5) and 108(5)]***
Superannuation Contributions Tax (Application to the Commonwealth) Act 1997	3(3) 6(1)	Inserts a definition of 'Finance Minister' and replaces the reference to 'Minister for Finance' with 'Finance Minister'. ***[Schedule 5, items 231 and 232, section 3, subsection 6(1)]***
Taxation Administration Act 1953	2(1) 14Q(1) 14S(4)(b)(i) 14S(5)	Inserts a definition of 'Immigration Secretary', repeals the definition of 'Immigration Department', and makes consequential amendments. ***[Schedule 5, items 233 to 236, subsections 2(1) and 14Q(1), subparagraph 14S(4)(b)(i) and subsection 14S(5)]***
Income Tax Assessment Act 1997	995-1	Amends paragraph (a) of the definition of 'Transport Department' and the definition of 'Transport Minister' by replacing references to '*Auslink (National Land Transport) Act 2005*' with '*Nation Building Program (National Land Transport) Act 2009*'. Clause 2 of the Bill provides for the commencement provisions for these amendments. ***[Schedule 5, items 237 and 238, section 995-1, clause 2]***
Taxation Administration Act 1953	2(1) 3ED(1)(b)(i) and (ii) and (3)(a)(i) and (ii) and (b)(i) 3ED(5)	Inserts definitions of 'Immigration Department', 'Immigration Minister' and 'migration officer' and makes consequential changes. Clause 2 of the Bill provides for special commencement provisions for these amendments. Items 239 to 243 are to commence at the later of just after the start of the day on which this amending Bill receives Royal Assent and just after the commencement of item 1 of Schedule 2 to the *Migration Legislation Amendment (Worker Protection) Act 2008* commences. ***[Schedule 5, items 1070 to 1090, subsection 2(1), paragraphs 3ED(1)(b)(i) and (ii) and (3)(a)(i), (ii) and (b)(i) and subsection 3ED(5), clause 2]***

Part 2 — Repeal of Part IV of the *Taxation Administration Act 1953*

Table 5.1: Amendments to the *Taxation Administration Act 1953*

Provision being amended	***What the amendment does***
Part IV 3(1) 3(2) 3B(1AA)(a) 3B(4) (definition of 'this Act') 3C(9) (definition of 'this Act') 8J(2)(p) 14ZQ (definition of 'appealable objection decision') 14ZR(1)(a) 14ZZ(a) to (c) 14ZZN 14ZZO 14ZZP 14ZZS(1)(a) and (b)	Repeals inoperative provisions and makes required consequential amendments. Part IV of the *Taxation Administration Act 1953*, in conjunction with section 39B of the *Banking Act 1959,* previously dealt with the protection of Commonwealth revenue, and ensured that foreign currency transfers were prevented if they would have led to the avoidance or evasion of an Australian tax liability. Part IV ceased to have effect from 1 July 1990 when the regulations implementing foreign currency controls were withdrawn. Foreign currency controls have since been replaced by reporting requirements under the *Cash Transaction Reports Act 1988* and the *Financial Transaction Reports Act 1988*. Consequential amendments include the repeal by item 253 of the definition of 'appealable objection decision' in section 14ZQ and the omission by items 256 and 257 of the word 'appealable' in various provisions. These consequential amendments do not remove or reduce any currently available rights of review by the Administrative Appeals Tribunal or of appeal to the Federal Court of Australia. The concept of 'appealable objection decision' is necessary under the current law only to exclude objection decisions made on a taxation objection under section 14E (see the current definition of 'appealable objection decision' in section 14ZQ). Section 14E is part of the current Part IV, which is proposed to be repealed. The amended wording of section 14ZZ (as proposed by item 255) fully retains current rights of review and appeal. ***[Schedule 5, items 246 to 257, Part IV, sections 14ZZN, 14ZZO, 14ZZP and 14ZQ (definition of 'appealable objection decision'), subsections 3(1), 3(2), 3B(4) (definition of 'this Act') and 3C(9) (definition of this Act), and paragraphs 3B(1AA)(a), 8J(2)(p), 14ZR(1)(a), 14ZZ(a) to (c) and 14ZZ(1)(a) and (b)]***

Table 5.2: Amendments to the *Banking Act 1959*

Provision being amended	*What the amendment does*
39B	Repeals an inoperative provision. Section 39B depends on Part IV of the *Taxation Administration Act 1953*, which is being repealed. It prevents the bank authority doing certain things unless the Commissioner of Taxation (Commissioner) has issued a certificate under Part IV, which has long been inoperative and which is now being repealed. ***[Schedule 5, item 245, section 39B]***

Table 5.3: Amendments to the *Administrative Decisions (Judicial Review) Act 1977*

Provision being amended	*What the amendment does*
Schedule 1, paragraph (g)	Repeals a provision made redundant as a result of repealing Part IV of the *Taxation Administration Act 1953*. ***[Schedule 5, item 244, Schedule 1, paragraph (g)]***

Part 3 — Amendments relating to foreign income tax offsets and foreign losses

5.17 The new foreign income tax offset rules in Division 770 of the ITAA 1997 were enacted by the *Tax Laws Amendment (2007 Measures No. 4) Act 2007*. They represented a rewriting and simplification of the previous foreign loss quarantining and foreign tax credit rules. They included transitional rules under Subdivisions 770-A to 770-C of the *Income Tax (Transitional Provisions) Act 1997* to allow certain existing foreign losses of entities to be used under the new foreign income tax offset rules.

5.18 All the amendments in Part 3 are to apply to income years, statutory accounting periods and notional accounting periods starting on or after 1 July 2008 — the start date for the new foreign income tax offset rules. This will ensure that the new foreign income tax offset rules work as intended from their first application and avoid uncertainty in the law by having a common application date. ***[Schedule 5, item 282]***

Table 5.4: Amendments to the *Income Tax Assessment Act 1997*

Provision being amended	***What the amendment does***
770-135(1)	Ensures that the section applies only to Australian entities (including partnerships with at least one partner that is an Australian entity). Section 770-135 ensures a streamlined set of rules to deem certain foreign income tax paid by CFCs or foreign investment funds (FIFs) to be paid by the Australian resident taxpayer or partnership holding the interest in the CFCs or FIFs in certain circumstances. Foreign income tax paid by second-tier FIFs (that is, FIFs indirectly held by Australian entities through CFCs or other FIFs) was not intended to be eligible for a foreign income tax offset in the hands of the underlying Australian entity. However, the section could currently be interpreted to apply not only to Australian entities but also to foreign entities (such as CFCs and first-tier FIFs). On that interpretation, and in conjunction with the operation of section 770-130, the Australian entity that includes in its assessable income and amount attributed from a second-tier FIF via, for example, a CFC or first-tier FIF, could potentially be eligible for an offset for foreign income tax paid by that second-tier FIF, which was not intended. (Note that, as CFC income is attributed to the Australian entity directly — and not cascaded down through all the foreign entities in between, as is the case with FIFs — all CFCs are in effect first-tier foreign entities for the purposes of the attribution and foreign income tax offset rules.) These provisions will continue to ensure that, where a partnership is interposed in a chain of companies with an Australian company at its base, the foreign income tax paid by the companies in which the partnership has an interest will *not* be eligible for an offset in the hand of the Australian company (including where the partnership is interposed between a CFC and a FIF company). ***[Schedule 5, item 258, subsection 770-135(1)]***

Table 5.5: Amendments to the *Income Tax (Transitional Provisions) Act 1997*

Provision being amended	***What the amendment does***
770-1	Amends the law by inserting new subsection 770-1(4) to ensure that relevant foreign losses converted into tax losses can be deducted in calculating the partnership's net income or loss under section 90 of the ITAA 1936, and not be in effect trapped in the partnership holding them. The transitional rules dealing with foreign losses accumulated under the previous foreign loss quarantining rules were intended also to apply to entity structures involving Australian partners and partnerships. However, it would seem that, while certain foreign losses held by a partnership on commencement of the new foreign income tax offset rules are eligible to be converted to tax losses under section 770-1 as intended, there is no mechanism by which they can be deducted from the net assessable income of the partnership (or added to a partnership loss) under section 90 of the ITAA 1936 and so be distributed to the partners for use against their own assessable income. Without such a mechanism, foreign losses could be converted into tax losses but then be 'trapped' in the partnership instead of being available to the partners. ***[Schedule 5, items 259 and 260, section 770-1]***
770-5(1)(a) and (b) 770-5(3) 770-10 (heading) 770-10	Amends these provisions to ensure that previously recouped foreign losses are not eligible to be convertible foreign losses. It was not intended that the transitional rules allow an overall foreign loss that had been *previously* recouped by an entity under the former rules in section 160AFD of the ITAA 1936 be a convertible foreign loss under sections 770-5 and 770-10 of the *Income Tax (Transitional Provisions) Act 1997*. Ensures that step 1 of the method statement in section 770-10 operates as intended for entities other than companies. ***[Schedule 5, items 261 to 267, paragraphs 770-5(1)(a) and (b), subsection 770-5(3), and section 770-10]***

Provision being amended	*What the amendment does*
770-165(1)(a) and (b) 770-165(3) 770-170 (heading) 770-170	Amends the required sections to ensure that previously recouped CFC losses are not eligible to be convertible CFC losses. It was not intended that the transitional rules allow a CFC loss that had been *previously* recouped under the former section 431 of the ITAA 1936 be a convertible CFC loss under sections 770-165 and 770-170 of the *Income Tax (Transitional Provisions) Act 1997*. ***[Schedule 5, items 277 to 281, paragraphs 770-165(1)(a) and (b), subsection 770-165(3), and section 770-170]***
770-30	Ensures that the deduction limit applying to convertible foreign losses does not prevent later year tax losses from being deducted in the current year. This is consistent with general practice where earlier year losses are prevented or restricted from being used by ownership tests, deduction limits or quarantining (unless otherwise expressly stated). The transitional rules allow an entity to convert certain foreign losses incurred before the new foreign income tax offset rules begin into convertible foreign losses under section 770-1 of the *Income Tax (Transitional Provisions) Act 1997*. These convertible foreign losses are then deductible under Division 36 of the ITAA 1997 like ordinary tax losses, up to a limit calculated using the table in subsection 770-30(1) of the *Income Tax (Transitional Provisions) Act 1997*. If the limit is reached, the entity can deduct no further convertible foreign loss for that income year, with any further convertible foreign loss waiting for a future year, as was intended. However, an entity may also have unrecouped ordinary tax losses, all of which were incurred after the oldest unrecouped convertible foreign loss (the further deduction of which may have been deferred because of the limit). These ordinary tax losses remain deductible despite the earlier year convertible foreign loss not being fully deducted. This is consistent with general practice in relation to using losses unless expressly otherwise stated. ***[Schedule 5, items 268 and 269, section 770-30]***

Provision being amended	*What the amendment does*
770-95(b) 770-95(c) 770-95 (notes 1 and 2) 770-100(2) 770-100(3) 770-165(1)(a) and (b) 770-165(3) 770-170 (heading)	Removes possible double counting in relation to convertible foreign losses used by a subsidiary entity before it joined a consolidated group. This is to ensure that the group's head company is not disadvantaged by an unintended reduction in its convertible foreign loss deduction limit. The drafting of the special reduction could be interpreted to account twice for such losses, to the unintended detriment of the head company/taxpayer. The current transitional rules include some special rules for head companies of consolidated groups. This is the case particularly where a joining entity had converted its foreign losses incurred before the new foreign income tax offset rules began into convertible foreign losses on commencement of the new foreign income tax offset rules and had used some of these losses before joining the group (that is, before transferring these losses to the head company). Those special rules were included to reduce the head company's deduction limit for these losses to the extent that they had been utilised prior to transfer. ***[Schedule 5, items 274 to 276, paragraphs 770-95(b) and (c), section 770-95 (notes 1 and 2), subsections 770-100(2) and (3), paragraphs 770-165(1)(a) and (b), subsection 770-165(3), section 770-170 (heading)]***

Part 4 — Other amendments and Part 5 —Transitional provision

Table 5.6: Amendments to the *A New Tax System (Australian Business Number) Act 1999*

Provision being amended	*What the amendment does*
25(2) (note 1) 41 (definition of 'electronic signature') 41 (definition of 'non-cash benefit') 41 (definition of 'withholding payment') 41 (definition of 'withholding payment' covered by a particular provision in Schedule 1 to the *Taxation Administration Act 1953*)	Changes references to '*Income Tax Assessment Act 1997*' to 'ITAA 1997', which is defined to mean the *Income Tax Assessment Act 1997* in this Act. ***[Schedule 5, items 283 to 287, subsection 25(2) (note 1), and section 41]***

Table 5.7: Amendments to the *Fringe Benefits Tax Assessment Act 1986*

Provision being amended	*What the amendment does*
10(3)(a)(v)(B) 10(3D)(c)	Repeals some references to sales tax that are no longer necessary in the law. Section 10 provides for the 'cost basis' that employers can use to work out the taxable value of car fringe benefits, and includes outdated references to sales tax. Sales tax has not applied since 1 July 2000. However, the provision was retained to cover affected cars that were still being leased out. Based on the effective life of cars it is likely there are few, if any, pre-2000 vehicles still being leased out and provided as fringe benefits. In other words, these provisions are effectively inoperative. In any event, section 8 (effect of repeal) of the *Acts Interpretation Act 1901* would apply to any remaining cases to ensure the continued application of the repealed provisions. ***[Schedule 5, items 288 to 292, sub-subparagraph 10(3)(a)(v)(B), and paragraph 10(3D)(c)]***
42(1)	Makes various improvements by, for example, correcting punctuation. ***[Schedule 5, items 293 and 296 to 303, subsection 42(1)]***
42(1)(a)(i) 42(1)(b)(i)	Removes provisions that increase the taxable value of an in-house benefit where sales tax was not paid, as they are no longer operative. These provisions relate to the taxable value of in-house property fringe benefits. Both subparagraphs provide that the taxable value is increased where sales tax was not paid on the acquisition by the providers. Following the introduction of the GST, this type of event is not subject to sales tax. ***[Schedule 5, items 294 and 295, subparagraphs 42(1)(a)(i) and (b)(ii)]***

Provision being amended	***What the amendment does***
148	Amends the FBT law to ensure that donations made to deductible gift recipients through salary sacrifice arrangements do not result in an employer incurring an FBT liability. The amendment applies from the start of the 2008-09 FBT year to ensure that consistent treatment applies for the whole FBT year. The 2008-09 year has been chosen because the bushfire appeals make it particularly significant for these arrangements. FBT may be payable by employers who make donations to deductible gift recipients under salary sacrifice arrangements with their employees. Gifts of $2 or more in cash or property (subject to certain rules) to deductible gift recipients are tax deductible (see Division 30 of the ITAA 1997). Under the Commissioner's workplace giving program, an employer may make donations to deductible gift recipients on behalf of their employees from the employee's after-tax salary and wages. The Commissioner then allows the employers to adjust the amount that must be withheld from an employee's salary and wages (under the pay as you go withholding system) to take account of the deduction the employee will be entitled to for the donation the employer has made on their behalf. This allows the employee in effect to obtain the benefit of the deduction immediately. If an employee enters into a salary sacrifice arrangement with their employer in which they voluntarily reduce their salary and wages in return for a benefit, the FBT regime may tax the employer on the benefit provided. FBT applies to fringe benefits provided to an employee (or their associates) in respect of their employment. The benefit is the donation made to the deductible gift recipient. Although a deductible gift recipient is not likely ordinarily to be an employee's associate, the anti-avoidance rule in subsection 148(2) of the *Fringe Benefits Tax Assessment Act 1986* treats the deductible gift recipient as the employee's associate as the benefit is provided under a salary sacrifice arrangement. ***[Schedule 5, items 304 and 305, section 148]***

Table 5.8: Amendments to the *Income Tax Assessment Act 1936*

Provision being amended	*What the amendment does*
6(1) (at the end of the definition of 'full self-assessment taxpayer')	Extends the definition of 'full self-assessment taxpayer' to include the trustee of an FHSA trust (that is, the trustee of a First Home Saver Account trust). This amendment ensures that superannuation funds assess the liability arising from an FHSA trust in the same manner as the remainder of the superannuation fund. Superannuation funds (which will be offering First Home Saver Accounts) are already full self-assessment taxpayers and their FHSA trusts should not be treated differently to the superannuation fund itself. The inclusion of FHSA trusts as full self-assessment taxpayers is consistent with the other entities listed as full self-assessment taxpayers. ***[Schedule 5, item 306, subsection 6(1)]*** This amendment applies in relation to the 2009-10 and later income years to ensure that taxpayers and the Australian Taxation Office have time to update their systems. ***[Schedule 5, item 307]***
16(5BA) 16(5C) 16(5C)(a)	Repeals an inoperative provision (subsection 16(5BA)) and makes necessary consequential amendments. Subsection 16(5BA) allows the Commissioner to provide the Treasurer and others with information about deductions for shares in companies listed under the *Management and Investment Companies Act 1983*. This Act was repealed in 2003. ***[Schedule 5, items 308 to 310, subsections 16(5BA) and (5C), and paragraph 16(5C)(a)]***
82KZL(1)(a) (definition of 'excluded expenditure') 82KZL(1)(b) (definition of 'excluded expenditure') 82KZL(2)(a)	Includes the words 'or' or 'and' at the end of each listed paragraph, consistent with modern drafting practice. ***[Schedule 5, items 311 to 312, paragraphs 82KZL(1)(a) and (b) and 82KZL(2)(a)]***
99H(1)(c)	Replaces an incorrect reference to 'subsection 12-400(4)' with the correct reference to 'subsection 12-405(4)'. This amendment does not change the practical effect of the law. This is because the present incorrect reference to subsection 12-400(4) is clearly a typographical error. The provision makes sense only if the incorrect reference is read as a reference to subsection 12-405(4). The courts would be expected to read the legislation in its correct form where there was clearly an error of this kind. For example, Justice Muirhead in the case of *Lindner v Wright* (1976) 14 ALR 105 read an incorrect reference to subsection (3) as a reference to the correct subsection (4). ***[Schedule 5, item 313, paragraph 99H(1)(c)]***

Provision being amended	*What the amendment does*
128W(1) 128W(2) 128W(3) 128W(7)	Repeals inoperative provisions. Subsections 128W(1), (2), (3) and (7) related to the payment of mining withholding tax that became due and payable before 1 July 2000. The provisions relating to the collection and recovery of mining withholding tax and other amounts are now covered by Part 4-15 of Schedule 1 to the *Tax Administration Act 1953*. ***[Schedule 5, items 314 and 315, subsections 128W(1) to (3) and (7)]*** The amendment does not apply to any mining withholding tax that became due and payable before 1 July 2000. ***[Schedule 5, item 316]***
161AA(d)	Replaces references to 'fund that is an eligible superannuation fund (as defined in section 267)' with 'superannuation fund'. Section 267 was repealed in 2007 by Schedule 1, item 8 of the *Superannuation Legislation Amendment (Simplification) Act 2007*. ***[Schedule 5, item 317, paragraph 161AA(d)]*** The amendment applies in relation to the 2009-10 and later income years. ***[Schedule 5, item 318]***

Table 5.9: Amendments to the *Income Tax Assessment Act 1997*

Provision being amended	*What the amendment does*
30-25(1), table item 2.1.7	Replaces a reference to 'declared by a signed instrument to be a technical and further education institution within the meaning of the *Employment, Education and Training Act 1988*' with 'determined to be a technical and further education institution under the *Student Assistance Act 1973*'. The *Employment, Education and Training Act 1988* was repealed by the *Australian Research Council (Consequential and Transitional Provisions) Act 2001*. The *Student Assistance Act 1973* covers the same relevant ground as the repealed Act. ***[Schedule 5, items 319 and 344, item 2.1.7 in the table in subsection 30-25(1)]***
30-86(4)	Replaces the word 'declaration' with the word 'recognition', which is consistent with the language used elsewhere in the section. ***[Schedule 5, item 320, subsection 30-86(4)]***
40-425(2)	Changes the punctuation of the subsection to make it easier to understand. ***[Schedule 5, item 321, subsection 40-425(2)]***

Provision being amended	*What the amendment does*
54-10(2) 54-10(1)(e) 54-10(1A)(e) 995-1(1) (Dictionary)	Extends the definition of 'State Insurers' to the whole Act and makes necessary consequential amendments. The term 'State Insurers' is at present defined only for the purposes of subsection 54-10(2). Defining a term for only a portion of the Act is inconsistent with drafting protocols, which require definitions to apply across the whole Act. At present, subsection 54-10(2) is the only provision in the Act that uses this term. ***[Schedule 5, items 322, 323 and 341, paragraphs 54-10(1)(e) and (1A)(e), subsections 54-10(2) and 995-1(1)]***
124-10(3) (note 2)	Amends a statutory note to ensure it refers to relevant provisions. Note 2 of subsection 124-10(3) alerts the reader to provisions that modify the consequences of CGT replacement asset roll-overs. This amendment includes in the note a reference to 'Subdivision 124-C (about statutory licences)'. ***[Schedule 5, item 324, subsection 124-10(3) (note 2)]***
124-40(1) (notes)	Includes a statutory note (note 2) to provide a signpost to provisions in Subdivision 124-C of the *Income Tax (Transitional Provisions) Act 1997* that modify the CGT statutory licences roll-over for certain water-related licences. A consequential amendment renumbers the existing unnumbered note as note 1. ***[Schedule 5, items 325 and 326, subsection 124-140(1)]***
130-90(3)(a)(i) 130-90(3)(a)(ii) 130-90(3)(c)	Amends the CGT provisions relating to employee share schemes to ensure that they operate as intended. The amendment clarifies that there is no potential for double taxation in the described circumstance. *Tax Laws Amendment (Budget Measures) Act 2008* amended subsection 130-90(3) to remove double taxation by disregarding capital gains or capital losses arising when an employee becomes entitled to shares held in the trust as a result of exercising a right acquired under an employee share scheme. There arguably remains potential for double taxation in the circumstance where an employee share scheme right is exercised and the shares remain in the trust because of restrictions that apply to the shares. This creates uncertainty about whether the employee on ultimately acquiring the shares from the satisfaction of a beneficial interest has acquired the shares as a result of exercising a right acquired under an employee share scheme. ***[Schedule 5, items 327 and 328, subparagraphs 130-90(3)(a)(i) and (ii) and paragraph 130-90(3)(c)]***

<table>
<tr><th>Provision being amended</th><th>What the amendment does</th></tr>
<tr><td>149-30(1)
149-30(2)
152-110(1)
152-125(1)(a)
152-125(1)(a)(iii)</td><td>These amendments give effect to a suggestion made through the Tax Issues Entry System.

Amends these provisions (including by making consequential amendments) to ensure that they apply more appropriately.

Section 152-125 (which is part of the CGT small business concessions) allows a company or trust to make exempt payments to a CGT concession stakeholder, including payments reflecting a capital gain that is exempt under the 15-year exemption or a pre-CGT capital gain.

The amendments allow the pre-CGT capital gain that existed on an asset before the operation of Division 149, which turns a pre-CGT asset into a post-CGT asset where there has been at least a 50 per cent change in ownership of a company or trust, to be distributed tax-free to a CGT concession stakeholder of the company or trust.

This is achieved firstly by amending subsection 149-30(1) so that it comprises two subsections.

The application of new subsection 149-30(1A) and section 149-35 is then ignored for the purposes of section 152-125.

The effect of these two amendments is that, where Division 149 has treated a pre-CGT asset as a post-CGT asset, the asset retains its original cost base and time of acquisition for the purposes of section 152-125.

This means the total capital gain, comprising the actual pre-CGT gain and actual post-CGT gain, is treated as a post-CGT gain for the purposes of allowing that capital gain to be an exempt amount under subsection 152-125(1).

The amendments also clarify that, in calculating the period an entity has continuously owned an asset for the purposes of section 152-110, any change in majority underlying interests in the asset is ignored. This means that the period of ownership of the CGT asset starts from the time the entity originally acquired the asset.

The amendments similarly result in any change in majority underlying interests in an asset being ignored for testing whether an entity had a significant individual for at least 15 years for the purposes of section 152-110. [Schedule 5, items 329 to 335, subsections 149-30(1) and (2), 152-110(1), subparagraph 152-125(1)(a)(iii), paragraph 152-125(1)(a)]

The Division 152 amendments apply to payments made by a company or trust on or after the day on which this Bill receives Royal Assent. [Schedule 5, item 336]</td></tr>
</table>

Provision being amended	***What the amendment does***
855-20(a)	A foreign resident is liable for CGT if the relevant CGT asset is 'taxable Australian property' (as defined). This includes real property in Australia. The amendment puts beyond doubt that 'taxable Australian real property' in this context includes a lease over land. This accords with the intended application of the provisions when introduced. A lease in this context would include a sublease. The amendment applies in relation to CGT events happening on or after 20 May 2009, the date on which the amendment was first foreshadowed. The amendment is to be disregarded for interpreting the provisions in their previous form in relation to CGT events happening before 20 May 2009. The effect of this is to ensure that no inference can be drawn from the amendment that the law operated differently before the amendment. This is important because the intention of the amendment is not to change the existing law but merely to clarify how it was always intended to apply. ***[Schedule 5, items 337 and 338, paragraph 855-20(a)]***
960-190(1) (table item 3)	Corrects asterisking of a defined term. In the ITAA 1997, the drafting protocol is to mark defined terms with an asterisk but to do so only for the first occurrence of the term in each subsection (see subsection 2-15(1)). However, 'partnership' is included in the list in subsection 2-15(3) of defined terms not identified with an asterisk. ***[Schedule 5, item 339, item 3 in the table in subsection 960-190(1)]***
995-1 (paragraphs (a) and (b) for the definition of 'legal personal representative')	Replaces references to 'a person' with 'an individual' given that only an individual can die or be under a legal disability. ***[Schedule 5, item 340, section 995-1, paragraphs (a) and (b) for the definition of 'legal personal representative']***

Table 5.10: Amendments to the *International Tax Agreements Act 1953*

Provision being amended	***What the amendment does***
16(4) 16(5)(b)	Omits references to the repealed section 104 of the ITAA 1936 and consequentially rewrites the provision. Section 104 was repealed by the *Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006*. It previously made private companies liable to pay additional tax on undistributed profits. It ceased to apply from 1 July 1986 with the introduction of the imputation system. ***[Schedule 5, item 342, subsections 16(4) and (5)]***

Table 5.11: Amendments to the *Tax Laws Amendment (2007 Measures No. 5) Act 2007*

Provision being amended	***What the amendment does***
Schedule 7, item 14	Corrects an error in the *Tax Laws Amendment (2007 Measures No.5) Act 2007* that incorrectly applies an application provision to a general regulation-making power also inserted by the Schedule. Item 13 of Schedule 7 of the Act created a general regulation-making power for the *Income Tax (Transitional Provisions) Act 1997*. The remaining items of Schedule 7 concerned CGT statutory licence roll-over provisions in Subdivision 124-C of the *Income Tax (Transitional Provisions) Act 1997*. Item 14 of Schedule 7 at present inappropriately applies all the amendments made by Schedule 7 to CGT events happening in the 2005-06 and later income years. This is inappropriate for the general regulation-making power given that regulations made under it may have nothing to do with CGT events. At this stage, no regulations have been made for the purposes of the *Income Tax (Transitional Provisions) Act 1997*. The amendment excludes item 13 from the application provision. ***[Schedule 5, item 343, item 14 of Schedule 7]***

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