

2011

EXPOSURE DRAFT

*DISALLOW DEDUCTIONS AGAINST REBATABLE
BENEFITS*

EXPLANATORY MATERIAL

(Circulated by the authority of the
Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP)

Chapter 1

Disallow Deductions Against Rebatable Benefits

Outline of chapter

1.1 Schedule # to this Bill will amend the *Income Tax Assessment Act 1997* (ITAA 1997) to ensure that expenses incurred in gaining or producing a rebatable benefit are not deductible.

Context of amendments

1.2 Subsection 8-1(1) of the ITAA 1997 allows a taxpayer to deduct from assessable income any loss or outgoing to the extent that it is incurred in gaining or producing assessable income; or it is necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

1.3 Subsection 8-1(2) of the ITAA 1997 states that a loss or outgoing cannot be deducted if it is capital or is capital in nature; or private or domestic in nature; or it is incurred in gaining or producing exempt income or non-assessable non-exempt income.

1.4 In November 2010, the High Court of Australia held that individuals who incurred study expenses in gaining Youth Allowance (Student) were able to deduct the expenses from their assessable income. Because the entitlement to Youth Allowance (Student) requires an individual to satisfy an ongoing statutory activity test, such as undertaking full-time study, the expenses were held to be incurred in gaining or producing assessable income.

1.5 The High Court also considered the expenses were not private or domestic in nature as they were incurred in the retention of a statutory right to payment.

1.6 The Australian Taxation Office (ATO) indicated in its final decision impact statement that, in addition to Youth Allowance (Student), the High Court decision applied to a range of other taxable government assistance payments including ABSTUDY living allowance, Austudy living allowance and Newstart Allowance and Youth Allowance (Jobseeker). This is because the payments require

the individual to satisfy regular and ongoing statutory activity requirements in order to qualify for the payment.

1.7 The High Court decision represented a departure from the principle that study expenses unrelated to employment are not deductible. The decision means that individuals in like circumstances (such as students with the same income) have different tax obligations depending on the type of government assistance payment they receive, or whether they receive any government assistance payments at all.

1.8 In that sense, the decision has long-term implications for the integrity of basic tax principles; involves a costs to revenue; and introduces additional horizontal inequities into the tax system.

1.9 The Government announced in the 2011-12 Budget that it would disallow deductions against all 'government assistance payments' from 1 July 2011. Disallowing deductions going forward recognises that taxable government assistance payments are effectively tax-free and provides certainty as to the scope of eligible deductions.

1.10 Individuals are able to receive a deduction for expenses incurred in gaining a rebatable benefit for the 2010-11 and prior income years.

Summary of new law

1.11 Schedule # amends the ITAA 1997 to disallow deductions for expenses incurred in gaining or producing a rebatable benefit.

1.12 Section 160AAA of the *Income Tax Assessment Act 1936* (ITAA 1936) provides a rebate in respect of certain pensions and benefits.

1.13 From 1 July 2011, individuals will no longer be able to claim a deduction for expenses they incur in qualifying for a payment that is eligible for a rebatable benefit.

1.14 Disallowing a deduction for expenses incurred in gaining or producing a rebatable benefit recognises taxable government assistance payments are effectively tax-free and individuals should not be able to receive an additional benefit by way of a tax deduction against their assessable income for any expenses they incur in qualifying for the payment.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>Individuals will not be able to deduct a loss or outgoing they incur in gaining or producing a rebatable benefit (as defined in section 160AAA of the <i>Income Tax Assessment Act 1936</i>) even if the loss or outgoing is not considered private or domestic in nature.</p> <p>If an individual uses property in gaining or producing a rebatable benefit, the use of property is taken to not have been for the purpose of producing assessable income, and is not deductible.</p>	<p>Individuals may deduct a loss or outgoing they incur in gaining or producing a rebatable benefit, provided the loss or outgoing is not considered private or domestic in nature.</p>

Detailed explanation of new law

1.15 These amendments disallow deductions for expenses incurred in gaining or producing a rebatable benefit from 1 July 2011.

1.16 The amendment gives effect to the 2011-12 Budget measure to disallow deductions against government assistance payments.

1.17 Item 2 inserts a new section into the ITAA 1997 to disallow deductions for expenses incurred in gaining or producing a rebatable benefit. The provision will be included in Division 26. [*Schedule #, Item 2, subsections 26-19(1) and (2)*]

Scope of Rebatable Benefit

1.18 A rebatable benefit is defined in subsection 160AAA(1) of the ITAA 1936.

1.19 The effect of a beneficiary rebate is that taxable government assistance payments that are rebatable benefits are concessionally taxed. This means that government assistance payments that are taxable in law are in effect tax-free due to the rebate.

1.20 If an individual has no other income except their taxable government assistance payment, then the beneficiary rebate extinguishes their tax liability.

1.21 Taxpayers who have other assessable income, such as employment or investment income in addition to their taxable government assistance payment still have the tax on their government assistance payment extinguished by the beneficiary rebate, but are taxed on any other assessable income at their marginal tax rate. These taxpayers can reduce their tax liability by claiming deductions.

1.22 Only taxpayers that have other assessable income in addition to their taxable government assistance payment are able to access the benefit conferred by the High Court decision. Taxpayers who receive a taxable government assistance payment, but have no other assessable income are unable to benefit as the operation of the beneficiary rebate means they have no tax liability to claim deductions against.

1.23 A taxpayer receives the beneficiary rebate when they receive a taxable government assistance payment during a financial year.

1.24 Government assistance payments that are eligible for the beneficiary rebate include, but are not be limited to:

- Austudy living allowance
- ABSTUDY living allowance
- Newstart Allowance
- Youth Allowance (Student)
- Youth Allowance (Jobseeker)

1.25 The beneficiary rebate is only available to individuals that receive a taxable government assistance payment during a particular financial year. The beneficiary rebate is not available to individuals that receive a tax exempt government assistance payment, as the individuals pay no tax on these payments.

No deduction for losses or outgoings incurred in gaining or producing a rebatable benefit

1.26 Section 8-1 of the ITAA 1997 is the general deduction provision that allows an individual to deduct a loss or outgoing if it is

incurred in gaining or producing assessable income unless a provision in the ITAA 1997 prevents them from deducting it (paragraph 8-1(2)(d) of the ITAA 1997).

1.27 Item 2 insets a new section into the ITAA 1997 that will prevent an individual from deducting losses or outgoings they incur in gaining or producing a rebatable benefit. The new provision will be in Division 26 of the ITAA 1997. *[Schedule #, Item 2, subsections 26-19(1) and (2)]*

1.28 Subsection (1) of Item 2 will prevent an individual from claiming any loss or outgoing that is incurred in gaining or producing a rebatable benefit. *[Schedule #, Item 2, subsection 26-19(1)]*

1.29 This will reinstate the original policy intent that deductions should not be allowable against taxable but effectively tax-free government assistance payments such as ABSTUDY living allowance, Austudy living allowance, Newstart Allowance or Youth Allowance.

Example 1.1

Nathan is looking for a job and receives the full amount of Newstart Allowance. Newstart Allowance is a taxable government assistance payment that is eligible for the beneficiary tax offset. During the income year, Nathan earned \$890 in interest income.

To satisfy the statutory activity requirements, Nathan is required to regularly apply for jobs and attend interviews. As part of this requirement, Nathan travelled interstate to attend a job interview at a cost of \$400. Nathan is unable to deduct the \$400 travel cost because he is unable to deduct any loss or outgoing he incurs in gaining or producing a rebatable benefit (the beneficiary tax offset).

1.30 Subsection (2) of Item 2 will preclude an individual from deducting a loss or outgoing for property under other provisions of the ITAA 1997 such as Division 40, which is concerned with the deductibility of capital expenditure. *[Schedule #, Item 2, subsection 26-19(2)]*

1.31 The effect of subsection (2) of Item 2 is that property is not considered to be for the purpose of providing assessable income if it was used in gaining or producing a rebatable benefit.

Example 1.2

Tanuja attends university full-time. She receives a part-rate amount of Youth Allowance (Student). During the income year, Tanuja receives \$11,000 from her part-time job as a barista. Youth Allowance

(Student) is a taxable government assistance payment and is eligible for the beneficiary tax offset.

During the income year, Tanuja purchases a laptop for \$1,200 to assist her to complete her studies. The laptop is expected to have a useful life of three years, is used solely for her studies and is depreciated using the prime cost method, with a decline in value of \$400 per year.

Tanuja is unable to claim a deduction for the depreciation cost of her laptop even though the laptop is used solely for her studies. Tanuja is unable to deduct the depreciation cost of the laptop as it is taken to not have been for the purpose of producing assessable income.

1.32 Item 3 will amend the note at the end of the definition of 'purpose of producing assessable income' in subsection 995-1(1) of the ITAA 1997 to make a reference subsection 26-19 about using property in gaining or producing a rebatable benefit. *[Schedule #, Item 3 subsection 995-1(1)]*

Application and transitional provisions

1.33 The amendments in Schedule # apply to the 2011-12 income year and later income years. *[Schedule #, Item 4]*.

Consequential amendments

1.34 There are no consequential amendments related to this Schedule.

Chapter 2

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Disallow Deductions Against Rebatable Benefits

2.1 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

2.2 This schedule amends *the Income Tax Assessment Act 1997* (ITAA 1997) to ensure that expenses incurred in gaining or producing a rebatable benefit are not deductible.

Human rights implications

2.3 This Schedule does not engage any of the applicable rights or freedoms.

Conclusion

2.4 This Schedule is compatible with human rights as it does not raise any human rights issues.

The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer

