

# *Tax implications and issues for affected organisations*

**pwc**

*What would you like to grow?*

The devastation caused by recent flooding throughout Australia will impose many challenges that must be faced by individuals, businesses and the community at large

While the immediate issue to focus on is the provision of immediate and meaningful assistance to those most in need, there are any number of taxation implications arising directly or indirectly from the devastation that will themselves need to be considered as the rebuilding of affected communities takes place

In this article we summarise some of the issues that will need to be considered particularly by the business sector.

## ***Boosting cash flow - tax administration and compliance issues***

The devastation caused by the recent floods will in many cases impact on business activity in the short to medium term, with a resulting reduction in cash flows. In such times, ensuring that tax payments are legitimately reduced and that available payment extensions are obtained will be of paramount importance to many taxpayers. Already, the Commissioner of Taxation has announced that businesses located within the flood affected areas (identified by postcode on the Australian Taxation Office (ATO) website) can obtain an extension of time to lodge their December 2010 monthly Business Activity Statement (BAS) and pay the tax shown in the BAS. The extension is from 21 January 2011 to 21 February 2011.

However, businesses affected directly or indirectly by the devastation should also consider the possibility of varying their Pay As You Go (PAYG) instalments to reflect any downturn in levels of profit from the business. Without formally requesting a variation, taxpayers will be required to pay instalments calculated by reference to business activity of prior years, and in many cases, payment of these amounts will have a material adverse impact on the cash flows of the business.

Businesses should review all of their tax obligations (whether Federal, State or Local Government) and ensure that where hardship concessions are available that these are promptly and properly obtained.

Lodging claims for refunds sooner rather than later is also an important consideration to keep in mind.

In many cases, the flood devastation will have destroyed not only property used in the business, but also records necessary to properly determine obligations with respect to taxation. Where records are destroyed or are incomplete it will be necessary for taxpayers to reconstruct the records, which, in many cases, will require obtaining information from third parties (such as banks and suppliers) and the making of informed estimates. Where records are recreated in this manner, it will be necessary in many cases to liaise with the revenue authorities to confirm the appropriateness of the methodology used. On its website, the ATO indicates that where records have been destroyed through flooding, the ATO will assist in reconstructing the records and taxpayers can register with the ATO for an assistance visit during which ATO officers will assist in the reconstruction process.

In addition to the ATO, the Office of State Revenue (OSR) in each of New South Wales, Queensland and Victoria have announced temporary relief from the payment of State taxes and the lodgment of returns for businesses affected by the floods in each relevant State. The details of the relief can be found on the relevant OSR website.

The government has also recognised the impact of the floods on cash flow for businesses. The Queensland and Federal Governments have made grants of up to \$25,000 available for Primary Producers and Small Businesses (defined as those with an ABN and less than 20 employees) directly impacted by the floods. More information can be found at [www.business.qld.gov.au](http://www.business.qld.gov.au) or [www.qraa.gov.au](http://www.qraa.gov.au). Low interest rate loans of up to \$250,000 are also available to fund the repair or replacement of plant & equipment, buildings or stock.

Finally, with legislation to implement the Government's flood levy currently before Parliament, businesses will need to monitor their obligations in this regard. The levy will be collected through the PAYG withholding and PAYG instalment payment systems applicable for the 2011-12 financial year. Accordingly, employers will need to apply a new PAYG withholding schedule in respect of relevant employee earnings for the 2011-12 financial year. Any persons who receive an Australian Government Disaster Recovery Payment in relation to the 2010-11 floods will be exempt from the levy.

## *Income tax issues*

The devastation caused by the recent floods across the nation will in many cases also create income tax issues requiring consideration. While not exhaustive, the following issues will need to be considered depending on the taxpayer's particular circumstances:

- Tax implications arising from the loss or destruction of business assets. In all cases the capital gains tax implications (CGT) will need to be considered including the possibility of 'rolling over' any capital gain arising as a result of insurance proceeds, to the acquisition of a replacement asset. In the case where the assets are 'depreciating assets' under the income tax law, a similar issue will arise with any gain (or loss) on destruction of the asset being treated for income tax purposes on revenue account.
- The tax treatment by business taxpayers of insurance recoveries.
- The adverse effect that the devastation may have on business asset values, with a resulting detrimental impact on the calculation of 'maximum allowable debt' under the thin capitalisation provisions of the income tax law.
- Whether expenditure incurred on rectification work is a deductible repair or alternatively, is on capital account and added to the cost base for tax purposes of the particular asset.
- The tax treatment of benefits provided to employees affected by the floods including implications under the income tax law and fringe benefits tax (FBT) law (including FBT exemptions for certain "emergency assistance").
- The implications arising from the injection of capital into businesses affected by the devastation including under the CGT rules (incorporating the value shifting rules), the thin capitalisation rules, the debt forgiveness rules and the tax loss rules (where in the case of a tax consolidated group a capital injection may adversely impact on the ability to claim certain tax losses as a deduction).
- The tax classification of capital expenditure on reconstruction activities and, in particular, whether the expenditure forms part of the cost of a 'depreciating asset' or an improvement to a building or is deductible under the 'black hole' business expenditure rules.
- Whether the Commissioner would exercise discretion to disregard non-compliance with the obligation to make minimum loan repayments under the deemed dividend rules applicable to private companies (Division 7A of the Income Tax Assessment Act 1936) in cases where non-compliance arises because of the affect of the devastation on cash flows.
- Whether discretionary relief can be obtained from the Commissioner under the non-commercial loss rules where the taxpayer's business activity has been adversely affect by floods.
- Setting up Workplace Giving Programs so that employees can provide donations through the payroll system.
- Whether individuals can obtain 'early access' to superannuation entitlements because of hardship caused by the devastation.
- The tax implications of employee severance payments.
- The tax deductibility of donations.

***For further details around these issues please contact  
Julian Myers on 07 3257 8711***

## *Indirect tax issues*

Assessing the GST treatment of transactions may provide opportunities to boost cash flow. Opportunities to consider include:

- Looking at debtors – if an account is likely to be unpaid as a result of the floods or because it is long overdue, businesses can claim back a refund of any GST they have previously paid to the ATO. They will also be entitled to an income tax deduction for the bad debt.
- Talking to creditors – if they are in a position to extend trade terms, some creditors may be prepared to issue tax invoices earlier so that GST credits can be claimed before creditors need to be paid.
- Looking at any accrued creditors – if businesses account on an invoice basis, they can claim the GST credit on those costs as long as they hold the tax invoice, even without paying their creditor.
- Looking at the proportion of private use of cars and equipment – if businesses have previously only claimed a small portion of GST on those items, but they are used in the business more than they originally thought, they are entitled to seek a refund of under-claimed GST.

***For further details around these issues please contact Tony Windle on 07 3257 8854.***

- Fuel Tax Credits - One cost to businesses that is likely to have significantly increased as a result of the floods is fuel, as businesses purchase excess amounts to operate machinery and equipment as part of flood mitigation, clean-up and reconstruction works. Businesses should ensure that they maintain records of all fuel purchases and correctly determine any entitlement to fuel tax credits.
- Reducing customs duty on imported equipment – Businesses should ensure that opportunities to reduce customs duty on imported equipment and stock are maximised. Often goods can be imported duty free, which may not always be picked up by customs brokers.

***For further details around these issues please contact Gary Dutton on 07 3257 8783 or Stephen Hobbs on 07 3257 8586.***

## *Transfer Pricing issues*

Examples of potential transfer pricing issues which may need to be considered include:

- Breaches of critical assumptions in APAs (e.g. lower than expected profits).
- One-off expenses related to flooding that may not be reimbursed by related parties.
- Delayed delivery of products and services to / from Australia and potential penalties under related party agreements.
- No insurance coverage for flood damaged inventory (e.g., which party bears the expense).
- Year-end adjustments for Australian entities with low risk transfer pricing models.
- Impact on group insurance premiums paid on related party or group-wide insurance coverage.
- Impact on financial results and breaches of financial covenants on arm's length debt test.

***For further details around these issues please contact Ben Lannan on 07 3257 8404.***

## *Research and Development Tax Concession on eligible restoration costs*

- The Research and Development Tax Concession allows companies to claim an additional deduction for expenditure upon eligible R&D activities and may include a cash rebate for small companies under the R&D Tax Offset.
- Responses to the devastating impacts of floods is likely to involve innovative solutions to problems caused by silt and sediment build up, contamination and destabilisation of soils and associated environments and the promotion of new knowledge in relation restoration and construction techniques.
- Responses satisfying that description may qualify for the R&D Tax Concession, however, early identification of such projects will assist in managing compliance with the R&D plan and contemporaneous documentation requirements (e.g. it is a requirement that R&D activities be the subject of an R&D plan that is prepared and authorised before the substantive activities involved in undertaking the project).

***For further details around these issues please contact Charmaine Chalmers on 07 3257 8896***

## *Legal issues*

Common legal issues to be considered include:

- Commercial contract commitments, including review and renegotiation of supplier and customer contracts as necessary.
- Obligations under existing loan and security arrangements.
- Access to new loan facilities and temporary finance arrangements.
- Contract interpretation (including rights and obligations under force majeure clauses).
- Consideration of other general legal risks and exposure.
- Impact on real property transactions - rights to terminate; insurance implications; financing.
- Leases - rent abatement provisions, insurance provisions, liability to reinstate, termination rights.
- Construction and planning issues - enforceability of construction contracts, environmental obligations.
- Employment issues.

***For further details around these issues please contact Benn Wogan on 02 8266 6240.***

## *Employment and staff issues*

In times of natural disaster, employers may be forced to shut down a workplace, either because access to the workplace is not possible, or where no useful work can be performed due to structural damage. Even where a workplace remains open, many employees may not be able to work, because they are unable to travel to work or because they are dealing with the effects of the natural disaster on their personal lives.

Businesses affected by the floods may encounter the following 'people' and 'employee' challenges:

- FBT issues on direct financial and other assistance programmes for employees.
- Setting up workplace giving programs.
- Managing OH&S risks.
- Maintaining records of workplace injuries.
- Managing employee rights and entitlements, e.g. in relation to business shutdown; employee absences; consultation with unions; requirements for flexible work arrangements or alternative duties.

***For further details around these issues please contact Allana Haiduk on 07 3031 9336.***