



## GST administration reform update

In the last two months we have seen some significant developments in the GST administration reform process, which arose from the Board of Taxation's review of the legal framework for the administration of the GST (see *TaxTalk GST Reform Special Edition* of 19 May 2009).

### Deferred start date for some key measures

On 19 January 2010, at a meeting with the Institute of Chartered Accountants in Australia (ICAA), Treasury announced that a number of GST administration reform measures which were expected to be in place from 1 July 2010 will not commence until 1 July 2011. The following measures are affected:

- adoption of the income tax self-assessment regime
- reforming the change of use adjustments (including Division 129 adjustments for changes in the extent of creditable purpose) to provide higher thresholds, fewer and shorter adjustment periods, and greater alignment with other adjustment rules
- allowing adjustments for pre-registration acquisitions

- reforming the treatment of tax law partnerships, including clarifying the GST treatment when a tax law partnership is formed or dissolved, or when it makes a supply or an acquisition
- simplifying the GST grouping membership interests rules (by replacing the current rules with principle based rules) and allowing grouping of non-operating holding companies, and
- introducing a reverse charge for supplies of going concerns and farmland.

The Treasury representatives also flagged some revisions which have occurred since the commencement of the consultation process, including:

- annual testing of the financial acquisitions threshold (FAT), which will now be considered as part of the financial services review, and
- the decision not to proceed with the Board's recommendation that recipients and suppliers should be able to rely on each other's rulings in relation to tax status of supplies between them, where they agree to provide their rulings to each other for this purpose.

### Legislation update

Two GST amendment Bills containing a range of amendments were granted Royal Assent on 24 March 2010. *Tax Laws Amendment (2009 GST Administration Measures) Act 2010* and *Tax Laws Amendment (2010 GST Administration Measures No 1) Act* include measures to:

- insert a new adjustment for third party rebates (e.g. a manufacturer's rebate which is paid directly to a customer)
- impose a four-year amendment period for claiming input tax credits and fuel tax credits
- clarify that taxpayers are able to defer the attribution of input tax credits (subject to the four-year rule above)
- allow residents of Australia's External Territories to claim refunds of GST or Wine Equalisation Tax under the Tourist Refund Scheme
- increase the range of entities entitled to act as a principal for GST accounting purposes
- clarify how a gambling operator's margin is calculated
- ensure that overpaid refunds of GST, luxury car tax or fuel tax are treated as an amount due and payable from the date of the overpayment, and
- ensure the GST treatment of a supply to an associate without consideration is as an input-taxed supply, a GST-free supply, or a financial supply where appropriate.

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On 18 March 2010, *Tax Laws Amendment (2010 GST Administration Measures No 2) Bill 2010* was introduced into Parliament. The Bill contains amendments to:

- allow entities to self-assess their eligibility to form, change and dissolve a GST group or GST joint venture, and to do so at any time during a tax period
- allow members of a GST group to enter into indirect tax sharing agreements with the representative member to limit the indirect tax law liabilities of the members for tax periods for which they are a member of the GST group (similar rules are also included for GST joint ventures)
- include indirect tax rulings and excise advice within the general tax rulings system, and
- simplify the requirements for a document to be a tax invoice, by replacing the current prescriptive list with equivalent, but more flexible, principles. It also integrates and streamlines the special requirements for tax invoices that are recipient created tax invoices (RCTIs).

These amendments were previously released as exposure draft legislation (as detailed in the February 2010 edition of *TaxTalk*). The Bill differs to the exposure draft in some respects, with the most significant changes being in relation to the inclusion of RCTIs in the simplified tax invoice requirements rules.

## Further exposure draft released

On 26 February 2010, the Assistant Treasurer released for public comment draft legislation aimed at improving the operation of the GST law by streamlining its application to the domestic transport of imported and exported goods. The proposed amendments are intended to:

- reduce the involvement of non-residents in the Australian GST system
- improve consistency in the GST treatment of postal and non-postal containerised goods, and
- assist domestic sub-contracted transport suppliers with GST compliance.

## Where to from here?

The new timeframe means that of the 41 recommendations by the Board of Taxation which were originally accepted by the Government, around a dozen are still intended to apply from 1 July 2010. For 8 of these we have legislation, Bills before Parliament, or exposure draft legislation.

We have also seen the proposed legislation for a further 5 measures with start dates other than 1 July 2010. As a result, there is now sufficient information for organisations to start considering how they will be affected by the proposed amendments, including whether there are transitional issues which need to be considered prior to 30 June 2010.

Federal Parliament resumes on 11 May 2010 for the Federal Budget, with five sitting weeks for the House of Representatives and three for the Senate scheduled before the end of June. There are significant income tax changes also expected to be in place by 1 July 2010, so we anticipate a lot of activity in the coming months. However we are hopeful that the new timetable for the GST administration reforms should allow for legislation to be in place before the end of the financial year for those measures with a 1 July 2010 start date.

The welcome deferral of the start date for the items listed above will also allow more time for consultation on these significant measures, including how they will interact with the reforms which will already be in place.

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## Metrics and motivation

This year we have been running a series of articles in *TaxTalk* on the operational aspects of running a 'tax function'. This month we discuss the metrics commonly used by tax departments, whether they are driving the optimum behaviour for the organisation, and some ways to motivate your team.

### Metrics

An organisation's tax strategy is the blueprint against which the longer-term performance of a tax function should be measured. As such, the key performance indicators (KPIs) for each individual within the tax department need to be aligned with this tax strategy and reflect the key strategic goals of the business and other head office functions. When this alignment is in place, an organisation can be confident that its tax function is heading in the desired direction.

Therefore it is extremely important to identify the right performance measures for the tax function. The goals of most tax functions fall within one of the following categories:

- compliance and reporting
- risk management
- business partnering
- value creation, and
- people.

In addition, any performance measure should be SMART (Specific, Measurable, Acceptable, Realistic and Timely).

### What are groups typically measuring?

Our experience is that the most common performance measures are based upon the following:

- filing of tax returns on time
- tax return adjustments
- keeping to cost budget
- internal customer satisfaction
- achieving a certain Australian Taxation Office risk rating
- group risk measures
- value added by tax function
- effective tax rate management
- analysis of the structural/natural rate analysis
- cash tax payments
- competitor comparison
- raising the profile of the tax function internally, and
- external profile (i.e. lobbying).

While there is nothing wrong in principle with using any of the above measures, some of them are not focused on value. For example, it is relatively easy to file

your tax returns on time, and while this may eliminate late filing penalties, there is no quality measure included within this goal. The goal does not measure success in identifying the tax planning opportunities contained within the return, or how well your tax returns will withstand Tax Office scrutiny during a subsequent tax audit (i.e. will you be forced to make adjustments which will increase your effective tax rate in future years?).

### Balanced scorecard approach

Increasingly, organisations are using balanced scorecard metrics for their tax function. This approach uses both financial and non-financial measures to assess performance. As well as the traditional financial measures, there is usually a focus on both ‘customers’ (e.g. customer surveys, service level agreements) and staff (e.g. morale, retention, learning and growth, knowledge sharing, personal development).

### Evidencing value

Many ‘in-house’ tax professionals feel that the importance of their function is not appropriately recognised within their organisation. Tax may no longer report directly to the Chief Financial Officer (CFO), or the Head of Tax may not be a member of the senior management community. Often this is because the organisation does not appreciate the

value its tax function can add. It should be noted that ‘value’ takes many forms – for example, managing risks well adds value to an organisation (i.e. value protection). Similarly, identifying and executing tax planning opportunities adds value to an organisation (i.e. value creation).

Well-designed metrics, which are stretch goals, can be an effective way to help the tax function evidence their value to the organisation. This will strengthen the department’s position when negotiating for more resources, promotions, pay rises and so on. It is also important to communicate the tax team’s achievements regularly. Often a Chief Executive Officer or CFO will only hear about tax when something negative happens, but sometimes the message that “no news is good news” needs to be reinforced.

## Motivation

A recent survey by Chandler Macleod found that an astonishing 73 per cent of all employees in Australia are actively looking for work, and a further 22 per cent are passively looking or open to offers. This statistic is probably driven, at least in part, by the sacrifices that employees have had to make in recent times as a result of the global economic crisis. Clearly, if a tax function wants to retain its best people at a time when

the ability to increase remuneration is constrained, it must find other ways to ensure staff remain motivated.

Another survey by McKinsey showed that for many employees, the following are more effective motivational tools than financial incentives:

- praise and commendation from their immediate manager
- attention from leaders, and
- opportunities to lead projects.

Therefore, now more than ever, managers should explore opportunities to use these and other non-financial tools. In addition, they should ensure that staff can see a clear plan for their skills development, a variety of work, and possibly the potential to rotate roles or go on secondment outside the tax function, to help their team remain motivated.

## Summary

Most tax functions have formal performance measures in place. However, many of these measures still focus on the basics rather than the real value a tax function adds. If a tax function wishes to raise its profile internally, it should welcome and suggest stretch goals which allow it to demonstrate the value that tax brings to the organisation.

Furthermore, to ensure that staff are motivated and loyal to an organisation as we emerge from the global financial crisis, Heads of Tax need to employ a range of non-financial tools and ensure that they are truly in touch with their teams.

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## High Court decision for Bamford case – appeals from Federal Court dismissed

On 30 March 2010 the High Court handed down its decision in the Bamford case (*Commissioner of Taxation v Bamford* [2010] HCA 10) and dismissed both the Commissioner's and the taxpayer's relevant appeals from the Full Federal Court.

As explained in our TaxTalk article (July 2009) the Bamford case concerned the meaning for tax purposes of the phrases "share of the income of the trust estate" and "so much of that share of the net income of the trust estate".

With respect to the first phrase, the Commissioner submitted to the Court that "income" meant income according to ordinary concepts. The High Court

disagreed and held (as the Full Federal Court had held) that the phrase directs attention to the process in trust administration by which the share is identified and entitlement established.

With respect to the second phrase the High Court agreed with the view of the Full Federal Court that in determining the share of the net income, the proportionate rule applies. Thus, a beneficiary's percentage entitlement to income of the trust estate is used in determining the beneficiary's share of the trust's net income.

A detailed analysis of the Bamford case will be included in the May 2010 edition of *TaxTalk*.

## Another recovery weapon for the Commissioner

Foreign companies planning to operate in Australia for limited periods of time face the potential of having to provide security to the Commissioner of Taxation in respect of future tax liabilities, under legislation introduced into Parliament on 17 March 2010. Failing to provide the security will be an offence with penalties of \$11,000 for individuals and \$55,000 for companies.

Under the proposed new Subdivision 255-D of Schedule 1 to the *Taxation Administration Act 1953*, which will commence from 1 July 2010 (and which replaces section 213 of the *Income Tax Assessment Act 1936*), the Commissioner may require a taxpayer to give security for the payment of an existing or future tax-related liability if he has reason to believe the taxpayer intends to carry on an enterprise in Australia for a limited time only. There is no limit on the amount of security the Commissioner can require, nor on when he can require it to be provided.

A press release issued by the Assistant Treasurer (see 'Legislation update' of this *TaxTalk*) about this legislation focuses on these provisions being part of a crackdown on phoenix business activity.

The Explanatory Memorandum (EM) states in part: "The Commissioner may ask for security where he or she believes there is a serious risk of a tax-related liability not being paid".

Examples of such situations include:

- where a taxpayer plans to temporarily carry on an enterprise in Australia and leave without returning
- where the taxpayer has a history of non-compliance, and
- to protect the integrity of the tax system against schemes such as 'fraudulent phoenix activity'.

The proposed legislation is silent, however, on the need for a serious risk of non-payment of a tax-related liability. It is sufficient that the Commissioner simply believes the taxpayer will operate its enterprise for a 'limited time only', which is not defined. The EM states that the Commissioner must consider all relevant matters and act reasonably in respect of requiring security, but there is no guidance as to what amounts to a 'serious risk' of non-payment. A taxpayer who is required to give security by the Commissioner can seek judicial review of that decision in the Federal Court.

Given recent statements made by the Commissioner about the operation of foreign ‘private equity’ firms in Australia (see Draft Taxation Determination TD 2009/D18), it is not hard to imagine the Commissioner making use of these powers in circumstances where he believes a private equity firm should be taxed on profits made in Australia on an income rather than on a capital basis.

The Commissioner will need only to provide a written notice to a taxpayer requiring security for a future tax liability, and the notice will be deemed to be served when it is posted rather than received by the taxpayer. This will be much simpler for the Commissioner than having to go to court to seek an injunction or seeking to recover funds from a third party.

If this proposed legislation becomes law, it will be another significant weapon in the Commissioner’s arsenal of recovery methods.

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## The revenue authorities are focused on contractors...are you?

Determining whether a worker is an employee or contractor is complex, with the employment tax (PAYG Withholding, Payroll Tax, Workers’ Compensation and Superannuation Guarantee) implications and considerations differing for each tax. In our experience, employment tax compliance on contractors is a significant area of exposure – equally for public and private organisations.

There is currently unprecedented focus on contractors by both the Australian Taxation Office (ATO) and the various State Revenue Authorities, through targeted questionnaires and audit programs. This is in addition to the Superannuation Hotline, which facilitates workers reporting employers where they consider they should have been paid superannuation. Our understanding is that this hotline is utilised regularly.

Organisations often make the mistake of assuming that independent contractor payments do not give rise to the various employment tax obligations. Common misconceptions include:

- If an individual has an Australian Business Number and is an independent contractor, they are not entitled to Superannuation.

- If an individual is engaged through an incorporated entity, payroll tax liability is avoided.
- If an individual is an independent contractor, they do not need to be covered by Workers’ Compensation insurance.

One particularly common misconception is that, as long as a worker does not do more than 80 per cent of his or her work for one engagement, the worker is an independent contractor and employment taxes do not apply. This 80 per cent rule is a myth!

Another key risk is the absence of effective contractual documentation, placing doubt over the contractor classification of the worker. This is a particular risk where the contractor claims to operate through an interposed entity. The ATO, in particular, has a clear view on ‘sham’ contractor arrangements.

If you consider that your organisation has contractors under control ask yourself the following question – are your processes and systems which identify, record and report contractor payments as robust as your payroll processes and systems to accurately identify, record and report



employee payments? Experience shows that many organisations may not even be aware of how many contractors they have, who within the organisation has engaged them or where they are located, let alone have specific data to assess whether payroll tax or superannuation guarantee applies.

Organisations engaging contractors need a ‘contractor management system’. Without a tailored contractor management system, supported by appropriate drafted contractual documentation and guidance materials, organisations are unlikely to comply with their employment tax obligations. When organisations are approached by the ATO or State Revenue Authority, they need to be able to demonstrate such a system and produce the requested data in a reasonable timeframe. Under current

employer obligation audits, the ATO is currently requesting the information below (from up to six years ago!) in relation to contractors:

- contracts
- tax invoices
- accounts records of contractor payments made
- timesheets, rosters and attendance registers, and
- cheque butts, electronic fund transfer advices, bank statements, cash books, cash payments journals and petty cash vouchers.

Most employers struggle to produce the necessary documentation to demonstrate an efficient system for managing contractor payments.

## Corporate tax developments

### Capital gains on termination of distribution agreement

On 10 March 2010, Justice Sundberg delivered his decision in the case of *Orica Limited v Federal Commission of Taxation* [2010] FCA 197. The case considered the capital gains tax (CGT) rules in the *Income Tax Assessment Act 1936* and not the CGT rules as now contained in the *Income Tax Assessment Act 1997* (albeit these rules are similar in many respects with the earlier rules).

The case focussed on whether the taxpayer (Orica) realised a taxable capital gain on the ‘disposal’ of a distribution agreement (DA) or the rights thereto, pursuant to which Orica was authorised by Zeneca (the other party to the agreement) to distribute certain products. The DA was signed in 1993 (1993 agreement) upon the termination of an existing distribution agreement entered into in 1935 (1935 agreement) between Orica and its overseas parent.

In the event that there was a disposal for CGT purposes, the Court also had to consider whether the amount determined by the Commissioner as the ‘consideration’ was excessive. In this respect, the capital gain assessed by the

Commissioner for the tax year ending 30 September 1998 (the relevant tax year) was in the amount of \$264,540,764, whereas the taxpayer appears to have returned no capital gain for that year.

In summary, the Court held that there was a disposal of the DA, but that the amount determined by the Commissioner as consideration for the disposal was excessive. In this respect, the Court was of the view that the amount used should have been \$250,500,000, being the market value of the DA as determined by the Commissioner’s expert witness. Accordingly, the Court concluded that the underpaid tax amounted to approximately \$90 million, and that the administrative penalties payable to the Commissioner on this ‘tax shortfall’ were \$22,545,000.

When the business carried on by one of its subsidiaries (Orica Aust) was sold to another taxpayer (Zeneca BV) for valuable consideration, Orica agreed to assign its rights under the DA to Zeneca BV. With regards to the assignment, the Commissioner assessed Orica on the basis that there was a capital gain, with the consideration for the disposal of the DA being the market value of the release obtained by Orica from Zeneca in respect of Orica’s obligations under the DA. The Commissioner appears to have determined



a market value of the release to be somewhere in the vicinity of \$265 million.

In the course of proceedings, Orica made a number of submissions to the effect that it had not disposed of the DA, and therefore should not be assessable on the capital gain as determined by the Commissioner. One of these submissions was that, in effect, Orica did not own the rights to the DA in the tax year in question (and therefore could not have disposed of the rights) because the rights were owned by Orica Aust which had, in 1979, acquired Orica’s business assets. Orica thus submitted that this transaction in 1979 effected a transfer of the 1935 agreement to Orica Aust, and that accordingly, the 1993 agreement, while

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entered into by Orica, actually belonged to Orica Aust. This submission was dismissed by Justice Sundberg, who held that while the business of Orica had been transferred to Orica Aust in 1979, the rights under the 1935 agreement and the 1979 agreement belonged to Orica. Under those agreements, Orica Aust, as a subsidiary of Orica, was authorised to distribute products covered by the agreements.

After dismissing the taxpayer's submissions that there was no disposal of an asset by Orica for CGT purposes, Justice Sundberg found that there was a 'disposal' when the DA was dealt with under the Assignment Deed. Specifically his Honour held that the assignment deed entered into by the parties effected a novation of the DA, such that Orica's rights under the DA were cancelled or discharged, and Zeneca BV and Zeneca became bound by a new agreement in the same terms as the DA. Based on this view, the rights belonging to Orica under the DA were not transferred by Orica to Zeneca BV. As discussed below, this aspect of the decision had an important bearing on the calculation of the capital gain arising from the disposal.

Having concluded that Orica disposed of the DA by cancellation or discharge, Justice Sundberg agreed with submissions by the parties that the release received by Orica from Zeneca in respect of its obligations under the DA

was a chose in action, and that for CGT purposes, the release (being a proprietary right) was the 'consideration' for the disposal. However, after considering the 'deemed consideration' provisions in the CGT rules, his Honour held that since the DA was not transferred from Orica to Zeneca BV (but was simply cancelled or discharged), the market value of the actual consideration (the release) was replaced with the market value of the asset disposed of, because the market value of the actual consideration was greater than or less than the market value of the asset disposed of.

In rejecting the submissions by Orica and its expert valuer that the market value of the DA was nil, Justice Sundberg accepted the valuation prepared by the Commissioner's expert that the market value of the DA was \$250.5 million. Since, according to his Honour, the market value of the release (i.e. the actual consideration) was less than \$250.5 million (and also less than the amount used by the Commissioner in assessing Orica), the deemed consideration for disposal of the DA was \$250.5 million. Since his Honour also held that Orica's view (that the DA was valueless) was not 'reasonably arguable', penalties were correctly imposed at 25 per cent of the tax shortfall to be calculated using the deemed consideration and not the amount used by the Commissioner in the assessment.

At a time when multinational enterprises are likely to be considering changes to arrangements affected by the global financial crisis, this decision highlights the need to carefully evaluate transactions. In particular, taxpayers need to carefully consider CGT and the possibility that the 'deemed consideration' provisions may apply. The decision also provides a useful insight into the way in which the Court deals with valuation evidence and the penalty implications where the valuations used by the taxpayer are rejected by the Court.



## Commissioner unsuccessful in dispute with BHP Billiton Finance

On 17 March 2010, the Full Federal Court in *Commissioner of Taxation v BHP Billiton Finance Limited* [2010] FCAFC 25 dismissed the Commissioner's appeal from the decision at first instance of Justice Gordon (see *BHP Billiton Finance Limited v Commissioner of Taxation* [2009] FCA 276). In summary, the Full Court agreed with Justice Gordon that the taxpayer (Finance) was entitled to claim deductions for the write-off of debts owing to Finance by other companies within the BHP Billiton Limited (BHPB) group of companies (BHPB Group).

Briefly, Finance was, at all relevant times, the internal financier to the group of companies headed by BHPB. It was incorporated as a wholly owned subsidiary of BHPB "for the purpose of borrowing funds to re-lend to Group companies". It was registered as a financial institution and a short-term money market dealer / operator for the purposes of the *Financial Institutions Duty Act 1982 (Vic)* and section 98I of the *Stamp Duties Act 1920 (NSW)*.

From the early 1990's, virtually all external borrowings of the BHPB Group to fund activities and projects were undertaken by Finance. The interest rate



charged on loans from Finance to BHPB Group companies was higher than the interest rate at which it borrowed those funds. Finance did not have its own staff. It utilised the services of BHPB for which it paid management fees. Most of the services provided by BHPB were accounting and treasury personnel.

Relevantly, in 1994 and 1995 Finance granted loans to BHP Billiton Direct Reduced Iron Pty Ltd (BHPDRI) in relation to the construction and operation of a hot briquetted iron plant and to Titanium Minerals Pty Ltd (BHPTM) in relation to the development of a titanium mine. The loans were made in accordance with Finance's standard lending terms.

Letters of comfort were issued in 1995, 1997, 1998 and 1999 whereby BHPB undertook to BHPTM to ensure that

BHPTM was provided with sufficient funds to pay certain debts. These letters expressly provided that they were not to be relied upon by any other person than BHPTM. The 1999 comfort letter was revoked before the write-off by Finance of the debt owing. The Court did not make a finding as to whether any of these letters had effect to the written off debt at the time of write-off.

In 2000, the mentioned projects of BHPDRI and BHPTM had not been successful. Finance wrote off as bad part of the debt owed by BHPDRI (approx. \$1.8 billion of the total debt of \$2.2 billion) and part of the debt owed by BHPTM (approx. \$311 million of \$339 million). Subsequently, Finance wrote to both the directors of BHPDRI and to BHPTM advising of the loan write-off and that following the write-off, the directors of Finance had resolved not to take any further action to recover the debt written off (as it appeared practically irrecoverable) but that Finance reserved the right to recover the balance.

Two consequential steps for tax purposes were taken. First, Finance claimed as a deduction (as a bad debt) the amount written off pursuant to section 25-35 of the *Income Tax Assessment Act 1997* (ITAA 1997). Secondly, BHPB (as the head company of the consolidated group including BHPDRI and BHPTM) applied the debt

forgiveness provisions of the tax law to those write-offs but not the provisions concerning limited recourse debt in Division 243 of the ITAA 1997. The Commissioner issued an assessment to disallow the deductions.

On appeal against the Commissioner's objection decision (disallowing Finance's objection), the Federal Court at first instance held that Finance was entitled to a deduction. On appeal, the Full Federal Court found in favour of Finance and dismissed the Commissioner's appeals. The Court agreed with Justice Gordon that a deduction was allowed for the amount written off as bad and that the general anti avoidance provision (Part IVA of the *Income Tax Assessment Act 1936*) did not apply to otherwise disallow that deduction. The Court also found that from the borrower's perspective, the debt was not 'limited recourse debt'.

The following are some of the important observations arising from the decision by the Full Court:

- The Court rejected the Commissioner's submissions that Finance was not in the business of money lending and also the submission that whether or not Finance was in the business of lending money, there was insufficient evidence to establish that the advances made to BHPDRI and BHPTM were made in the ordinary course of Finance's business.

On this point, that Court found that the advances were in the ordinary course of Finance's business, which consisted of "borrowing money from external sources and from entities within the Group and lending the funds so borrowed to other entities in the Group at a margin over its cost of funds".

- The Court held, in the alternative, that the written-off debts were deductible under the general deduction provision (section 8-1 of the ITAA 1997) as losses (not being losses of capital or of a capital nature) incurred by Finance, in the year of income in which they were written off, in carrying on business for the purpose of gaining or producing assessable income.
- In confirming that Part IVA did not apply, the Court also observed, in relation to the question of the 'dominant purpose' of the scheme, that "*in the face of the Commissioner's concession ... that the most obvious and simple commercial solution is what transpired – the writing off of the TM debt by Finance – it is difficult to envisage that any of the matters to which one is mandated to have regard in s177D(b) [of Part IVA of the ITAA 1936] viewed alone, together or in the aggregate, would point to a conclusion that the sole or dominant purpose of Finance or any other party which entered into or carried out*

## Goods and Services Tax (GST) Developments

the identified scheme was to obtain for Finance the relevant allowable deduction”.

- The Court upheld the judgment of the Court at first instance that Division 243 of the ITAA 1997 did not apply to the BHPDRI debt, i.e. the debt was not ‘limited recourse debt’ under Division 243. In this respect, the Court was of the view that in determining whether a debt was ‘limited recourse debt’, using the criterion of whether the borrower is fully at risk in relation to expenditure (rather than one based on the borrower’s financial resources) sits more comfortably with the common language used in the provision defining ‘limited recourse debt’. That is, the rights of the creditor as against the debtor are limited.

### Exposure draft on global roaming by visitors to Australia

On 23 March 2010, the Assistant Treasurer released for public comment draft legislation to ensure that access to global roaming telecommunications services by visitors to Australia remains GST-free, in accordance with Australia’s obligations under the International Telecommunication Regulations (the Melbourne Agreement).

In particular, the exposure draft contains measures to ensure that the following supplies of mobile telephone global roaming and mobile internet roaming services are GST-free:

- the supply, made by an Australian resident telecommunications supplier to a non-resident telecommunications supplier, of use of its network in Australia, and provided to subscribers of the non-resident telecommunications supplier when visiting Australia, and
- the supply by the non-resident telecommunications supplier of global roaming facilities made to its subscribers visiting Australia.

The amendments are proposed to apply, retrospectively, to supplies made on or after 1 July 2000.

The draft legislation takes into account the views expressed by stakeholders during the consultation process on an earlier draft of the legislation which was released in December 2008. The current consultation closes on 13 April 2010.

### Appeal news

- The taxpayer in the *Travelex Ltd v Commissioner of Taxation* [2009] FCAFC 133 has been granted special leave to appeal to the High Court. The case concerns the GST treatment of the supply of foreign currency on the ‘airside’ of the customs barrier, and in particular whether the supply is GST-free as a supply made in relation to rights which are for use outside Australia. It is anticipated that the appeal will be heard in May 2010.
- In the last edition of *TaxTalk*, we reported the Federal Court’s decision in *Sunchen Pty Limited v Commissioner of Taxation* [2010] FCA 2 on the meaning of the term ‘predominantly for residential accommodation’. The Federal Court found in favour of the Commissioner, and the taxpayer has

subsequently lodged an appeal to the Full Federal Court.

The outcome and key implications of both of these appeals will be reported in future editions of *TaxTalk*.



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## International developments

### Tax information exchange agreement with Saint Christopher and Nevis

On 12 March 2010, the Assistant Treasurer issued a media statement advising that a Tax Information Exchange Agreement (TIEA) was to be signed with the Caribbean state of Saint Christopher and Nevis (St Kitts and Nevis) and when signed, will be Australia's thirteenth TIEA with an overseas jurisdiction.

In issuing the media statement, the Assistant Treasurer said that Australia's access to offshore tax and banking information had been significantly enhanced with the new TIEA with St Kitts and Nevis, and the entry into force of agreements with Jersey, Antigua & Barbuda and the Isle of Man.

### Amended tax treaty with Malaysia

On 24 February 2010, the Assistant Treasurer issued a media statement advising that an amended tax treaty between Australia and Malaysia had been signed, enabling the greater exchange of information on potential tax abuse. According to the media

statement, the protocol signed by the Assistant Treasurer amends the existing tax treaty between the two countries, allowing the exchange of a broader range of information, including banking details and transactions. The Assistant Treasurer said that the protocol "will support global cooperation on tax matters and improve information exchange and transparency – important priorities for the G20 and the work of the Global Forum on Tax Transparency, which Australia chairs".

Under the terms of the protocol, the Australian Taxation Office will be able to request information relevant to the imposition of all Australian federal taxes, including the goods and services tax. It is proposed that legislation will be introduced into Parliament in relation to the expanded protocol as soon as practicable.

### Legislation passed to give effect to international agreements

On 25 February 2010, the Assistant Treasurer announced that the *International Tax Agreements Amendment Bill (No. 2) 2009* had passed through the Parliament. This Bill enacts Australia's new tax treaty arrangements



with New Zealand (August 2009) and also with the European jurisdictions of Belgium and Jersey (July 2009).

The New Zealand agreement (refer August 2009 edition of *TaxTalk*) is a comprehensive tax treaty which will replace the current treaty between Australia and New Zealand when it enters into effect.

The Belgian agreement (refer August 2009 edition of *TaxTalk*) is a protocol which will amend the existing Australia-Belgium tax treaty by upgrading the 'exchange of information' article to the current international standard.

The Jersey agreement (refer July 2009 edition of *TaxTalk*) will allocate taxing rights between Australia and Jersey over certain income derived by retirees, government employees and students, and provide a mechanism to help resolve transfer pricing disputes.

The Bill enacts into law these three agreements by inserting the text of each agreement into the *International Tax Agreements Act 1953* and will come into force at Royal Assent.

### Tax information exchange agreement with San Marino

On 5 March 2010, the Assistant Treasurer announced the signing of a tax information exchange agreement (TIEA) between Australia and San Marino that will allow the two countries to exchange taxpayer information.

According to the media statement, the "agreement with San Marino meets the requirements of tax information exchange standards developed by the OECD and endorsed by the G-20 and the United Nations". The TIEA will enter into force after Australia and San Marino have completed their respective domestic requirements.

## Australia and Chile sign new tax treaty

On 10 March 2010, the Assistant Treasurer announced that Australia and Chile have signed a new income tax treaty – the first between the two countries. Legislation to give the new treaty the force of law will be introduced into the Parliament as soon as practicable.

According to the media statement, after entry into force, the provisions of the new tax treaty will take effect in Australia in four stages, namely:

1. in respect of withholding tax, on income derived on or after the first day of the second month following entry into force
2. in respect of fringe benefits tax, on fringe benefits derived on or after 1 April in the year following entry into force
3. in respect of other tax, on income derived in the year beginning 1 July following entry into force, and
4. in respect of administrative provisions, upon entry into force.

Key aspects of the treaty include:

- Reductions in source-country withholding taxes on certain cross-border payments of dividends, interest and royalties

- Rules to determine when an enterprise or an individual of one country may be taxed on its activities abroad
- An agreed basis for determining the allocation of profits within a multinational company to reflect the pricing that would be adopted by independent parties. These rules are an important tool in dealing with international profit shifting through transfer pricing
- Rules that ensure that profits derived from the operation of ships and aircraft in international traffic are generally taxed only in the country of residence of the operator. Also, income derived by crew members from employment exercised aboard an aircraft operated in international traffic is only taxable in the cabin crews' country of residence
- Rules for the taxation of income, profits or gains from the alienation of property
- Provisions that ensure that pension and retirement annuities are taxed only in the country of residence of the recipient
- A general obligation for both countries to relieve double taxation on cross-border income by permitting tax paid under the other country's laws, and in accordance with the proposed treaty, to be allowed as a credit against tax payable under their own laws
- Mechanisms through which the Australian and Chilean administrators may by mutual agreement resolve tax disputes and relieve double taxation
- Rules to protect nationals and companies of one country from tax discrimination in the other country
- A framework to provide for the full exchange of taxpayer information, and
- Special rules to preserve the application of existing tax arrangements between Chile and Australian companies under the provisions of the Chilean legislation DL 600 (Foreign Investment Statute). This is of particular importance to Australian mining companies with investments in Chile.

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## State taxes

### Queensland: First home-owner cap and 'top-hatting' relief

On 9 March 2010, the Queensland Treasurer announced that he had introduced legislation into the Queensland Parliament (the *Revenue and Other Legislation Amendment Bill 2010*) that will cap the State Government's \$7,000 First-Home Owner's grant to homes worth up to \$750,000. The Treasurer said that the current cap of \$1 million has applied since the start of the new year, but this legislation would restrict it further from 31 March 2010.

In the same media statement, the Treasurer advised that the legislation also introduced measures to increase business investment in Queensland by providing relief from duties paid to facilitate the restructure of 'stapled entities'. The Treasurer said that "this will simplify present investment structures for Australian Real Estate Trusts, and also provide exemptions for the so-called 'top-hatting' of land rich corporations, listed public unit trusts and widely held public unit trusts".

For further details on 'top-hatting' relief, see our *TaxTalk* special edition dated July 2008.

The *Revenue and Other Legislation Amendment Bill 2010*) also proposes a significant number of other changes including:

- Broadening the tracing rules for trust look through duty, land rich duty and corporate trustee duty in respect of agreements to acquire an interest in a trust;
- retrospective amendments dating back to 14 January 2010 (as previously announced by the Queensland Treasurer) to the insurance duty provisions affecting global insurance policies, captive insurers and life insurance riders;
- retrospective amendments dating back to 13 August 2004 broadening the scope of the change in trustee exemption;
- expanding the Managed Investment Scheme exemption for transfers between responsible entities and custodians;
- changes to restrict the application of corporate reconstruction rules in respect of restructures involving subdivision of land arrangements;
- broadening the cancelled transfer exemption to apply circumstances where a transfer instrument is cancelled prior to registration;
- changes to the wholesale trust rules concerning the definition of insurer relevant to the concept of a funds manager; and

- expanding the Commissioner's ability to register first ranking charges over land to secure payment of unpaid land rich duty.

## Western Australia: pay-roll tax amendments

On 24 February 2010, the *Pay-roll Tax Assessment Amendment Bill 2010* was introduced into Parliament. The Bill seeks to implement:

- a package of measures aimed at achieving a greater level of harmonisation in a number of areas of the pay-roll tax regime between Western Australia and the other States and Territories, such as the timing of the lodgment of returns; the motor vehicle allowances exemption; the accommodation allowances exemption; the treatment of fringe benefits; the treatment of employee share acquisition schemes; the treatment of services performed outside a jurisdiction and the treatment of superannuation contributions. Harmonisation changes to grouping are to commence at a later date.
- two new exemptions announced in the 2009-10 Budget for wages paid in relation to parental or adoption leave and specified emergency services volunteers, and
- new nexus arrangements that govern where tax is to be paid when services



are provided in more than one jurisdiction in a month. Generally, the changes will only affect employers that have employees who provide services in more than one jurisdiction in the course of a month. Where that is the case, the employer is to determine where the tax is payable by reference to the principal place of residence of the relevant employee. A number of further nexus provisions have been included in the relevant provisions to deal with situations where the employee's principal place of residence is not located in Australia. The new nexus arrangements will commence on the date of Royal Assent, however, the transitional provisions apply these changes as if the provisions had commenced on 1 July 2009.

## Western Australia: Revenue laws amendment

On 10 March 2010, the *Revenue Laws Amendment and Repeal Bill 2010* and the *Revenue Laws Amendment Bill 2010* were introduced into Parliament.

The *Revenue Laws Amendment and Repeal Bill 2010* proposes to:

- put in place simplified arrangements for the lodgment of documents and payment of transfer duty under the *Duties Act 2008* (WA) (the Duties Act);
- improve the operation of the partnership provisions of the Duties Act;
- clarify the timing of lodging an application for an entity restructuring exemption under the Duties Act;
- allow a fee to be charged to offset the merchant fees incurred when payments are made to government by credit card;
- strengthen the confidentiality provisions of the *First Home Owner Grant Act 2000* (WA) and the *Taxation Administration Act 2003* (WA) to ensure that information relating to taxpayers and grant applicants cannot be assessed by unrelated third parties;
- make other minor amendments to the *Taxation Administration Act 2003* (WA) to improve the administration of the revenue statutes; and

- repeal debits tax legislations which have ceased to impose and collect debits tax since 1 July 2005.

The *Revenue Laws Amendment Bill 2010* proposes to:

- make a minor change to the superannuation provisions of the Duties Act, such that a nominal assessment will only be available to transfer of dutiable property from the trustee of a superannuation fund to a member of that fund where there is no consideration paid;
- close a potential loophole in the entity restructuring provisions of the Duties Act, such that the exemption will not be available to certain landholder transactions that do not involve members of a “family” (as defined in the Duties Act for entity restructuring relief purposes); and
- delay the abolition of transfer duty on non-real business assets until 1 July 2013.

## Personal taxation

### Non-commercial losses: income from income protection policy was not business income

On 4 March 2010, the Full Federal Court in *Watson v Deputy Commissioner of Taxation [2010] FCAFC 17* dismissed the appeal by the taxpayer against the decision of Justice Mansfield (see *Watson v Deputy Commissioner of Taxation [2010] FCA 1173*). In that earlier decision, Justice Mansfield had held that the income received by the taxpayer under an ‘income protection’ insurance policy was not income derived from the business activity carried on by the taxpayer as a financial planner. This was despite the fact that the taxpayer had taken out the policy to protect against the possibility that he may at some future time not be in a position to actively carry on the financial planning business because of illness or incapacity.

The effect of the decision in favour of the Deputy Commissioner was that the excess of allowable deductions in the year from the business over the fee and commission income derived from the business could not be offset for tax purposes against the income from the

policy. Rather, the excess was required to be carried forward to a later year under the ‘non-commercial loss’ rules in the taxation law for offset only against the income from the financial planning business. Therefore despite incurring a ‘business loss’ in the year, the taxpayer was fully taxable on the income received under the policy.

In reaching its decision, the Full Court considered the use of the words “income from the business activity” in the non-commercial loss rules. In stating that it could not see a basis for concluding that the taxpayer would lose the right to receive the policy income if he ceased to carry on the business, the Court said that the policy income was received because the taxpayer was unable to undertake the full range of business activities which he would have undertaken had he not fallen ill. Therefore the income was derived from his incapacity to conduct business activity, not from the activity which he actually undertook. The income was therefore not *from* his business activity in the relevant year.

An implication of the decision is that taxpayers affected by the non-commercial loss rules will need to carefully evaluate the basis on which income may be regarded as income derived from the relevant business activity.



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## Legislation update

*Tax Laws Amendment (2010 Measures No 2) Bill 2010* was introduced into Federal Parliament on 17 March 2010. The Bill includes measures to:

- With effect from 1 July 2009 amend Division 7A of the *Income Tax Assessment Act 1936* to prevent a shareholder (or their associate) of a private company accessing tax-free 'dividends' from the provision of company assets for less than their market value; extend the application of Division 7A to closely held 'corporate limited partnerships' and non-resident private companies; and modify the 'unpaid present entitlement rules' in Division 7A'
- extend the existing tax file number (TFN) withholding arrangements to cover 'closely held trusts', including 'family trusts'
- exempt from income tax the value of benefits received under HECS-HELP
- remove certain unlimited amendment periods in the income tax law
- update the list of deductible gift recipients, and
- make the Global Carbon Capture and Storage Institute Limited exempt from income tax for a four-year period.

*Tax Laws Amendment (Transfer of Provisions) Bill 2010* was introduced into Federal Parliament on 17 March 2010. The Bill includes measures to re-write:

- certain provisions dealing with the collection and recovery of income tax
- the commercial debt forgiveness rules
- the luxury car lease provisions
- the farm management deposit scheme for eligible primary producers, and
- the tax treatment for general insurance companies.



## Other news

### Ruling on superannuation contributions

The Commissioner has issued Taxation Ruling TR 2010/1, which explains the Commissioner's views as to the ordinary meaning of the word 'contribution', where it is used in relation to a superannuation fund, approved deposit fund or retirement savings account in the *Income Tax Assessment Act 1997* (ITAA 1997). As noted in TR 2010/1, certain aspects of the Ruling are also relevant to the meaning of 'contribution' in the *Superannuation Industry (Supervision) Act 1993* (SISA) and the *Superannuation Industry (Supervision) Regulations 1994* (SISR). However, the Ruling notes that the definition of 'contribution' in the SISR modifies the ordinary meaning of the word.

The Ruling covers matters such as when a contribution will be taken to be made and the requirements to be satisfied so that a contribution made by an employer or an individual may be deducted for taxation purposes.

### IGT report on U-turns

On 17 March 2010, the Inspector-General of Taxation (IGT) made public his report to the Assistant Treasurer on perceived 'ATO U-turns', addressing the issue of delays or changes in approach by the Australian Taxation Office (ATO) with respect to significant interpretative matters which is inconsistent with past administrative practices. The review and report was requested by the Assistant Treasurer on 10 March 2009.

After receiving submissions from concerned taxpayers and their representatives, the IGT conducted his review and made the following observations:

- Perceived, delayed or changed ATO views or practices on significant interpretative matters are one of the main reasons for some private sector dissatisfaction with ATO governance arrangements. In some quarters, this has resulted in substantial erosion of confidence in the ATO as a fair administrator and driven a reluctance to work with the ATO on technical issues.

- In the absence of binding advice, the law as currently applied allows the ATO to apply its views retrospectively without protection against primary tax for taxpayers. The examples raised in submissions to the IGT show that the main problem is not that one binding ATO advice clearly changes another binding advice. Rather, the examples reflect disagreements over whether a previous ATO view or practice existed, or instances where the ATO rejected an industry view which taxpayers and their representatives believed the ATO was aware of and had accepted. The situation is further compounded by ATO delays in firstly identifying its compliance concerns and, secondly, finalising its position in relation to those concerns.
- On this basis, the IGT has concluded that taxpayers' perceptions of ATO changes in views or practices are justified in certain circumstances.

Based on the findings, the IGT made the following recommendations:

1. The Government should consider whether the current legislative framework adequately provides effective transparency and certainty for taxpayers where the ATO retrospectively applies new, 'changed' or 'clarified' views.
2. To reduce the adverse impact of delayed or changed ATO views on

significant issues, the ATO should openly develop, within 12 months and in collaboration with the taxpayer community, its administrative practice concerning the circumstances in which it seeks to apply its views retrospectively by incorporating the process steps outlined by the IGT in his report.

3. The ATO should, in collaboration with the taxpayer community, improve its framework for taxpayer engagement in developing its technical views and ensure that all staff adhere to the improved framework. The improved framework should incorporate the features identified by the IGT in his report.
4. Where the ATO comes across a taxpayer practice or view which it does not agree with in a compliance activity, and the taxpayer has acted in accordance with that practice because they perceived that it would be accepted by the ATO, the ATO should follow the process and criteria set out in recommendation 2 and deal with the compliance activity accordingly.
5. To reduce the timeframes elapsing between industry practices developing and the ATO becoming aware of compliance concerns (i.e. concerns with practices that are perceived to be incorrect at law), the ATO should be more proactive in identifying areas of compliance concern as early as

possible. This includes supplementing existing consultative forums with technical issues forums and, in relation to developing guidance on new law, making better use of ATO and industry knowledge learned from the development of the relevant legislative.

### Removing tax deductibility for political donations

On 25 February 2010, the Assistant Treasurer issued a media statement in which he welcomed the final passage of legislation in Parliament giving broad effect to the Government's election commitment to abolish the tax deduction for donations to political parties and independent candidates and members.

The *Tax Laws Amendment (Political Contributions and Gifts) Bill 2008*, which passed the Senate on 25 February 2008, limits existing provisions that allow tax deductions for gifts and contributions by businesses to political parties and independent candidates and members. In his media statement, the Assistant Treasurer said "businesses will no longer be able to deduct political donations, either under the existing \$1,500 capped specific deduction in the tax law, or as a general business deduction. The measure applies retrospectively from 1 July 2008, meaning businesses will not be able to deduct their political donations from that day".

The Assistant Treasurer also advised that "in reaching the Bill's final form, the Rudd Government has amended its original policy, at the request of the Senate, and has agreed not to remove deductions for individuals. Individuals will still be able to claim deductions for donations to political parties and independent candidates and members up to the \$1,500 cap. These gifts and contributions remain subject to the existing conditions outlined in the tax law".

The Act (*Tax Laws Amendment (Political Contributions and Gifts) Act 2010*) has now received Royal Assent.





## Tax relief for investors in instalment warrants

On 10 March 2010, the Assistant Treasurer announced plans by the Government to amend the tax law to confirm the practice of treating the investor in an instalment warrant over a single exchange traded security in a company, trust or stapled entity as the owner of the listed security for income tax purposes. In his media release, the Assistant Treasurer said that “this will benefit investors in instalment warrants primarily by confirming there is no capital gains tax (CGT) event at the time of the last instalment” and that “these changes will ensure investors in instalment warrants over listed securities don’t have

to meet their capital gains obligations until they sell those investments”.

It is proposed that the income tax amendments will apply for tax assessments for the 2007-08 and later income years.

Initial consultation will be undertaken on the design of these tax amendments, with a consultation paper providing further information about the proposal being available on the Department of Treasury’s web site.

The Assistant Treasurer noted that the proposed measure complements the 10 March 2010 announcement by the Minister for Financial Services, Superannuation and Corporate law which is detailed below.

## Financial services consumer protection extended to super fund borrowing arrangements

On 10 March 2010, the Minister for Financial Services, Superannuation and Corporate Law and Minister for Human Services announced a Government proposal to amend the *Corporations Regulations 2001* to provide that certain borrowing arrangements by superannuation fund trustees permitted by the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) are financial products under the *Corporations Act 2001*. The Minister said that “the amendments will extend the Government’s consumer protection framework to cover certain superannuation borrowing arrangements such as instalment warrants and thereby help protect the savings of fund members. The measure will ensure that only licensed financial services providers offer these arrangements to superannuation funds.”

The Minister also announced that the Government proposes to amend the tax law so that a superannuation trustee who enters into a limited recourse borrowing arrangement to purchase an asset, as permitted under subsection 67(4A) of the SIS Act, will be treated as the owner of the asset for income tax purposes. The Minister said that “the changes will ensure that trustees of superannuation

funds who have entered into permitted limited recourse borrowing arrangements will not face capital gains tax obligations at the time the last instalments are paid”.

This proposal complements the announcement by the Assistant Treasurer, outlined above whereby the Rudd Government plans to amend the tax law to confirm the practice of treating the investor in an instalment warrant over a single exchange traded security in a company, trust or stapled entity as the owner of the listed security for income tax purposes.

It is proposed that the income tax amendments will apply to assessments for the 2007-08 and later income years.

## Enhanced Renewable Energy Target scheme

On 26 February 2010, the Minister for Climate Change and Water and the Minister Assisting the Minister for Climate Change issued a media statement advising that the Government’s Renewable Energy Target scheme will be enhanced to provide greater certainty for households, employees and businesses within the renewable energy industry. According to the media statement, the Renewable Energy Target, which guarantees 20 per cent of Australia’s energy in 2020 will come from renewable sources, will include two

parts from 1 January 2011 – the Small-scale Renewable Energy Scheme (SRES) and the Large-scale Renewable Energy Target (LRET).

The LRET, covering large-scale renewable energy projects like wind farms, commercial solar and geothermal, will deliver the vast majority of the 2020 target. This will free these projects from uncertainties that may have been caused by strong demand for small-scale renewable technologies.

The SRES will cover small-scale technologies such as solar panels and solar hot water systems and deliver the remainder of the target. It will provide a fixed price of \$40 per megawatt hour of electricity produced, providing direct support for households that take action to reduce emissions.

According to the statement, under this fixed price, a Sydney household that installs a 1.5 kilowatt solar panel system

in 2011 will benefit from an upfront subsidy of \$6,200. If the same household decides to install a typical solar water heater, they will receive \$1,200 in support under the SRES.



The Government intends to release an industry consultation paper with respect to the proposals, and intends to legislate the changes in the winter sittings of parliament.

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