



The New R&D Tax Incentive: Key actions for your business

Background

The Federal Government introduced the *Tax Laws Amendment Bill (Research & Development) Bill 2010* (Bill) into Parliament on 13 May 2010. The Bill proposes to introduce the new research and development (R&D) tax incentive (to replace the existing concession) and is due to take effect from 1 July 2010.

Below we have summarised the new Bill and provide some key action points to assist you in preparing your business for the new program. Our February 2010 edition of *TaxTalk* provided readers with an overview of the incentive based (at that time) on exposure draft legislation.

Main aspects of the new program

The Bill confirms that the new R&D tax offset will be two-tiered as follows:

- 45 per cent R&D tax offset (refundable) for companies with group aggregated turnover less than \$20 million, and

- 40 per cent R&D tax offset (non-refundable) for companies with group aggregated turnover of \$20 million or more.

Action One: Grouped turnover

Based on your anticipated group aggregated turnover for the 2011 year consider whether you will likely be eligible for the refundable R&D tax offset. The refundable R&D tax offset may be a significant source of funding for many start up operations since refunds can be obtained even even though no income tax may be payable.

Action Two: New definition of Core R&D Activities

A new definition of core R&D activities has been included, which does not refer to the existing terms 'innovation', 'novelty' or 'technical risk'. Under the new definition, core R&D activities as defined in the Bill:

- must be 'experimental activities whose outcome cannot be known or determined in advance'



- are to be determined by 'applying a systematic progression of work that is based on principles of established science', and
- are conducted for the purpose of generating new knowledge.

You should gain an understanding of the new definition to determine whether your R&D activities meet the criteria provided above, and to ensure that you maintain appropriate evidence on file to substantiate any R&D activities that you believe satisfy the new definition.

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Action Three: Dominant purpose test

The new program includes a ‘dominant purpose’ test for supporting R&D Activities in some circumstances. Generally, supporting R&D activities will be eligible for the R&D offset concession where they are ‘activities directly related to core activities’. However, a stricter ‘dominant purpose’ applies to supporting core R&D activities if the activities:

- appear on the ‘exclusions list’ (e.g. market research, prospecting, management studies, and so on); or
- are (or directly related to) the production of goods or services.

The Bill provides claimants with greater clarity regarding eligible activities by removing quality control, pre-production activities (including demonstrating commercial viability, tooling-up and trial runs) as well as routine collection of information from the exclusions list.

You will need to delineate between core and supporting activities within your R&D projects. We recommend that appropriate protocols are implemented to ensure that R&D undertaken in a commercial setting (and the relating process and outcomes) is correctly documented and that clear evidence of a dominant R&D purpose can be provided.

Action four: Software R&D

Software R&D continues to be supported and will only be excluded from the program if developed for ‘internal administration’ use. However it may still qualify as supporting R&D if it is directly related to core activities, and it satisfies the ‘dominant purpose’ test. Software that is developed for sale or is embedded in other products or devices is not intended to be caught by the internal administration exclusion. Similarly, software developed to facilitate the on-line delivery of a company’s goods and services is also not intended to be caught by the exclusion.

The purpose of undertaking software R&D should be clearly documented, and additionally you will need to consider whether the activities are core or supporting R&D in relation to the overall R&D project. If software is developed for internal use but supports another core R&D activity, consider whether it satisfies the dominant purpose test.



Action Five: Registration requirements

Registration under the new program will require companies to differentiate projects between core and supporting R&D activities.

Ensure that you have the appropriate processes in place to clearly identify and document between core and supporting R&D activities.

Action Six: Administration

Innovation Australia will have greater powers in relation to registration of activities and has foreshadowed that it will subject applications to greater scrutiny prior to granting registration. It will also have the ability to provide private binding rulings, which is a major change and will provide an increased level of certainty to claimants.

Focus on preparing a robust R&D claim and consider whether it might be appropriate to seek a private binding ruling in relation to your R&D activities.

Action Seven: Changes from the second Exposure Draft

The main changes tabled in the Bill from the second Exposure Draft released on 31 March 2010 are as follows:

- The addition of the feedstock provisions (which were not previously released). The new rules are intended to act similarly to the existing program, however rather than limiting the amount of the R&D tax offset, the provisions act to instead increase a company’s tax liability when a company sells a feedstock output (or applies it for use), aimed to negate the benefit the company claimed under the R&D tax offset.
- A number of activities were removed from the ‘exclusions list’ as detailed above.

An understanding of the operation of new feedstock provisions will be required by companies to ensure that feedstock output and any increase in tax liability is correctly understood, calculated and applied.

Other aspects of the program

Other aspects affirmed in the Bill include:

- Foreign owned R&D will be able to access the program (regardless of cost reimbursement).
- The ‘expenditure not at risk’ provisions are contained in the Bill but do not apply to activities undertaken in Australia for foreign related companies.

- Overseas activities will be allowed at higher expenditure levels as costs will now be able to be included, as long as the overseas costs are less than the Australian R&D costs. However, companies will still be required to meet certain approval and other eligibility requirements.
- The receipt of R&D related grants does not affect the availability of the R&D tax offset. However similar to the new feedstock provisions, an extra tax liability applies to negate the benefit received from the grant related R&D tax offset.
- Core technology expenditure will no longer be eligible for support and the normal tax treatment to such expenditures will apply.

Action Eight: Other considerations

Companies should assess the impact of the new program upon their business, particularly in circumstances where there is:

- significant spending on R&D, especially where R&D claims involve work under contract or costs of production.
- R&D services undertaken for a foreign parent company.
- expectation of significant overseas R&D costs.

What happens now and what you need to do

The new legislation has been referred to a Senate Committee for its consideration. The Committee's report is due by 15 June 2010 ahead of the intended start date of 1 July 2010.

To prepare your business for the new program, we suggest you follow the eight actions outlined above. Please contact a member of the R&D team listed below if you require assistance with understanding the new program and related definitions, establishing your new R&D processes and the implementation of protocols.

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Revised EPBS Guidelines Released

Following an announcement in July last year from Senator Carr (Minister for Innovation, Industry, Science and Research) on the Government's plans for changes to restore balance to the Enhanced Project By-law Scheme (EPBS), AusIndustry has released its revised guidelines which took effect on 30 April 2010.

EPBS is a Government incentive scheme which affords certain customs duty concessions on eligible imported equipment when the project proponent can evidence that full, fair and reasonable access has been given to Australian industry.

Following a number of national seminars held by AusIndustry, the changes are not expected to jeopardise projects looking at the EPBS as a way to obtain significant duty savings. However, more awareness is required of the timing aspects and robust procedures should be put in place.

The changes will have an impact on all applicants looking to participate in the scheme, with the areas outlined below requiring the most significant attention.

Earlier engagement with AusIndustry in relation to the Australian Industry Participation Plan

The new guidelines have been written to encourage early communication with AusIndustry and thought around the introduction of Australian suppliers to the project.





There is an implicit need for applicants to draft an Australian Industry Participation Plan (AIP) for lodgement with AusIndustry at a very early stage of the project. This allows consultation and for recommendations to be made in order to strengthen the commitments put forward by applicants. This will require awareness from project management that AusIndustry involvement will need to be considered once procurement discussions/considerations (e.g. long lead items) have commenced.

Project proponents are required to develop a final AIP and lodge it with AusIndustry (along with its Project Acceptance Application (PAA)) before any of the major procurement decisions have been made on the project. Whilst the AIP assessment criteria has been reduced from fifteen down to five items, preparation can be as early as pre-feasibility and will require very early

identification of any EPBS opportunities. This could potentially result in the need for a quick turn around on developing the strategies that will offer full, fair and reasonable access to AusIndustry.

An important point to note is that any variations to what is originally set out in an approved AIP will require additional approval from AusIndustry.

More stringent requirements surrounding evidence of non-availability of local supply

It is our understanding that AusIndustry will be tightening up on the requirements for applicants when providing evidence of non-availability of goods within Australia. While the traditional methods are still available (letters from the Industry Capability Network (ICN) and Tariff Concession Orders), both AusIndustry and Customs will be monitoring the

application of the evidence more closely to ensure that 'Functional Units' are provided down to a suitable level as to not exclude Australian suppliers.

Under the new guidelines, any applicant which provides misleading information in an EPBS application (PAA or Implementation Report) may be punished under the relevant provisions of the Customs legislation, giving AusIndustry officers the right to issue penalties to such applicants as an 'officer of Customs'.

There will also be some timing challenges for applicants, as ICN or Customs based evidence will need to be initiated well before the lodgement of an Implementation Report.

Transitional Measures

In order to assist its existing customers through the changes outlined in the revised guidelines, AusIndustry has implemented the following transitional measures:

- All EPBS applicants at the Implementation Report stage that have lodged, and have had approved, an Implementation Report before 30 April 2010 will be unaffected by the new guidelines and transitional arrangements
- All new EPBS project acceptance applications and Implementation Reports received on or after 30 April

2010 will be assessed according to the new EPBS guidelines, and

- Any applicant that has lodged an Implementation Report before 30 April 2010 but has not received approval, will be assessed under the new guidelines. However, a four month consultation period (finishing 31 August 2010) will be granted to allow the applicant to provide any additional information required to meet the new guidelines and preserve the original lodgement date.

While the revised guidelines have introduced a number of changes within itself, applicants are also encouraged to review the new PAA form as it to has also changed, and the level and type of information required should be considered early on.

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Use of shared service centres for tax activities

During 2010 we are publishing a series of articles regarding the operational aspects of running a tax function. This month we comment on how tax activities may be performed in a Shared Service Centre (SSC). While the wider finance function has been moving processes into a shared services environment for many years, generally tax has been one of the last finance activities to be considered for a SSC, mainly because of the belief that ‘you need local expertise’. However, for the reasons discussed below, businesses are increasingly looking at how they can use their SSC to perform tax activities.

What are the triggers to move tax processes into an SSC?

The common scenarios for tax processes to be considered to be moved to an SSC include where:

- The broader finance function is moving towards an SSC structure, and tax is included in this exercise. In such a scenario, the tax function should take the opportunity to collaborate with the finance team to develop a common vision and harmonise the way their processes, people and technology work together.

- The tax function is under pressure to reduce costs. If implemented correctly, SSCs can offer significant reduction in costs through economies of scale, process efficiencies, and wage cost arbitrage from low cost locations.
- The tax function is being hampered by non-standardised and complex processes, leading to inconsistent controls, inefficiencies and lack of transparent and quality data.



What does an SSC look like?

An SSC is an internal service provider, often based offshore, with its own resources and service assignments focusing on improvement and standardisation of processes for finance and tax functions.

The tax function typically transfers those processes to the SSC, which can be standardised and managed by a centralised team.

The home-country tax team usually retains responsibility for activities such as:

- undertaking sophisticated management analysis
- providing tax advice to the business
- focusing on quality review, exception reporting and controls, rather than performing calculations
- providing quality and timely data to the tax authorities
- maintaining relationships with tax authorities, and
- being ultimately accountable for tax matters.

Harnessed correctly, an SSC can be highly efficient in managing taxes both from a cost and a process perspective.

Which processes may be moved to an SSC?

One of the key decisions to be made when moving activities to an SSC is determining which tax processes should be performed by the SSC and which should remain decentralised. Some typical processes which can be moved to an SSC include:

- tax processes which can be standardised or automated
- preparation of direct, indirect and withholding tax returns (or detailed tax data packs enabling the home country tax team to finalise the tax returns)
- monthly tax accounting calculations
- preparation of transfer pricing documentation, and
- converting accounting data prepared under Australian International Financial Reporting Standards (AIFRS) into data complying with another jurisdiction’s accounting standards and vice versa.

It should be recognised that the Australian tax regime is very complicated by global standards. The nuances and details of our tax code mean that a layer of Australian tax technical support will usually need to be maintained by the group either on

an insourced or outsourced basis to provide business support. This local expertise is often also needed to complete a process which has been partly moved to a SSC, e.g. to advise on the tax accounting journals needed under Australian Urgent Issues Group (UIG) Interpretation 1052. Therefore considerable thought must be given to the division of responsibilities for the process between the SSC and the home-country tax function, and strong communication channels must be built.

The converse of this is that if a SSC can succeed in efficiently managing all or part of an Australian tax process, e.g. preparation of a Business Activity Statement (GST return), then often the more complicated Australian process can be leveraged to allow returns for countries with 'easier' goods and services tax (GST) regimes to also be processed by the SSC. It is well worth investing some time and effort to optimise your chances of successfully transitioning your Australian tax processes to a SSC.

What are the critical success factors?

The above sounds very simple, however there are instances where businesses have moved tax processes, particularly to an offshore SSC, only to bring them onshore again a short time later. This can be for a multitude of reasons, including

under-estimating the complexity of the Australian tax system as noted above.

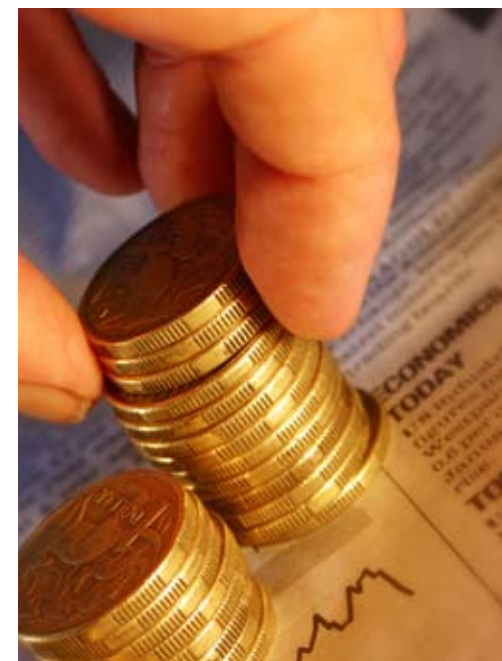
The SSCs which successfully undertake tax activities typically display some or all of the following features:

- The SSC is properly equipped with the necessary knowledge and resources (including both people and technology) to perform its function and cope with any regulatory changes.
- Both the tax function and the SSC have a clear understanding of their respective roles and responsibilities.
- Clear communication channels and protocols regarding 'hand-offs' of processes are in place.
- There is a service agreement in place with specific, measurable key performance indicators. Alternatively there may be clear reporting lines back to the tax function.
- Processes are fixed and documented prior to being moved to the SSC. An extensive training and handover exercise is performed.
- The local tax team maintains the required specialised local knowledge and technical capacity needed.
- The local tax function works collaboratively as a single team with the SSC, rather than treating it as a separate back-office data provider.
- Turnover of SSC staff is minimised. Often a SSC is based offshore in a lower-cost country in a different

time zone. Multinational groups are competing for staff in such locations, and high turnover of staff is often cited as a problem. To minimise staff turnover, try to provide your SSC team with the best working conditions possible. For example, unless absolutely necessary, do not insist that your offshore team works the same office hours as your local team, when you probably only need an overlap of one to two hours on most days.

Concluding comments

More and more groups seem to be moving some of their tax processes into a SSC. Tax is increasingly no longer regarded as being in the 'too hard' basket, and many tax directors have had to accept that some of their team members will no longer necessarily be based in the same country as them. Those tax functions that embrace the change of moving some of their activities to an SSC, and invest the necessary hard work in transitioning processes, can find themselves pleasantly surprised at the improvements and efficiencies that can arise. In particular, the thought process should not be "what activities can we move in to the SSC?" but rather "how can we work as a team with the SSC to deliver more efficient tax processes?"



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Federal Court to challenge ATO's accountant's concession

The Federal Court has ruled that a decision by the Commissioner of Taxation to override his accountant's concession policy and access tax advice documents prepared by a tax advisor can be challenged under administrative law principles.

The accountant's concession is an Australian Taxation Office (ATO) policy designed to provide a level of protection to tax advice given by tax advisors, so that there are only limited circumstances under which the ATO can access that advice. This is similar to the way that legal professional privilege protects advice given by lawyers to their clients, although the accountant's concession is only an administrative policy and not a rule of law.

Stewart & Ors v The Deputy Commissioner of Taxation [2010] FCA 402 is a case arising from the Project Wickenby investigations. Documents seized by the Australian Crime Commission from the applicant were provided to the ATO, including documents the applicant said should be subject to the accountant's concession. Some time after receiving the documents, the ATO made a decision to lift the concession, the effect of which was to allow it to examine the documents.

Justice Perram found that it was open to the applicant to argue that the Commissioner's decision to lift the concession was a breach of the rules of procedural fairness, either on the basis that the Commissioner had not properly followed his own policy in making the decision or that the decision was so unreasonable that no reasonable decision-maker would have made it.

He also found that it was open to the applicant to argue that a decision by the Commissioner to issue him with a notice to attend and give evidence should be set aside on the ground that the decision to issue the notice was based on the documents alleged to have been accessed by the Commissioner in breach of the rules of procedural fairness.

It is important to note that this decision of the Court only relates to the question of whether these grounds are arguable, and it is not a final decision about whether they will be successful. It does however show that the ATO must comply with its own policies when making a decision to lift the concession.

It is also notable that in December 2007, the Australian Law Reform



Commission issued a report on legal professional privilege which included a recommendation that a form of privilege apply to protect tax advice prepared by tax advisors. If this recommendation is eventually implemented, tax advice will be protected from disclosure to the ATO irrespective of whether it is provided by a tax advisor or a lawyer, and the accountant's concession will cease to have any practical application. Until then, taxpayers should carefully consider how they can best protect their tax advice from disclosure to the ATO.

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New tax system for Managed Investment Trusts

On Friday 7 May 2010, the Assistant Treasurer released the Board of Taxation's report into the tax arrangements for Managed Investment Trusts (MITs) and announced a new MIT taxation regime.

The proposed regime, which commences from 1 July 2011, will provide much-needed certainty and simplification by ending some long-standing points of confusion between tax and trust law and fixing the potential for double taxation. The key features of the proposed new MIT tax system are:

- the provision of an elective 'attribution' system of taxation to replace the present entitlement system whereby investors will be taxed only on the income that the trustee allocates to them on a fair and reasonable basis, consistent with their entitlements under the trust deed or the trust's constituent documents
- establishing the ability to deal with "over or under" distributions within a five per cent cap so that trusts are not required to re-issue statements and investors are not required to revisit tax returns

- removing double taxation by providing for cost base adjustments for amounts distributed to unit holders that have been taxed but not distributed, and
- abolishing Division 6B of the *Income Tax Assessment Act 1936 (ITAA 1936)* (corporate unit trusts) and including a new ‘arm’s length rule’ in the public trading trust rules in Division 6C of the ITAA 1936.

The announcement is a significant reform. In some respects a clear victory for the investment management industry and investors alike because it will provide certainty that is long overdue (although arguably the recent High Court decision in Bamford already delivered much of this certainty).

However, based on recent experience we will all need to watch very carefully the implementation to ensure the promised benefits materialise in practice and do not become lost in overzealous revenue protection complexity. In addition there are two clear challenges to the attractiveness of the proposals.

Firstly, the reform benefits will only apply to MITs, and currently the Government’s proposed definition of MIT is hugely restrictive and needs to be widened.

Secondly, the five per cent cap on unders/overs will, we believe, prove to be very hard to achieve in practice but given it will be a very clear test, any breaches

of the five per cent level may be expected not to be tolerated with a result of potential penal taxation rates being born by funds or their trustees. This can be contrasted with the current, informal but flexible approach to unders/overs which works well within the industry even though it is not specifically addressed in current tax law.

Provided it is implemented well, and the above two issues are addressed, the new system should help boost economic activity and create jobs in the financial services wealth management sector.



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Proposed investment management regime

On 11 May 2010, the Minister for Financial Services, Superannuation and Corporate Law and the Assistant Treasurer jointly announced the Government’s decision to ask the Board of Taxation to develop the key features of an investment manager regime (IMR). In making the announcement, the Minister and Assistant Treasurer issued a Consultation Paper on the treatment of conduit income of managed funds, and indicated that the outcomes of the consultation process on the treatment of conduit income will assist the Board of Taxation as it considers the design issues relating to an IMR.

The decision to request the Board of Taxation to develop the key features of an IMR arises from the Government’s acceptance of the recommendation made by the Australian Financial Centre Forum, which investigated the opportunities and constraints impacting on the development of a sustainable Australian financial centre. For further details of the recommendation, see our February 2010 edition of *TaxTalk*.

With respect to the treatment of conduit income, the Consultation Paper notes that the independent Australia’s Future Tax System (AFTS) review (the Henry Review) also considered the tax arrangements applying to managed

funds, and recommended that the current arrangements be improved to provide greater certainty that conduit income will not be subject to tax (Recommendation 35). In this respect, the Consultation Paper states that an important element of the IMR will be to ensure that non-residents investing in offshore assets will not face further Australian tax on their investments when using Australian intermediaries.

Accordingly, in advance of the review being undertaken by the Board of Taxation into development of an IMR, the Government is seeking comments on the treatment of conduit income flowing through or managed from Australia. The Consultation Paper reviews the current managed fund taxation arrangements and considers potential reform directions to further refine existing arrangements that address the treatment of conduit income.

For further information with respect to the Board of Taxation review in respect of a proposed IMR and/or with respect to the treatment of conduit income dealt with in the Consultation Paper, contact:



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Corporate tax developments

Employee share scheme reporting obligations

The new employee share scheme (ESS) rules, which apply from 1 July 2009, impose annual reporting (and certain withholding) obligations on employers. Importantly, the new reporting requirements applies not only to ESS interests acquired post 30 June 2009 but also to interests acquired earlier and which are transitioned into the new rules where an income tax event has not occurred in respect of the interest before 1 July 2009. Employers providing ESS interests to their employees (or to associates of an employee) are required to provide information to their employees and the Australian Taxation Office (ATO)

by 14 July 2010 and 14 August 2010 respectively.

While the first year for annual reporting is 2009-10, the ATO is yet to issue the finalised pro-forma for employers to ensure compliance with the new regime. A draft pro-forma for the 14 July 2010 reporting date was issued by the ATO, but has not been finalised.

High Court refuses grant of special leave in a number of corporate tax disputes

In previous editions of *TaxTalk* we reported the Full Federal Court decisions in two important tax cases as detailed below. In each case, the taxpayer was

Case name	Issue in dispute	TaxTalk edition where case reported	Date on which special leave refused
Tasman Group Services Pty Limited v Commissioner of Taxation [2009] FCAFC 148	Certain aspects of the debt forgiveness rules in the taxation law	November 2009	23 April 2010
Handbury Holdings Pty Limited v Commissioner of Taxation [2009] FCAFC 141	Whether certain liabilities of a company which exited a tax consolidated group upon the issue of shares were to be taken into account as liabilities of the company at the 'leaving time'	November 2009	23 April 2010



unsuccessful in challenging the position taken by the Commissioner of Taxation. Since reporting the outcome of those Full Court decisions, each relevant taxpayer requested leave of the High Court to appeal the Full Court's decision. In each case, special leave was refused by the High Court. The table below sets out the details of each case and the month it was covered in *TaxTalk*.

Asymmetric swap arrangements

On 28 April 2010, the Commissioner of Taxation published Taxation Determination TD 2010/12, which answers the question – can Part IVA of the *Income Tax Assessment Act 1936* apply to an asymmetric swap scheme? Asymmetric swaps are financial products used predominantly in the banking industry, and commonly consist of two swap transactions entered into between an Australian resident company and an

unrelated non-resident counterparty. With respect to the arrangements described by the Commissioner in TD 2010/12, the Commissioner concludes that on an objective analysis of the facts, the dominant purpose of the resident company is to obtain a fixed return and is indifferent to making any profit above the fixed return. According to the Commissioner, the scheme is designed to ensure that the risk and exposure of the hedge is effectively passed from the swap parties to the revenue authority. As a result, the Commissioner is of the view that the anti avoidance provisions contained in Part IVA of the *Income Tax Assessment Act 1936* will apply and any 'tax benefit' otherwise obtained will be forfeited with resulting tax and penalties.

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International developments

Tax information exchange treaty (TIEA) with the Marshall Islands

On 13 May 2010, the Assistant Treasurer announced that Australia had signed a bilateral tax treaty with the Marshall Islands for the exchange of tax information.

In addition to the TIEA, the Assistant Treasurer announced that Australia and the Marshall Islands had also signed an Additional Benefits Agreement (ABA). The ABA will establish an administrative mechanism to resolve transfer pricing disputes between taxpayers and the revenue authorities of Australia and the Marshall Islands and eliminate double taxation of certain income derived by retirees, government employees and students.

The new arrangements will also assist the Marshall Islands' revenue authorities to implement the TIEA through the provision of technical assistance and training to be delivered by the Australian Taxation Office.

These agreements will enter into force after both countries have completed their relevant domestic requirements.

Proposed foreign source income anti deferral-rules

On 28 April 2010, the Assistant Treasurer released for public consultation exposure draft legislation for an anti-roll-up fund rule that will apply to certain offshore investments. The anti-roll-up fund rule is part of wider reforms to Australia's foreign source income anti-tax-deferral rules that were announced in the 2009-10 Federal Budget, and follows the decision to repeal the foreign investment fund (FIF) rules. In summary, the Government announced that the controlled foreign company (CFC) and transferor trust rules would be retained and modernised, while the foreign FIF and deemed present entitlement (DPE) rules would be repealed. In this respect, on 13 May 2010 the Government introduced a Bill into Parliament (the *Tax Laws Amendment (Foreign Source Income Deferral) Bill (No. 1) 2010*) to repeal the FIF rules and DPE rules with effect from 1 July 2010.

In summary, it is proposed to introduce a targeted anti-roll-up rule which applies where:

- an investor holds an interest in a foreign accumulation fund
- the investor receives a tax deferral benefit as a result of the interest, and

- the investor entered into the scheme with the dominant purpose of obtaining a tax deferral benefit.

In instances where the rules apply, the Commissioner may make a determination to include the whole or part of the tax deferral benefit in the investor's assessable income for the relevant income year. Investors who have an amount attributed to their assessable income as a result of this rule will be protected from double taxation against future distributions from the foreign accumulation fund.

Some classes of investors, however, will be specifically excluded from the operation of the rule although the list of exclusions is still to be determined.

Under the proposal, a foreign accumulation fund is an entity:

- that is a foreign resident
- that is not a CFC
- whose investment returns are subject to a low level of risk, and
- that does not distribute substantially all of the profits and gains of the fund.

It is generally agreed that the repeal of the FIF rules (and its replacement by the anti-roll-up deferral rule) will most profoundly affect the wide range of foreign superannuation funds around the world. Ironically, the replacement rules may mean foreign pension plans will all be treated equally.

Australia's tax treaty with Turkey

On 29 April 2010, the Assistant Treasurer announced that Australia and Turkey had signed the first income tax treaty between the two countries. The treaty will enter into force when both countries advise that they have completed their domestic requirements. Legislation for this purpose will be introduced in the Australian Parliament as soon as practicable.

Australia signs tax information exchange agreement (TIEA) with Vanuatu

On 21 April 2010, the Assistant Treasurer announced that Australia and Vanuatu had signed a TIEA that provides a legal basis for the bilateral exchange of information for both civil and criminal tax purposes. In making the announcement, the Assistant Treasurer said that "the signing of this agreement demonstrates Vanuatu's commitment to international tax standards and is indicative of the progress that is being made worldwide to improve transparency in the financial system and prevent offshore tax avoidance and evasion".

The TIEA will enter into force after Australia and Vanuatu have completed their respective domestic requirements.

United States: IRS requirements for disclosure of uncertain tax positions

On 26 January 2010, United States (US) Internal Revenue Service (IRS) Commissioner, Doug Shulman, announced plans to require large companies to disclose certain information in their income tax filings about their uncertain tax positions.

On 19 April 2010, the IRS released a draft schedule (UTP) and instructions for the proposed disclosure. The draft instructions provide explanations of several key topics including what tax positions must be reported and how to calculate the 'maximum tax adjustment' for a tax position. Disclosure is required regardless of whether the audited financial statements of a taxpayer are issued under US Generally Accepted Accounting Principles (GAAP), International Financial Reporting Standards (IFRS), or another country-specific accounting standard that requires a taxpayer to record a reserve for US federal income tax positions.

Generally, to the extent a foreign related party records a 'reserve' (broadly defined to include a tax payable and temporary item) in an audited financial statement, these items would need to be disclosed to the IRS. What makes this particularly troubling for Australian companies is

the disparity between the definition of 'probable' (requiring the company to book a tax reserve under Australian IFRS) as compared to the US GAAP standard which is 'more likely than not'. This issue is not exclusive to Australian companies with operation in the US but could also apply to groups from other jurisdictions whose form of GAAP is not identical to US GAAP.

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Personal and expatriate taxation

Review of superannuation system

On 29 May 2009, the Government announced the *Super System Review* (the Review), a comprehensive review of Australia's superannuation system. Under the broad terms of reference, the Review Panel was requested to examine and analyse the governance, efficiency, structure and operation of Australia's superannuation system.

On 29 April 2010, the Review Panel released *Self Managed Super Solutions Phase Three Preliminary Report* in respect of self-managed superannuation funds (SMSFs). In the report, the Review Panel articulates ten guiding principles that it believes should underpin the regulation of SMSFs, and makes a number of recommendations including:

- that the relevant legislation be amended to provide the Australian Taxation Office (ATO) with the power to issue administrative penalties against SMSF trustees on a sliding scale reflective of the seriousness of the breach, and that any such penalties should not be payable from the corpus of the fund, and may be applied jointly or severally against the trustees or trustee directors

- that the relevant legislation be amended to provide the ATO with the power to issue relevant persons with a direction to rectify specified contraventions within a specified reasonable time, and that a breach of a direction should be a strict liability offence
- legislating full audit independence whereby an individual or firm providing any service in connection with an SMSF or its individual trustees or trustee directors in any capacity is to be expressly prohibited from auditing that SMSF



- prohibiting the acquisition of collectables and personal use assets by SMSF trustees and that where SMSFs own collectables or personal use assets, the trustees be provided a transitional period, up to 30 June 2020, in which to dispose of those assets. Funds regulated by the Australian Prudential Regulatory Authority (APRA) should be exempt from these changes, and
- that the 5 per cent ‘in-house asset’ (IHA) investment limit be removed so that no IHA investments would be allowed. For SMSFs with existing IHA investments, they should be provided a transitional period, up to 30 June 2020, in which to dispose of their IHA investments (with no new or further IHA investments being permitted during this transition period). However funds regulated by APRA should be exempted from these changes.

Self managed superannuation funds and the purchase of trauma insurance

In Self Managed Superannuation Fund Determination SMSFD 2010/1, the Commissioner of Taxation considers whether a self managed superannuation fund (SMSF) can purchase a trauma insurance policy in respect of a member and still satisfy the sole purpose test in section 62 of the *Superannuation Industry (Supervision) Act 1993* (SISA).

Under a trauma insurance policy, it is normally the policy owner that is paid a lump sum if the insured person is diagnosed with one of a range of critical illnesses or suffers injuries that are defined in the policy. Trauma conditions commonly covered include cancer, stroke, coronary bypass and heart attack. A trauma insurance benefit is typically paid when the diagnosis is confirmed, provided the insured person survives the medical condition for a specified period. Payment is made regardless of whether the insured person ceases work or becomes permanently disabled because of the illness or injury suffered.

In SMSFD 2010/1 the Commissioner concludes that purchase of such a policy will not breach the sole purpose test provided that any benefits payable under the policy:

- are required to be paid to a trustee of the SMSF
- are benefits that will become part of the assets of the SMSF at least until such time as the relevant member satisfies a condition of release, and
- the acquisition of the policy is not made to secure some other benefit for another person such as a member or member’s relative.

However, if a trustee purchases a trauma insurance policy that provides for benefits payable under the policy to be paid directly to someone other than

a trustee of the SMSF (for example, the policy provides for the insured member or member’s relative to directly receive benefits payable under the policy), the Commissioner concludes that this would be inconsistent with the sole purpose test in section 62 of the SISA and in these circumstances, the trustee would contravene section 62.



Board of Tax Review and Government response to ESS reforms

On 23 April 2010, the Assistant Treasurer released the Board of Taxation’s review into elements of the taxation of employee share scheme (ESS) arrangements. The Assistant Treasurer had requested the Board to examine how best to determine the market value of ESS benefits, and whether shares and rights under an ESS that are provided by start-up, research and development and speculative-type companies should be subject to a tax deferral arrangement, despite not being subject to a real risk of forfeiture.

The Board’s review makes five recommendations and includes a report by the Australian Government Actuary into the valuation of unlisted rights. The recommendations made by the Board are as follows:

Recommendation 1: Valuation of listed securities

The Board recommends that the valuation methodology for valuing listed securities issued under ESS arrangements be in accordance with the ordinary meaning of market value and that the Commissioner of Taxation release a public document that offers taxpayers further guidance on acceptable valuation methodologies for valuing listed securities.

Recommendation 2: Valuation of unlisted shares

The Board recommends that the valuation methodology for the valuation of unlisted shares issued under ESS arrangements be in accordance with the ordinary meaning of market value. The Board also recommends that the Commissioner of Taxation release a public document which offers taxpayers further guidance on acceptable valuation methodologies that can be applied when valuing unlisted shares issued under ESS arrangements.

Recommendation 3: Valuation of unlisted rights

The Board recommends that the valuation methodology for the valuation of unlisted rights issued under qualifying ESS arrangements be in accordance with the ordinary meaning of market value. The Board also recommends a statutory ‘safe harbour’ valuation methodology in accordance with which participants can elect to value unlisted rights.

Recommendation 4: Statutory valuation tables

The Board recommends the continued use of the statutory valuation tables as a ‘safe harbour’ for valuing unlisted rights, but also recommends that the factors underlying the statutory valuation tables be reviewed and updated to more accurately reflect current market conditions. In this respect the Board

makes the further recommendation that the basis and assumptions behind the statutory valuation tables should be made available to the public and that the Commission of Taxation should develop an online calculator tool to assist taxpayers to apply the statutory valuation tables to value their unlisted rights.

Recommendation 5: Separate tax deferral regime for start-up, research and development (R&D) and speculative-type companies

The Board **does not** recommend the introduction of separate tax deferral arrangements for start-up, R&D and speculative-type companies. The Board recommends that, should the Government wish to provide additional support to start-up, R&D and speculative-type companies, the Government consider more targeted approaches to providing this support outside of the ESS tax regime.

In response, the Assistant Treasurer said that the findings of the Board are consistent with the Government’s employee share scheme reforms and that it had thus accepted the first four of the recommendations. In respect of the fifth recommendation, the Assistant Treasurer said that it had been partially accepted, however the Government would delay the consideration of one particular aspect of the recommendation to a later date. On the tax treatment of employee share

schemes used by start-up, research and development and speculative type companies, the Assistant Treasurer said that “the Board has recommended that support for these industries is best provided directly, and that is what we are doing”.

Super System Review

On 20 April 2010, the Super System Review released *MySuper: Optimising Australian Superannuation*. This preliminary report provides more detail on the choice architecture outlined by the Review Panel in its Phase One preliminary report *Clearer Super Solutions* released late last year. ‘MySuper’ is the new name for the universal fund concept proposed in that report.

Review Chair, Jeremy Cooper, said: “MySuper would be a simple, cost-effective product that redefines what Australians should be able to expect from their super in the twenty-first century”. Some of the proposed features of MySuper include:

- a ban on trailing commissions
- no contribution fees
- a new duty on trustees to manage the overall cost to members
- a default post-retirement product, and
- trustee duties focused entirely on looking after the member.

The final report (encompassing all three phases) will be delivered to the Government by 30 June 2010.

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State taxes

Victoria Budget for 2010-11

The Victorian Budget for the 2010-11 financial year was delivered on 4 May 2010 with a projected surplus of \$872 million. Following is a summary of the more significant taxation measures announced.



Land tax exemption for retirement villages and other facilities

The current land tax exemption for retirement villages, residential care facilities, supported residential services and residential services for people with disabilities will be extended. Broadly, these exemptions currently apply to land that is occupied or currently available for occupation. The exemption will now be extended to include the construction phase of these facilities. However, the exemption is limited to a period of two years.

Payroll tax

A reduction in the payroll tax rate by 0.05 percentage points (from 4.95 per cent to 4.90 per cent) was announced, effective from 1 July 2010. This measure is expected to cost \$193 million over four years, with this rate giving Victoria the second lowest rate of any State.

Motor vehicle duty threshold harmonisation

From 1 July 2010, the duty threshold for charging a higher rate of duty for new passenger cars will be aligned with the Commonwealth luxury car threshold. This harmonisation will reduce the complexity for motor vehicle taxation in Victoria.

Other measures

The Budget also included the following announcements:

- E-lodgement service – the development of a web-based system to streamline the payment and stamping of land transfer duty. This measure aims to reduce the compliance costs associated with stamp duty lodgement obligations.
- Extension for First Home Bonus re-targeted to new homes – Victoria's First Home Bonus for the acquisition of established homes (currently \$2,000) will expire on 30 June 2010 but will be increased for the purchase or construction of new homes. Eligible applicants will receive \$13,000 in assistance (an increase of \$2,000) plus an additional \$6,500 (previously \$4,500) if the new home is situated in regional Victoria. Those purchasing first homes (whether existing or new) will still be eligible to receive the \$7,000 in assistance under the First Home Owner Grant. These changes will apply to purchases commencing on or after 1 July 2010.

Australian Capital Territory (ACT) Budget for 2010-11

The ACT Budget for the 2010-11 financial year was delivered on 4 May 2010 by the ACT Treasurer, who acknowledged that the global financial crisis is still having a significant impact on ACT finances. However, the Budget does not introduce any new stamp duties and includes the proposed abolition of marketable securities duty, and duty on the application to register, or to transfer registration on, caravans or camping trailers. No changes are proposed to the payroll tax or land tax rates applying in the ACT.

Abolition of marketable securities duty

In maintaining the ACT commitment to abolish marketable securities duty made under the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations, the Treasurer has announced that the ACT will abolish marketable securities duty on the transfer of unlisted shares from 1 July 2010, notwithstanding the current decreased revenue position.

Abolition of duty on caravans

The Treasurer also announced that duty on the application to register, or to transfer registration on, a caravan or camping trailer in the ACT will be abolished from 1 July 2010.

Other non-taxation revenue measures

The Treasurer has also announced an increase in a number of minor fees and charges, including increases in fire and emergency services levy, parking fees in city and town centres, and fees under the *Firearms Act 1996*.

Northern Territory Budget for 2010-11

The Northern Territory (NT) Budget for the 2010-11 financial year was delivered on 4 May 2010. A number of Territory tax-related measures were announced, with some applying from 4 May 2010 and others from 1 July 2010.

Importantly, the NT Budget reaffirmed that stamp duty will be abolished from 1 July 2012 on transfer of non-real property business assets (e.g. goodwill and other intangible assets).

The measures applying from 4 May 2010 include:

- removing the concession from landholder duty for an acquisition of interests in a corporation or unit trust scheme acquired pursuant to a financing arrangement and replacing it with a more restrictive duty deduction regime
- amending the meaning of valuable consideration in respect of a grant of a lease to include valuable consideration given for an option under which the lease is granted

- increasing the stamp duty First Home Owner Concession to a maximum of \$26,730
- introducing a new senior, pensioner or carer stamp duty concession of up to \$8,500 for non-first home buyers
- increasing the Principal Place of Residence stamp duty rebate from \$2,500 to \$3,500
- changing the home occupancy requirements relating to the stamp duty First Home Owner Concession to more closely align with the rules for the First Home Owners Grant, and
- extending the First Home Owners Grant and stamp duty home ownership incentive schemes to certain long-term leases granted under the *Aboriginal Land Rights (Northern Territory) Act 1976 (Cth)*.

The measures applying from 1 July 2010 include:

- increasing the mineral royalty rate from 18 per cent to 20 percent of the net value of a mine's production over \$50,000
- major changes to the landholder duty timing rules regarding when an interest is taken to be acquired in cases where an acquisition will be evidenced by a transfer of shares or units
- new provisions allowing the Commissioner to create a memorandum for reassessment of stamp duty purpose where it is impractical or impossible for the original instrument to be lodged or where motor

- vehicle duty has been under-paid based on incorrect vehicle value
- extending the substituted purchaser provisions that provide no double duty on transfers to a related person by broadening the concept of family trust
- changing the dutiable value rules for the grant of freehold land or a convertible Crown lease where all or part of the consideration is unascertainable at the time of grant by the Northern Territory
- introducing a new stamp duty exemption for the establishment and transfer of dutiable property to a Special Disability Trust where no valuable consideration has been given, and
- amending the NT's *Taxation Administration Act* to ensure that payments by a taxpayer can be allocated in the order of interest, penalty tax and primary tax and ensuring that the former *Pay-roll Tax Act* and *Stamp Duty Act* and the Act previously titled the *Taxation (Administration) Act* continue to be taxation laws.

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Legislation update

The following revenue related Bills have been introduced into Parliament:

The *Tax Laws Amendment (Research and Development) Bill 2010* (the Bill) and *Income Tax Rates Amendment (Research and Development) Bill 2010*, introduced into Parliament on 13 May 2010, implement the Government's new tax incentive for research and development (R&D). The new R&D tax incentive (which is intended to replace the existing R&D tax concession program from 1 July 2010) provides eligible entities with a tax offset for expenditure on eligible R&D activities and for the decline in value of depreciating assets used for eligible R&D activities. The rate of the tax offset and whether it is refundable depend primarily on the 'aggregated turnover' of the R&D entity. The Bill is an amended version of the second Exposure Draft that was released for comment on 31 March 2010. See front page article for further information.

The *Tax Laws Amendment (Foreign Source Income Deferral) Bill 2010*, which was introduced into Parliament on 13 May 2010, proposes to repeal the deemed present entitlement (DPE)

rules and the Foreign Investment Fund rules for the 2010-11 and later years. In addition, the Bill ensures that provisions dealing with the disposal of interests in foreign entities where amounts have been previously attributed will continue to operate as intended.

The *Tax Laws Amendment (Medicare Levy and Medicare Levy Surcharge) Bill 2010*, which was introduced into Parliament on 13 May 2010, proposes to increase the Medicare levy and Medicare levy surcharge low-income thresholds for individuals, families and pensioners below age pension age.

The *Excise Tariff Amendment (Tobacco) Bill 2010*, which was introduced into Parliament 12 May 2010, amends the *Excise Tariff Act 1921* to increase the excise rate applying to tobacco, cigars, cigarettes and snuff. An equivalent change to the excise-equivalent customs duty is contained in the *Customs Tariff Amendment (Tobacco) Bill 2010* which was also introduced into Parliament on 12 May 2010. This proposed legislative change is discussed under *Other news*.

Other news

Fuel tax on alternative fuels from 1 July 2011

On 13 May 2010, the Government confirmed its intention to impose fuel tax on alternative fuels from 1 July 2011. The proposal affects biofuels, ethanol and biodiesel, and the gaseous fuels including liquefied petroleum gas (LPG), liquefied natural gas and compressed natural gas. The measures will have a direct impact on the excise liability of manufacturers and importers of alternative fuels and will increase fuel costs for businesses and private motorists using these fuels in vehicles on public roads.

The rates of excise duty (and excise-equivalent customs duty) for alternative fuels will be imposed at a discount of 50 per cent of the full energy content rate. The excise will be progressively phased in over the period beginning 1 July 2011 and ending 1 July 2015. Under the measures as currently proposed, Government grants will reduce the effective excise during this transitional period. For example, from 1 July 2011, LPG will be subject to an effective excise rate of 2.5 cents per litre, which will progressively increase to the final rate of 12.5 cents per litre by 1 July 2015.



The Government will undertake consultation with stakeholders on the reforms including whether offsetting grants are the best mechanism to phase in effective excise. A discussion paper to this effect is expected to be released shortly by the Assistant Treasurer.

IMF Interim Report for the G-20 – new taxes for the financial sector

The International Monetary Fund (IMF) recently released an Interim Report that responds to the request by the Group of Twenty (G-20) Finance Ministers and Central Bank Governors to examine the range of options available to countries on how the financial sector could make a contribution towards paying for government interventions to repair the banking system.

The IMF Interim Report has been prepared in the context of the global

financial crisis (GFC) and the significant interventions by governments around the world to support their banking and wider financial systems.

Two specific categories of tax measure have been proposed by the IMF in its Interim Report:

- A levy on financial institutions to cover the net fiscal costs of direct public support to financial institutions and to help reduce excessive risk-taking. The levy would be a 'Financial Stability Contribution'.
- A further contribution from the financial sector would be raised by a 'Financial Activities Tax' levied on the sum of the profits and remuneration of financial institutions.

In addition to the above measures, there is a call to address current tax distortions (such as the bias in relation to debt finance) and aggressive tax planning.

Improvements to running account measures

On 20 May 2010, the Assistant Treasurer announced that the Government would rewrite the running balance account provisions of the taxation law to provide the flexibility to manage tax debts and entitlements more efficiently and in a way that is more useful for taxpayers.

In making the announcement, the Assistant Treasurer said the running balance account system, enacted in 1999, was originally intended to provide taxpayers with a single tax account statement that covered all their tax debts, like a credit card statement. However, according to the Assistant Treasurer, the current system has not achieved its original goal. As an example, the system prevents certain debts such as general interest charge being brought into the running balance system and limits the ability of the Australian Taxation Office (ATO) to manage running balance accounts to meet specific taxpayer preferences.

A discussion paper was released by the Assistant Treasurer seeking the public's views on how best to streamline and improve the operation of these provisions. The paper also seeks comments on ways to improve and simplify the rules that entitle taxpayers to interest when they overpay their tax

debts – for example, when an income tax assessment is reduced after a taxpayer successfully objects to the assessment. This includes whether interest on these overpayments should be payable on more tax debts and the longer-term possibility of integrating it with the running balance account provisions. Such an approach could result in a simplification of the law in this area and its administration.

The consultation period closes on 8 August 2010.

Discussion paper: CGT treatment of earnout arrangements

Since the introduction of capital gains tax (CGT) in 1985, the tax treatment of earnout arrangements entered into when businesses (or interests in businesses) are sold has been somewhat contentious. From a practical perspective, payments received under a standard earnout are simply viewed as proceeds from sale of the relevant asset (such as the goodwill of the business). However from a CGT perspective, the earnout rights under the sale contract are themselves a separate CGT asset (distinct from the asset actually sold) and the disposal of that asset (when earnout payments are received) has its own CGT consequences. Similarly, there are tax complications for the party making the



earnout payments and the complications for the seller and the buyer will further depend on the exact manner in which the earnout is structured.

In view of these complexities, the Government has proposed specific legislative amendments to apply 'look-through' CGT treatment for qualifying earnout arrangements. In general terms, in the consultation paper released by Government it is proposed that in respect of 'standard' earnouts, additional payments made under the earnout are

to be treated as related to the original asset for the seller and adding to the cost base for the buyer. In respect of 'reverse earnouts' (where the seller pays back an amount to the buyer if the performance hurdles are not met), it is proposed that the payments made will be treated as effectively a repayment of part of the capital proceeds for sale of the underlying asset.

Submissions with respect to the consultation paper are required to be made by 11 June 2010. Taxpayers wishing to make submissions should contact their PricewaterhouseCoopers adviser.

Overhaul of financial advice

On 26 April 2010 the Minister for Financial Services, Superannuation and Corporate Law, announced a package of legislative reforms in response to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into financial products and services in Australia. The package includes the following:

- A prospective ban on conflicted remuneration structures including commissions and volume based payments, in relation to the distribution and advice of retail investment products including managed investments, superannuation and margin loans. The measure does not initially apply to risk insurance.

- The introduction of a **statutory fiduciary duty** so that financial advisers must act in the best interests of their clients, subject to a ‘reasonable steps’ qualification, and to place the best interests of their clients ahead of their own when providing personal advice to retail clients.
- Increasing transparency and flexibility of payments for financial advice by introducing ‘**adviser charging**’ that: will help align the interests of the financial adviser and the client; is clear and product neutral; and where the investor will be able to opt in to the advice in response to a compulsory, annual renewal notice.
- **Percentage-based fees** (known as assets under management fees) will only be charged on ungeared products or investment amounts and only if this is agreed to with the retail investor.
- **Expanding the availability of low-cost ‘simple advice’** to provide access to and affordability of financial advice.
- **Strengthening the powers of the Australian Securities and Investments Commission to act against unscrupulous operators.**
- The examination of a **statutory compensation scheme** by a corporate law expert.

The majority of these reforms will commence from 1 July 2012 and the Government will consult with industry on the implementation of the reforms.

Consultation paper: native title, indigenous economic development and tax

On 18 May 2010, the Government released a consultation paper entitled *Native Title, Indigenous Economic Development and Tax*. The paper discusses:

- the interaction between the income tax system and native title and sets out three possible approaches to reform
- how existing deductible gift recipient (DGR) categories could be better adapted to reflect the needs of indigenous communities, and
- whether a new general DGR category that includes organisations that carry out activities across multiple DGR categories would better reflect the needs of indigenous communities.

The Consultation paper was issued in response to concerns that the potential income tax implications of native title claims are complex and uncertain. To deal with that uncertainty and complexity, the paper outlines three options for reform in this area. The three options are:

1. An income tax exemption, so that payments made under a native title agreement are exempt from income tax and not subject to capital gains tax.
2. A new tax exempt vehicle, so that payments received into the vehicle would remain tax exempt when they

are used for certain purposes. The enabling legislation could specify a range of design features including the kinds of payments the fund can receive, the purposes (or uses) of the fund and its governance arrangements.

3. A native title withholding tax regime, under which parties who make payments for the suspension of native title rights and interests would be required to withhold an amount of tax (four per cent was the rate proposed) and pass it to the Australian Taxation Office before the payment goes to the native title holders. The rest of the payment would then be income tax exempt if on-distributed to the native title holders or their representative body (further conditions may also be applied to the use of the payment).

Closing date for submissions from interested parties is 2 July 2010.



Board of Taxation to review tax laws in the context of Islamic finance

On 26 April 2010, the Assistant Treasurer and the Minister for Financial Services, Corporate Law and Superannuation issued a joint media statement announcing that the Board of Taxation would undertake a comprehensive review of Australia's tax laws to ensure that, wherever possible, they do not inhibit the expansion of Islamic finance, banking and insurance products.

According to the media statement, the main tax issue faced in relation to accommodating Islamic compliant financial products in most Western tax systems is the form-based nature of such instruments. That is, whereas Western tax codes normally focus on the details of the transaction in question and levy

tax accordingly, this approach may give rise to anomalous tax treatments for Islamic instruments. In a strict ‘form’ approach, a transaction may, on its face, indicate one tax outcome, while the economic substance of the transaction may indicate another.

Islamic finance is finance that is consistent with Shariah or Islamic law, as set out in the Qu’ran. Among other features, Islamic finance:

- must exclude the payment of interest
- prohibits excessive uncertainty and investments in certain sectors such as gambling and alcohol
- provides that there must be a genuine and tangible underlying asset to any investment and that profit and loss must be shared.



On 18 May 2010, the Assistant Treasurer announced the terms of reference for the Board’s review, which includes the making of recommendations (for Commonwealth tax laws) and findings (for State and Territory tax laws) that will ensure, wherever possible, that Islamic financial products have parity of tax treatment with conventional products.

After considering the views of all stakeholders, the Board plans to provide a final report to the Assistant Treasurer by June 2011.

New foreign investment rules for residential housing

On 24 April 2010, the Assistant Treasurer announced a major tightening of the foreign investment rules as they relate to residential real estate, and a package of new civil penalty, compliance, monitoring and enforcement measures.

Under the proposed changes to the law, all temporary residents seeking to purchase an existing property in Australia will now be brought within the Foreign Investment Review Board (FIRB) notification, screening and approval process. Temporary residents will be required to notify, be screened or be approved by FIRB. The changes will ensure that temporary residents are subject to the same compulsory notification, screening and approval

requirements required of foreign non-residents.

In addition, the Assistant Treasurer announced that temporary residents who are approved will have to:

- compulsorily sell the established property they have bought when they depart Australia, and
- be required, where undeveloped land has been purchased, to commence construction on that land within 24 months or have the land compulsorily sold.

The Assistant Treasurer also announced that the Government will also work to put in place, for the first time, a full civil penalties regime that will apply to breaches of the foreign investment in Australian real estate regime.

As part of the new civil penalties regime, the Government will introduce:

- sanctions for purchasers, sellers and agents for being involved in transactions in breach of the law
- an explicit compulsory divestment requirement where property has been purchased in breach of the real estate investment regime, and
- an additional monetary penalty equivalent to any capital gain made by the breaching purchaser at the time of the forced sale, with the capital gain to be measured in accordance with the relevant tax legislation.

In addition to the new civil penalty regime, the existing penalty regime for offences under the *Foreign Acquisitions and Takeovers Act 1975 (FATA)* will be retained.

According to the announcement, the regime will be complemented by:

- a new national data-matching compliance monitoring program
- a new ‘1-800’ community hotline
- measures to improve compliance by real estate agents, and
- steps to ensure better enforcement outcomes.

Tax agent services concession

On 23 April 2010, the Assistant Treasurer announced that the new tax agent services regime will not apply to taxation services that satisfy a proposed ‘related entity concession’ that is to be included in the tax agent services legislation.

The related entity concession is to cover:

- services provided between entities that are part of the same GST group
- services provided by an entity in discharging their own formal obligations to another entity, namely trustees and responsible entities of a managed investment scheme
- services provided between separate legal entities that are carrying on a common economic enterprise and

- have the same or near same owners, namely wholly owned corporate groups, stapled groups, non-wholly owned groups and listed groups, and
- services provided between dual listed companies and between joint venture partners.

In addition, the Assistant Treasurer announced that custodians will not be captured by the regime and there be a one-year deferral of the regime for holders of an Australian Financial Services Licence providing financial planning services. This deferral is to allow for further consultation.

Anti-smoking action

On 29 April 2010, the Commonwealth Government announced a comprehensive package targeting smoking, including an increase in the tobacco excise of 25 per cent. In announcing the reforms, the Government stated that “the increase in tobacco excise will provide an extra \$5 billion over four years, which along with existing revenues from tobacco, will be directly invested in better health and hospitals through the National Health and Hospitals Network Fund”.

The Government’s anti-smoking action includes:

- A 25 per cent increase in the tobacco excise effective from midnight on 29 April 2010.
- The requirement from 1 July 2012 that cigarettes be sold in plain packaging. The legislation will restrict or prohibit tobacco industry logos, brand imagery, colours, and promotional text other than brand and product names in a standard colour, position, font style and size.
- A restriction on internet advertising of tobacco products.
- Injecting an extra \$27.8 million into ‘hard-hitting’ anti-smoking campaigns.

IGT review of ATO’S Change Program

In our May 2010 edition of *TaxTalk*, we reported that the Assistant Treasurer had asked the Inspector-General of Taxation (IGT) to undertake a review of the ‘Change Program’ implemented by the Australian Taxation Office (ATO). The Change Program is the program under which the ATO has been replacing all of its tax processing information and communications technology with one integrated core processing system. The reason for the request to the IGT to conduct a review is that taxpayers, tax practitioners and their representatives have raised concerns about the implementation program that have resulted in extended delays in processing

returns and a number of processing errors and delays in rectifying the errors.

On 5 May 2010, the IGT invited interested parties to make submissions consistent with the Terms of Reference, and in this respect the IGT advised that the final date for making submissions was 7 June 2010.

Taxpayers who have experienced problems as a result of the Change Program with the processing of returns and in obtaining refunds should consider making a submission to the IGT.

Exposure draft legislation: extending the scope of the scrip for scrip rollover relief

On 22 April 2010, the Assistant Treasurer released draft legislation designed to make it easier for takeovers and mergers regulated by the *Corporations Act 2001* to qualify for capital gains tax (CGT) scrip for scrip rollover relief.

The scrip for scrip rollover enables taxpayers to defer realising capital gains from exchanging shares in one company for shares in another as part of a merger or takeover. Similar relief is also available for the exchange of trust interests.

It is a requirement of the scrip for scrip rollover that members in the target entity have the ability to participate in the arrangement on substantially the

same terms. This measure carves out mergers and takeovers that comply with Australia’s corporations law from having to meet the participation requirements of the scrip for scrip rollover.

The measure is to apply to CGT events that happen from 6 January 2010, the day the Assistant Treasurer announced the Government’s intention to introduce the legislation. For further details regarding the announcement, see the February 2010 edition of *TaxTalk*.

Exposure draft legislation: tax deductibility of TPD insurance paid by superannuation funds

On 6 May 2010, the Department of Treasury released exposure draft legislation designed to provide transitional relief to complying superannuation funds for the deduction of insurance premiums for Total and Permanent Disability (TDP) benefits for the income years 2004-05 to 2010-11. The transitional relief is in line with current industry practice and will allow lead time for industry to make the required changes to comply with the current law.

Under the proposal, a comprehensive list of all the disabilities covered by policies industry has been treating as TPD policies is to be incorporated in a Regulation and premiums in respect of these will be covered by the transitional relief. This will give certainty to both to the superannuation industry and the Australian Taxation Office and will ensure that appropriate policies receive the full deduction for the premium in the years 2004-05 to 2010-11 in which the transitional provisions apply.

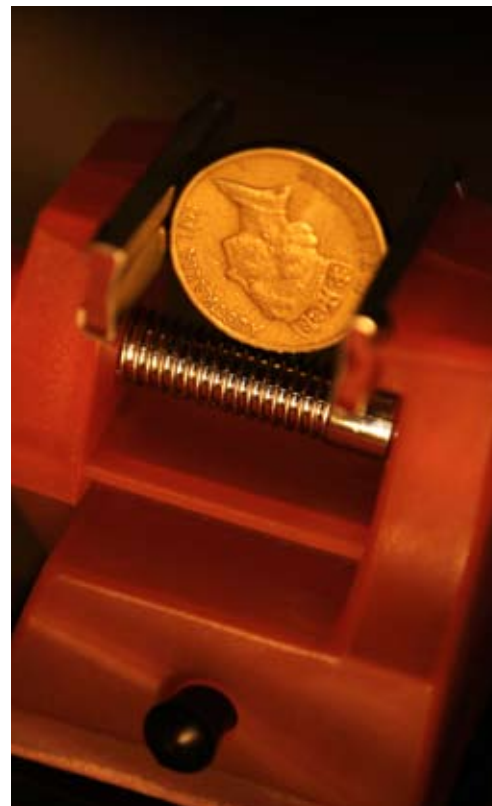
Release of the exposure draft legislation follows the Government's announcement in respect of this measure in October 2009, as reported in our November 2009 edition of *TaxTalk*.

The closing date for submissions in respect of the proposed changes is 3 June 2010.

Exposure draft legislation: acquisition of assets by a superannuation fund related parties

On 6 May 2010, the Department of Treasury released exposure draft legislation to amend the *Superannuation Industry (Supervision) Act 1993 (SISA)* to allow the trustee of a regulated superannuation fund to acquire an asset in-specie from a related party of the fund, following the relationship breakdown of a member of the fund, without contravening the prohibition in subsection 66(1) of that Act. Under the existing law, section 66 of the SISA can prevent the transfer or roll-over of certain superannuation interests resulting from a relationship breakdown.

The closing date for submissions in respect of the proposed changes is 3 June 2010.



Further information

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