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Exposure Draft Legislation: Bringing the MRRT to life

The much anticipated Exposure Draft (ED) legislation for the proposed Mineral Resource Rent Tax (MRRT) was released on 10 June 2011 and was accompanied by detailed explanatory material. The release of the ED is a major milestone of the consultation process and is a significant step towards the implementation of the proposed MRRT legislation.

This ED is not final and does not include the legislative provisions in relation to some of the more complex areas of the law that are yet to be drafted. As such, the MRRT legislation and consequential amendments (for example to the income tax and tax administration legislation) is not yet fully developed.

The final ED is envisaged to be released later this year. Notably, the draft legislation for the extension of the petroleum resource rent tax (PRRT) to all Australian oil and gas projects was not released simultaneously. This legislation is expected in the near future.

Generally, the ED is considered to be well drafted and appears to consistently reflect the Policy Transition Group's (PTG) recommendations for the design of the MRRT. However, the MRRT is a complicated tax with several technical aspects that inherently cause a degree of uncertainty for taxpayers and advisers. Further, the drafting style of the ED has created some additional technical issues (for example, in relation to the definition of 'mining project interest') that will need to be thoroughly considered and tested through the consultation process.

The submission period in respect of this ED closes on 14 July 2011. More detailed information on the MRRT ED and what it means for you is available at: http://pwc.com.au/tax/publications/index.htm

The MRRT is designed to be a profits-based, cash flow tax on the economic rents associated with the extraction of coal and iron ore. The ED appears to be broadly consistent with the Heads of Agreement and Government's MRRT announcement released on 2 July 2010 and the PTG's recommendations released on 21 December 2010.

The MRRT liability, as explained by the core rules in Division 7 of the ED, is calculated for each mining project interest held by a 'miner'. The MRRT is designed to tax the upstream profits of iron ore and coal projects as follows:

MRRT liability = MRRT rate X (Mining profit – MRRT allowances)

Where:

- MRRT rate is the headline rate of 30 per cent reduced by the 'extraction factor' of 25 per cent (i.e. an effective tax rate of **22.5 per cent**)
- Mining profit is the current year profit derived from the excess of the revenue attributable to upstream operations compared to upstream mining expenditure, and
- MRRT allowances which compensate miners for royalties paid, the value of their projects at 1 May 2010 (the starting base) and prior year losses (including an augmentation factor to maintain their real value and to provide a risk premium associated with the possibility the losses may never be used).

Key Observations on the ED

1 *The complexity of the ED is a result of a prescriptive drafting style as well as the complexity of the underlying tax*

The MRRT is a complex, new tax separate and distinct from any tax existing in Australia. Moreover, the ED is the product of a rigorous consultation and drafting process. The ED (subject to certain exclusions) deals with most of the issues that have been raised in the PTG's recommendations on the MRRT. However, the combination of a complex law and an intensive consultation / negotiation process means that the legislation is voluminous, complex and prescriptive.

2 *The calculation of the starting base is inherently difficult and this difficulty is exacerbated by the narrow definition of 'mining project interest'.*

The ED potentially suggests (or at least implies) that mining project interests should be valued individually for the purpose of calculating the transitional starting base allowance that provides a shield for investments in pre-existing projects. This will increase the compliance burden of performing starting base valuations because 'mining project interests' are defined by reference to production tenements (and many mining projects comprise several underlying tenements). Clarity is needed on how to value the starting base for integrated mining project interests that are combined for MRRT purposes.

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3 The calculation of the revenue subject to the MRRT will require detailed transfer pricing analysis.

The mining revenue calculation will require transfer pricing analysis where the first supply of the resource is not an arm's length transaction or where the first supply, use or export of the resource is after the taxing point (generally the 'Run-of-mine' stockpile).

Therefore some miners may be required to perform multiple arm's length pricing analyses which would add significant complexity to annual MRRT compliance.

4 The concessions available for small miners may come at the cost of benefits foregone

The ED includes provisions limiting the complexity for small miners (e.g. there is a simplified formula for calculating mining revenue in some circumstances).

However, these measures come at the cost of being denied the ability to carry forward MRRT attributes such as starting base losses, royalty credits and any mining losses. This cost diminishes the value of the 'concessions' because it reduces the tax synergies available to potential purchasers (and therefore the value of the projects) as well as potentially resulting in higher MRRT payable if the project grows beyond the thresholds.

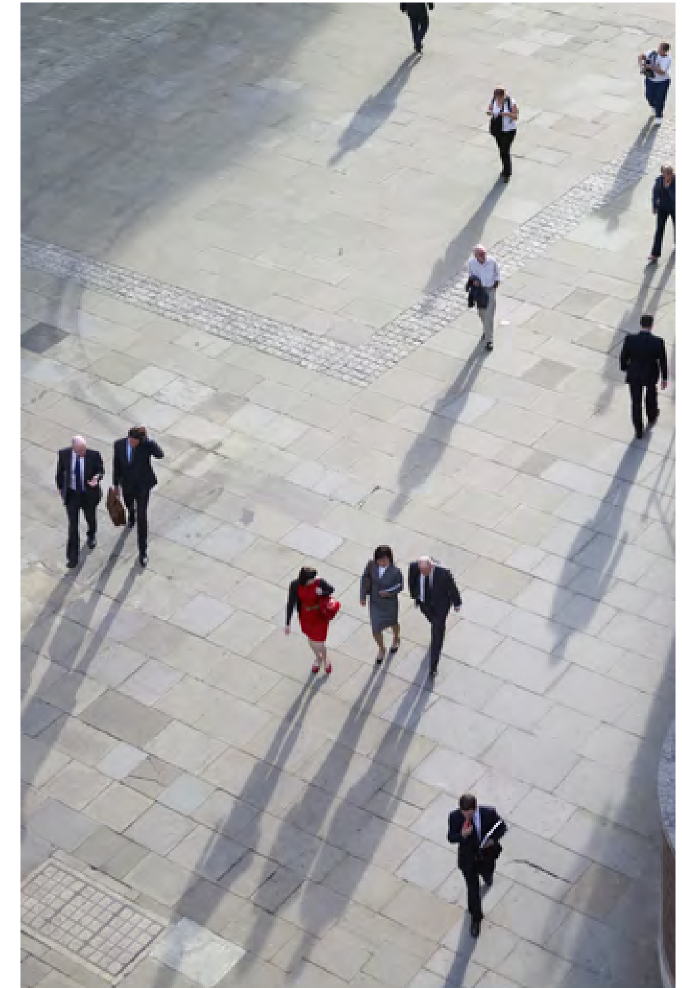
5 MRRT should be considered for all coal and iron ore transactions undertaken from 1 May 2010 onwards.

It is clear for taxpayers undertaking merger and acquisition (M&A) transactions from 1 May 2010 onwards that the appropriate disclosure, indemnity and assistance clauses will be required to ensure the optimum MRRT outcomes. This is because the inherited history rule that applies on acquisitions or transfers of project interests (e.g. revenue received post-completion of the transaction will be assessable to the buyer and this will need to be adjusted accordingly in the bid price) means that actions of the vendor will affect the MRRT outcomes for the purchaser.

6 More is yet to come

The MRRT ED, while extensive and complex, is still incomplete. Many significant issues (detailed below) have not been considered in this ED. Some of the topics that have not yet been drafted (for example, the calculation of the starting base for pre-production tenements, valuation principles generally and anti-abuse rules) will be significant and complex additions to further drafts.

Similarly, the draft legislation for the extension of the PRRT to onshore oil and gas projects has not been released yet. Whilst the PRRT is already legislated, the transitional measures will need to be adequately drafted and, in addition, the extended PRRT rules as a whole will need to appropriately cater for the unique characteristics of onshore coal seam gas operations in particular.



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What it means for you

Given the far-reaching and business-wide implications of the MRRT, affected taxpayers should consider the following immediate actions:

1. Review the ED and explanatory material as the 'devil is in the detail'.
2. Anticipate how the nuances of the MRRT will practically apply and impact your MRRT position based on your specific facts and circumstances, as well as the profile of each of your projects.
3. Refine your MRRT model to reflect the mechanics of the MRRT to the extent provided for in the ED.
4. Identify the issues to be raised in submissions on the ED (due by 14 July 2011) either individually or as part of submissions by the industry body or professional tax/accounting bodies.
5. Update and refine your MRRT implementation plan to encompass the aspects that have been clarified by the ED (e.g. how to define mining project interests for which a starting base valuation should be undertaken, planning for which projects can and/or should be combined, evaluating revenue calculation methodologies, and ascertaining the impact of accounting, tax and financial reporting systems changes).
6. Update key stakeholders on the projected impact on your forecasted MRRT positions (if any) based on the drafting of the ED.
7. Ensure the organisation is ready to meet continuous disclosure and financial reporting obligations as the development of draft legislation progresses.
8. Ensure MRRT due diligence and appropriate MRRT clauses are included in deal documents if presently undertaking M&A activity and transactions.

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R&D update

On 15 June 2011, the Government and Greens announced joint support for the new Research and Development (R&D) Tax Credit with a start date of **1 July 2011**. It is anticipated that the Bills to legislate this tax concession will be passed by Parliament in August 2011.

With the commencement of the program, companies need to immediately consider how to transition and preserve claims into the new regime, for example:

- The definition of R&D will change: what does "dominant purpose" mean in the context of claims and what arguments can be made and what substantiation will be helpful in the event of review?
- Core and supporting activities will have to be separately disclosed: what changes in processes are required such that disclosure requirements can be met?
- How do the new software rules impact claims?
- How can the preparation of a company's R&D claim for the financial year ended 30 June 2011 under the current regime be used to best prepare for the new regime?

We are currently in the process of planning industry specific 'R&D School' workshops to assist companies understand the new program and its implications. These will be promoted in our Upcoming Events section of *TaxTalk* in coming months.

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Accounting for a TOFA balancing adjustment within a tax consolidated group

For entities subject to Taxation of Financial Arrangements (TOFA), the new regime will apply to financial instruments that are entered into as from the entity's TOFA start date, and by exercising the so called transitional election, the TOFA regime will apply also to pre-existing financial instruments that are outstanding at the start date.

Where a transitional election is made, a balancing adjustment is to be made for the pre-existing financial instruments brought into TOFA to the extent there is a difference between the gains/losses that have been recognised through to the TOFA start date as compared to the gains/losses that would have been recognised had TOFA always applied. The balancing adjustment is brought to account, as an item of assessable income or allowable deduction, over the four income years commencing at the TOFA start date.

Where the entity in question is a tax consolidated group, it will be important to consider how the balancing adjustment is to be accounted for as between the head company and subsidiary members of the group. We believe that the appropriate accounting treatment is as follows:

- The balancing adjustment is taken into account in determining the tax base of financial instruments – consequently, there will generally be a change of deferred tax balances for those financial instruments included in the amount of the balancing adjustment.
- Within a tax consolidated group, the balancing adjustment is a tax attribute that is immediately assumed by the head company in much the same way as are tax losses and tax credits. For the head company, it is an item of current tax to the extent it is to be included in the current year's taxable income, and an item of deferred tax to the extent it is to be included in subsequent years' taxable income.
- To the extent that the balancing adjustment includes amounts in respect of subsidiary members of the group, the principles set out in UIG Interpretation 1052 (UIG 1052) issued by the Australian Accounting Standards Board are to be followed. The head company's assumption of the balancing adjustment amounts of subsidiaries is to be dealt with as a transaction through equity, other than to the extent that it can be dealt with through intercompany account under a tax funding agreement.
- In most cases, tax funding agreements will have been entered into before the TOFA balancing adjustment was contemplated; consequently, they often will not contain provision for balancing adjustment amounts to be charged/credited between the head company and the subsidiaries. In such cases, the agreement will need to be amended if the group wishes to avoid accounting entries through equity.

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Loss for Commissioner in SNF appeal

The Commissioner of Taxation has been unsuccessful in his appeal to the Full Federal Court in *SNF (Australia) Pty Ltd v Commissioner of Taxation* [2011] FCAFC74. The appeal decision was handed down on 1 June 2011 with a unanimous judgement that the Commissioner's appeal should be dismissed.

The decision highlights the transactional focus of Division 13 of the *Income Tax Assessment Act 1936* (ITAA 1936) and potentially has wide reaching implications for the application of Australia's transfer pricing rules, because it calls into question the Australian Taxation Office's (ATO) interpretation of the arm's length principle.

The key findings of the Full Federal Court included:

- The standard of comparability that the Commissioner asserted was necessary in order to apply the Comparable Uncontrolled Price (CUP) method was unrealistically high. The Court reviewed the 'comparables' presented by the taxpayer and concluded that the taxpayer's evidence of comparable transactions was sufficient to establish that the purchase prices paid by the taxpayer to related parties did not exceed an arm's length consideration.
- A key factual point which the Court considered critical for the taxpayer's case was that there was evidence of a 'global market' for the chemicals imported by the taxpayer from its related parties. The judgement emphasised that a 'global market' is not the same as a 'global price'.
- Despite having considered them, the Court found that the Guidelines published by the Organisation for Economic Co-operation and Development (OECD Guidelines) are not law and do not have to be referred to when interpreting Division 13.
- Poor trading results may be attributable to factors other than transfer pricing. The fact that the taxpayer had incurred losses over a prolonged period did not in itself provide evidence to support the Commissioner's argument that the prices paid by the taxpayer were excessive.

We have summarised the facts of the case and broader implications for Australian taxpayers in more detail below.

Background

The dispute related to the deductibility of the amounts paid by SNF Australia between the year ended 31 December 1997 and the year ended 31 December 2003 (the 1998 to 2004 income years) for purchases of products from related manufacturing subsidiaries of its parent, SNF France. The manufacturing subsidiaries were resident in France, the United States of America and China.

The Commissioner considered that there were no sufficiently comparable uncontrolled transactions available to enable the CUP method to be applied to SNF Australia's purchases. The Commissioner applied the Transactional Net Margin Method (TNMM) and proposed adjustments to SNF Australia's purchase prices that would increase its operating margin to an average of 1.7 per cent for the relevant income years (when in fact it has incurred operating losses over this period).

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Loss for Commissioner in SNF appeal

Implications flowing from the decision

- Where taxpayers have sufficiently reliable Comparable Uncontrolled Prices, these should be applied in preference to other profit based methods.
- The standard of comparability the Court was willing to accept in applying the CUP method was much lower than the standard suggested by the ATO.
- Taxpayers should carefully consider whether they have potential CUPs and whether these CUPs (with a lower standard of comparability) support their position. Caution should continue to be applied in deciding when and how to examine information which is held by an overseas parent entity or related party.
- Evidence played a key role in this case and taxpayers contemplating litigation or with complex transfer pricing issues should consider lessons learned.
- The decision raises questions over the ATO's views on the 'commerciality' of related party transactions, including financial transactions.
- The ATO is considering its response to the decision, including whether it will seek leave to appeal to the High Court as well as seek a change in the law. We expect an ATO Decision Impact Statement to issue in July 2011. However, in the meantime, the ATO's view is that it is 'business as usual'.
- The ATO will continue to review a taxpayer's profitability as one of the key factors in identifying transfer pricing risk. Taxpayers who incur losses should document the commercial and economic factors that have contributed to the losses.
- There continues to be a place for profit based methods for both the ATO and taxpayers as in many cases, CUPs will not be available and taxpayers will need to revert to profit based methods to support their transfer pricing position.

Conclusion

The SNF Australia appeal decision is important for Australian taxpayers because it provides further enlightenment on the application of Australia's transfer pricing laws under the income tax regime. The decision will be a significant blow to the ATO because it suggests that certain aspects of the ATO's approach to transfer pricing cases are inconsistent with the law and the OECD Guidelines. While the ATO's response to the decision is not yet known, it is possible the ATO will need to revise its approach in light of this. Australian taxpayers should review their own circumstances and may need to reconsider their transfer pricing processes in light of guidance obtained from the decision on the standard of comparability that is required when applying the arm's length principle.

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Reforms to the car fringe benefits rules

What are the changes?

In the 2011-12 Federal Budget, the Government announced that it would introduce a flat 20 per cent statutory rate for employers using the statutory formula method to value car fringe benefits. This rate will apply regardless of the distance travelled by the car during the FBT year.

Legislation to give effect to this proposal was passed by Parliament and has received Royal Assent.

When will the amendments apply?

The changes will apply to new commitments made by employees, employers or associates after 7.30PM (AEST) on 10 May 2011 for the "application or availability of a car". This means, for example, that where an employer or employee has committed to the acquisition of the car prior to this time, the benefit will generally continue to attract the progressive statutory rates applicable to the 2011 and prior FBT years (subject to a number of exceptions discussed below).

The new rate will be phased in over four years as follows:

Distance travelled during the FBT year (1 April – 31 March)	Statutory rate (multiplied by the cost of the car to determine a person's car fringe benefit)				
	Existing commitments	New commitments entered into after 7:30pm (AEST) on 10 May 2011			
		From 10 May 2011	From 1 April 2012	From 1 April 2013	From 1 April 2014
0 – 15,000 km	0.26	0.20	0.20	0.20	0.20
15,000 – 25,000 km	0.20	0.20	0.20	0.20	0.20
25,000 – 40,000 km	0.11	0.14	0.17	0.20	0.20
More than 40,000 km	0.07	0.10	0.13	0.17	0.20

Where an existing arrangement for an employer changes during the FBT year due to a new commitment, the new statutory rate will apply from the start of the following FBT year.

An employer can choose to skip the transitional arrangements (for post 7.30pm on 10 May 2011 commitments) and immediately use the flat statutory rate of 20 per cent, provided it obtains the consent of affected employees who will be worse off under the new rules. However, given it immediately increases the employer's FBT liability or, in the case of salary packaged cars, requires administrative effort, it is difficult to see this option being exercised.

At least in the short term, employers are left with a valuation measure that was originally intended to be concessional, but which may well be more onerous than using the alternative valuation method for car fringe benefits – the operating cost (or log book) method.

New Commitments

The key area of remaining uncertainty is what will constitute a new commitment by the employer, employee or associate. The phrase "committed to the application or availability of the car" replaces the Government's original proposed wording of "new vehicle contracts entered into". Based on current interpretation, a new commitment will include:

- a re-novation of an existing lease
- an extension of an existing lease arrangement
- entering into a new written contract or an unwritten, but evidenced binding agreement
- re-financing of an existing lease agreement, and
- transferring cars and/or employees to a new or related entity, if it affects the underlying vehicle contract.

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Simply adding non-business accessories to a car will not result in a new commitment. Similarly, amending salary packaging arrangements without any change to the underlying vehicle contract will not result in a new commitment.

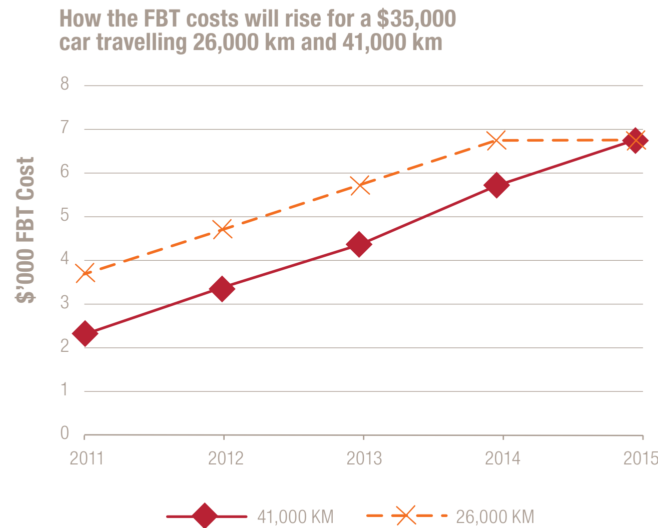
Accordingly, employers need to be careful about making a commitment that will trigger the new provisions in respect of an existing car. Further, it is recommended that recent and near future acquisitions of cars be reviewed to ascertain whether a commitment occurred prior to 7.30pm on 10 May 2011.

According to the Explanatory Memorandum to the amending Act, employers and employees who seek to end existing contracts early, and immediately enter into new contracts in order to obtain the benefit of the new rules, may be caught by the general anti-avoidance provisions. It will be interesting to see how this is applied to salary sacrificed car arrangements which are presumably entered into on the basis of obtaining a tax a benefit. Maybe it will only have practical application to employer car fleets.

What could the changes cost the employer?

The FBT cost of using the statutory formula method for cars that travel more than 25,000kms per year will almost double at the end of the four year transitional period, and for those cars that travel more than 40,000 kilometres, the FBT cost will almost triple.

The following chart shows how the FBT cost will climb for new commitments over the next four years.



The chart illustrates that the annual FBT cost of a $35,000 car (being a post-10 May 2011 commitment) that travels between 25,000 kilometres and 40,000 kilometres per year will increase by $3,025 and if that car were to travel more than 40,000 kilometres per year, the annual FBT cost would increase by $4,369.

For a fleet of 200 cars travelling between 25,000 kilometres and 40,000 kilometres and 200 cars travelling more than 40,000 kilometres this will mean an increase of approximately $1,478,530 per FBT year. Even for a small fleet of 20 cars travelling between 25,000 kilometres and 40,000 kilometres and 20 cars travelling more than 40,000 kilometres this will mean an increase of approximately $147,850 per FBT year.

What could the changes cost the employee?

Employees who salary package a car and travel more than 25,000 kilometres per year, will generally have an increased salary package cost and reportable fringe benefits amount. This may increase their liability to other imposts and/or reduce government benefits.

What can be done?

For tool of trade cars, employers may wish to consider the use of the operating cost (logbook) method of valuing car fringe benefits, which will in many cases result in considerable FBT savings. This will require the keeping of accurate and valid log books for a representative 12 week period.

Employers should also consider reviewing their car policy, which may reveal better and more cost efficient ways to provide tool of trade cars or salary package cars.

In addition, employers will need to communicate with employees now to warn them of the effect of the changes, in particular, the expected increase in their salary package cost, post-tax contribution requirements or reportable fringe benefits amount.

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The untouchable assessment – No crime, no foul

In the recent Full Federal Court decision of *Denlay & Denlay v Commissioner of Taxation* [2011] FCAFC 63, the Full Court found that amended assessments should not be set aside on the basis that those assessment relied on information that had allegedly been unlawfully obtained by a third party and then provided to officers of the Commissioner.

The taxpayers' case was that the amended assessments issued by the Commissioner should be set aside on the basis that officers of the Commissioner had breached section 400.9 of the *Criminal Code Act 1995* (Cth) (a person is guilty of an offence for receiving or importing into Australia money or other property which are proceeds of a crime in Australia or a foreign country). As a result of this contravention, those officers engaged in *"conscious maladministration of the assessment process"* by making a deliberate decision to use the information obtained, despite reasonably suspecting that this information had previously been obtained unlawfully.

The Court rejected the taxpayers' case finding that it was fatally flawed by evidentiary and substantive difficulties, including:

- insufficient evidence to satisfy the elements of a *prima facie* case for breach of section 400.9 of the Criminal Code, essentially as information is not property
- High Court authority which holds that *'conscious maladministration'* by the Commissioner or his officers requires actual bad faith rather than some form of "constructive" bad faith, and
- that *'conscious maladministration'* is concerned with the integrity of the assessment and not the process of obtaining information which leads to an assessment.

The decision is another example of the difficulties facing taxpayers when challenging assessments outside of the statutory objection and appeal process under the tax legislation. The taxpayers' case under the statutory appeal process is however currently proceeding in the Federal Court and the implications of the alleged unlawfully obtained information may be canvassed further, including through evidence from the person alleged to have obtained that information.

Whether the manner in which the information was obtained may prevent its use in any prosecution for taxation or fraud offences against the Commonwealth remains to be tested.

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Overhaul of Australia's Anti-Dumping System

On 22 June 2011, the Australian Government responded to the steady stream of enquiries, political posturing, union representation and industry concerns that have engulfed the debate on the most effective means of changing our approach to Australia's Anti-Dumping and Countervailing System for the last ten years.

The Minister for Home Affairs and Justice, The Hon Brendan O'Connor and the Minister for Trade, The Hon Dr Craig Emerson, issued their joint media release containing the key changes to Australia's Anti-Dumping and Countervailing system, consistent with our World Trade Organization (WTO) commitments.

Key reforms were announced as a result of the Australian Government Productivity Commission's final report as follows:

- The Government will establish the International Trade Remedies Forum. The Forum will work with Government to oversee the implementation of the reforms
- Improved timeliness through:
  - A 45 per cent increase in Customs staff working on anti-dumping issues over the next 12 months to ensure cases are dealt with more efficiently.
  - Introducing provisional measures at an earlier opportunity to remedy the negative effects of dumping sooner.
  - Introducing a 30 day time limit for Ministerial decisions on anti-dumping cases.
- Stronger compliance through:
  - A dedicated resource within Customs to boost monitoring of measures to ensure compliance.
  - Combating attempts to circumvent anti-dumping duties.
- Improved decision making by:
  - Greater use of trade and industry experts in investigating complaints.
  - The introduction of a more rigorous appeals process supported by more resources.
  - Clarifying the list of injury factors that can be claimed by domestic industry, and clarifying Customs' approach to injury determinations.
  - Providing flexibility in allowing extensions of time to complete complex cases.
- Better access to the anti-dumping system through:
  - A new Support Officer to support small and medium businesses and downstream manufacturers and producers to actively participate in anti-dumping investigations, improving access to imports and subsidies data, and clarifying the data requirements for making an application.
  - Clarifying the parties who can participate in investigations to include relevant industry associations, unions and downstream industry.
  - Providing a more flexible basis for parties wishing to seek a review of existing measures.
- Greater consistency with other countries through:
  - Regular consideration of the practices and decisions of other countries.
  - Allowing Australian companies to combat a wider range of subsidies.

These measures will be implemented over the coming months with a combination of amendments to administrative procedure (i.e. Customs Manual amendments), feedback from the International Trade Remedies Forum (to be established) and legislative amendments.

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GST and Deal Costs

Claiming input tax credits on direct acquisitions made in connection with a merger and acquisition activity

The Australian Taxation Office (ATO) issued guidance in early June 2011 on whether to claim input tax credits on acquisitions made in connection with merger and acquisition (M&A) activity. The guidance recommends adopting a conservative approach to claiming such input tax credits, but more aggressive claim methodologies throughout the deal life-cycle may be appropriate.

Basic Rules Revisited

- Input tax credits can be claimed where assets of an enterprise are acquired and the assets are used to make supplies that are taxable or GST-free (creditable purpose).
- Input tax credits will generally not be claimable where the transaction involves the purchase of shares of domestic targets.

Determining whether acquisitions related to M&A activity are for a creditable purpose

The ATO considers a number of factors in determining whether or not an acquisition is for a creditable purpose and therefore whether an input tax credit can be claimed. These include:

- whether the work performed is exploratory or specific
- whether there is board or senior management commitment to a proposed transaction, and
- whether there is a dedicated project team and specific consultants engaged.

These factors essentially look to find the 'nexus' between the acquisition and the form of the M&A activity.

When an acquisition is considered 'too remote' to relate to a potential M&A transaction, the ATO states that it may be appropriate for an entity to claim full input tax credits.

Safe Harbour

Instead of determining the extent of input tax credits throughout the M&A activity, it may be prudent to deny all input tax credits until after the M&A activity is complete.

Where the deal structure is unknown

The ATO suggests it may be appropriate to apportion input tax credits where there is uncertainty regarding the form of the M&A activity. For example, where the M&A activity is equally likely to give rise to an input taxed supply as a non-input taxed supply, it may be reasonable to claim 50 per cent of the input tax credits throughout the M&A activity.

The ATO does not make any comment as to the availability of 75 per cent Reduced Input Tax Credits (RITCs) and it may be prudent to instead claim 75 per cent on expected qualifying acquisitions.

Success Fees

Where a service provider is remunerated by way of success fee at completion, the success fee must be apportioned over the M&A activity's life-cycle (for assets versus shares outcomes) to determine the appropriate input tax credits.

Integration Costs

The ATO considers that genuine integration costs (e.g. HR consultancy to integrate new employees, or marketing for new branding) do not relate to M&A activity and can generally result in full input tax credits.

Indirect Costs

No commentary is included by the ATO regarding indirect cost allocations and it is appropriate to ensure that a justifiable apportionment of overheads is used.

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High Court finds for BHP Billiton on limited recourse debt rules

On 1 June 2011, the High Court dismissed the Commissioner's appeal in *Commissioner of Taxation v BHP Billiton Limited* [2011] HCA 17. In that case the Commissioner had argued that a loan between companies within the wholly owned BHP Billiton Group (BHPB Group), which had been used by the borrower to fund expenditure on substantial infrastructure, was *limited recourse debt* as defined in the taxation law. In the event that the debt was *limited recourse debt,* an affect of the debt being written off as 'bad' by the lender (Finance) in the 2000 tax year, was that deductions claimed in subsequent years by the tax consolidated group under the capital allowance provisions of the *Income Tax Assessment Act 1997* (ITAA 1997) were required to be reduced (resulting in an increased tax liability) to effectively reflect the fact that the borrower had not been fully at risk in relation to incurring the relevant infrastructure expenditure.

While it was clear, and the Commissioner accepted, that contractually, the rights of Finance to repayment of the debt were not limited to particular assets of the debtor, the Commissioner argued that the debt was *limited recourse debt* since sub-section 243-20(2) of the ITAA 1997 extended beyond contractual limitations as to repayment (which was covered by sub-section 243-20(1)), to situations where in relation to an obligation imposed by law on an entity (the debtor) to pay an amount to another entity (the creditor) "it is reasonable to conclude that the rights of the creditor as against the debtor in the event of default in payment of the debt or of interest are *capable of being limited*" wholly or predominantly to any or all of:

a) rights (including the right to money payable) in relation to any or all of the following:
   i) the *debt property* or the use of the *debt property*
   ii) goods produced, supplied, carried, transmitted or delivered, or services provided, by means of the *debt property, and*
   iii) the loss or disposal of the whole or a part of the *debt property* or of the debtor's interest in the *debt property;*

b) rights in respect of a mortgage or other security over the *debt property* or other property;

c) rights that arise out of any *arrangement* relating to the financial obligations of an end-user of the *financed property* towards the debtor, and are financial obligations in relation to the *financed property.*

The High Court noted that at trial, the Commissioner had submitted that sub-section 243-20(2) was intended to catch those arrangements which have the capacity to bring about a limitation on a creditor's rights of the kind described in (a), (b) and (c). The Commissioner elaborated on this during the High Court proceedings, and according to the Court's judgment, had contended that "the sub-section is concerned neither with current contractual limitations or rights, nor with economic equivalence, but rather with *a practical capacity or ability to bring about legal limitations on legal rights* irrespective of whether there is any arrangement to which the debtor is a party". On this point, the Commissioner contended that the expression *capable of,* as used in sub-section 243-20(2) means 'susceptible to' and that such construction encompassed "the possibility of contractual variation" between the debtor and creditor. Based on this construction the High Court noted that the Commissioner's argument was that "where a creditor's rights were, in practice, susceptible to being altered, so as to introduce a legal limitation on the rights of the creditor against the debtor in the event of default, the debtor has not been fully at risk in relation to the amount of the expenditure funded by the debt", and in these circumstances the debt is *limited recourse debt* for tax purposes. The taxpayer countered this submission by arguing that *practical susceptibility* to being altered, was not what was covered by the phrase *capable of being limited.*

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In relation to sub-section 243-20(2), the Court expressed the view that the sub-section "is directed to legal limitations on legal rights which arise other than by contract". The Court then said that "to describe a creditor's rights as *capable of being limited* is to refer to a power of a person to limit or bring about a limitation on those rights", and that "such a power must exist at the inception of the loan, whether it arises as a result of an arrangement or a circumstance of conduct (from which an arrangement may be inferred) or in some way other than the way covered by sub-section 243-20(2)". According to the Court, it followed that sub-section 243-20(2) "would not be satisfied by the existence, at the inception of the loan, of a possibility of a person acquiring a capacity (that is a power) to limit, or a power to cause the relevant limitation of, a creditor's rights of recourse at some point in the future". The Court noted in this respect that if the law did not apply in this manner "all loans used by a debtor to acquire property, including loans for special purpose projects involving a corporate group and intra-group financing, must be characterised...as limited recourse debts", and that "such an interpretation carries the potential recognised by Edmonds J [in the Full Federal Court decision], for discouraging investment in special purpose projects".

In dismissing the Commissioner's appeal the High Court said that "the Commissioner's identification of a *practical capacity* in BHPB [i.e. the parent company of the BHPB Group] existing at the inception of the loan, to cause a relevant limitation on Finance's rights or recourse against BHPDRI [i.e. the debtor], never rose above being a possibility of what might happen if certain contingencies arose", and that "because sub-section 243-20(2) is not directed to possibilities for a limitation of a creditor's rights of recourse which might arise in the future, sub-section 243-20(2) does not apply to BHPDRI's debt to Finance".

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Indirect Taxes update

GST reform – consultation papers released

Treasury has released consultation papers which provide further detail on three of the Goods and Services Tax (GST) measures announced in the 2011-12 Federal Budget. The consultation papers are intended to provide additional information on how the measures may operate, and to seek feedback on their design and implementation.

GST treatment of property in possession of a mortgagee

The proposed measure addresses the unintended consequences that arise from the overlapping provisions of Division 105 and Division 58 in the GST legislation as they apply to the specific circumstance where a mortgagee makes a supply of property in their possession or control belonging to a corporation. The two Divisions contain substantial differences in terms of registration and reporting requirements, which are a primary cause of uncertainty.

The consultation paper proposes that the legislation be amended to provide that Division 105 will take precedence in these circumstances. This is consistent with the Australian Taxation Office's (ATO) current GST treatment.

GST and certain supplies to health insurers

The Commissioner has administered the GST law on the basis that a payment made by a health insurer to a health care provider would often be consideration for a GST-free supply the health care provider made to a policy holder. However, in *Commissioner of Taxation v Secretary to the Department of Transport (Victoria)* (2010) FCAFC 84, the Full Federal Court took a broad approach to characterising third-party arrangements, with the potential implication that health related supplies provided via third-party arrangements in the course of settling insurance claims could in some contractual circumstances be characterised as involving two supplies.

The consultation paper indicates that the law will be amended to ensure that certain supplies from an entity to a health insurer are GST-free, where those supplies are in the course of the settlement of an insurance claim. The proposed amendment is to apply from 1 July 2000.

Allowing small businesses in a net refund position to access the GST instalment system

Currently, the GST legislation excludes a business from the GST instalments system if that business is in a net refund position. The Government will amend the GST law to allow small businesses in a net refund position to choose to access the GST instalment system if they wish. The policy objective is to assist those taxpayers that temporarily move into a net refund position (for example because of a one-off acquisition), and those taxpayers normally in a net refund position who consider that the compliance cost advantages of submitting their Business Activity Statement (BAS) annually outweigh the cash flow cost of delayed refunds.

The consultation paper states that the legislation will be amended to extend access to the GST instalment system to small businesses in a net refund position by providing these businesses with an instalment amount each quarter of zero. This means that any refunds due to the taxpayer (or any tax liability, should their position change) will be paid annually following their annual return.

Taxpayers who are affected by these proposals have until 6 July 2011 to make submissions.

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State taxes update

South Australia stamp duty amendments

The *Statutes Amendment (Land Holding Entities and Tax Avoidance Schemes) Bill 2011 (SA)*, which has been introduced into the South Australian Parliament, proposes to amend the *Stamp Duties Act 1923 (SA)* by implementing the landholder provisions announced in the State's 2010 Budget and replacing the land rich provisions contained in that statute. The Bill has not yet passed in South Australia and it appears that the Bill may be amended. The initial draft provisions are intended to protect the conveyance duty revenue base of the State, in relation to the indirect purchase of land through companies and unit trust schemes. The amendments are intended to apply from 1 July 2011 subject to transitional provisions applicable to agreements entered into before 1 July 2011 but completed on or after that date. These agreements will be dealt with under the existing land rich provisions.

The Bill also introduces new provisions into the *Taxation Administration Act 1996 (SA)* in relation to tax avoidance schemes. These provisions provide a broad and consistent approach to tax avoidance across South Australian taxes.

New South Wales – Primary Production land tax exemption

The recent decision of the New South Wales (NSW) Administrative Decisions Tribunal in *Romano v Chief Commissioner of State Revenue* [2011] NSWADT 73 (Romano) further illustrates the high level of Revenue interest in the primary production exemption. Unlike the earlier Supreme Court decision in *Leda Manorstead v Chief Commissioner* [2010] NSWSC (Leda), Romano involved the Revenue challenging the availability of the exemption where the land in question was zoned rural. Effectively the issue was whether the dominant use of the land was for primary production activity where the land was also used for residential leasing.

Unlike in Leda, there was no evidence of any development activity on the land in question nor was there any preparatory activity (e.g. a rezoning or development application). The land (approximately 15 acres in total) was held by a family for many years and there were four residential buildings on the land which had been occupied by tenants. The Tribunal found that the land area devoted to farming clearly exceeded that area devoted to the derivation of rental income and that there was no doubt that the dominant physical activity that the owner undertook on the land was farming activity. Furthermore, as stock levels where maintained at or above the calculated carrying capacity of the land, the level of intensity of the land's use was again in favour of primary production activities (albeit the carrying capacity (four cows) and actual level of activity (seven cows) was reasonably modest).

Despite these factors, the Tribunal found in the Revenue's favour. While the Tribunal emphasised that no one single factor is determinative, in concluding what was the dominant use of the land, it seemed to place considerable weight on the historical income derived from each activity. This information demonstrated that rental income clearly predominated (by a factor of 30 to 1) over income from primary production activities, and there was absolutely no possibility that the position could ever be reversed or reduced in any meaningful way.

The Tribunal relied heavily on the approach taken in Leda when determining dominant use and emphasised (as did the Supreme Court in Leda) that the determination of the dominant use of the land is a question of fact and degree and even perhaps one of impression.

The importance of this decision is that even if land is zoned rural, the primary production exemption does not automatically apply. The dominant use test is still relevant if the land is also used for a non-primary production purpose. All claims for the exemption need to be carefully and continually monitored. Additionally, it is clear from the decision that documentation is important since claims of one use being dominant over another need to be supported by detailed records regarding the income from the primary production activity, level of investment and time invested, business plans and specialist reports regarding carrying capacity. Even with thorough documentation, success is not guaranteed.

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While the case did not consider the issue, it is possible that the dominant use test could result in even preparatory activities (e.g., incurring significant costs to prepare a development application or rezoning application) jeopardising the availability of the exemption. Staging and quarantining activities to minimise the risk of tainting a genuine primary production claim may be useful.

New South Wales – Bill introducing payroll tax rebate for new employees

The *Payroll Tax Rebate Scheme (Jobs Action Plan) Bill 2011* has been passed by the New South Wales (NSW) Parliament and is awaiting Assent. The Bill proposes to establish a payroll tax rebate scheme that provides employers with an incentive to increase the number of their full time equivalent employees for a period of at least two years.

Under the scheme, a payroll tax rebate of $2,000 per year will be payable for each full time employee (and a proportional amount for a part time employee) employed in a new job on or after 1 July 2011 for a minimum period of two years. The rebate can be claimed for the first and second year of employment only, and is subject to certain eligibility criteria. The scheme will close on a date or dates appointed by the rebate criteria (or on 30 June 2013, if no date is appointed).

Queensland – Land valuation notices

Land valuation notices are now being issued by the State Valuer-General (VG) for holders of Queensland real property. One of the major changes made to the basis of valuation that is applicable to these valuations relates to non-rural land. Under the change, the value of land is to be determined on the basis of 'site value' rather than 'unimproved value'. In transitioning to the new regime, there are however a number of concessions available to developers that can reduce the statutory value as well as a 150 per cent valuation cap. Many of these concessions rely on the taxpayer objecting to the VG's valuation.

Objections to the VG's land valuation (whether in relation to 'valuation principle' or in respect of a failure of the VG to take into account concessions) must be lodged within 60 days of the date of issue of the relevant valuation i.e. and not as an objection to the land tax assessment (which will issue later). Since valuations commenced to be issued from 3 May 2011, immediate action will be required in affected cases.

For further information in relation to these land tax items or in relation to land tax generally contact Costa Koutsis on (02) 8266 3981.

South Australia Budget 2011-12

The South Australian Budget for the 2011-12 financial year was delivered on 9 June 2011.

Broadly, the State Government announced:

- A net operating deficit of $263 million forecast for the 2011-12 financial year.
- Total taxation revenue together with the State's share of Goods and Services Tax (GST) and State royalties for the 2010-11 and 2011-12 years will be almost $650 million lower than had been estimated as part of the 2008-09 State Budget (which was delivered before the global financial crisis).
- The Budget will return to surplus in 2012-13, with the surplus growing to $655 million in 2014-15. The slower return of the Budget to operating surplus is the result of the impact of lower taxation and GST revenue.

First Home Bonus Grant

The first home bonus grant will be phased out with the grant halved from $8,000 to $4,000 from 1 July 2012 and fully abolished from 1 July 2013.

Stamp Duty

No significant stamp duty announcements were made. The Government repeated its previously announced commitment to abolish stamp duty on non-real property transfers and non-quoted marketable securities from 1 July 2012.

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Land tax

Indexation to land tax brackets from 1 July 2011 will apply in line with average site value increases. This measure was previously announced.

Other insights

The South Australian economy is expected to maintain solid economic growth over the next four years. Economic growth of 2.75 per cent per annum is forecast from 2011-12 through to 2014-15. Taxation revenue is forecast to grow moderately at an annual average real rate of 3.3 per cent from 2011-12 over the forward estimates.

In 2011-12 the State Government will invest more than $3.3 billion in its infrastructure program and over the forward estimates infrastructure spending will reach $9.1 billion.

Queensland Budget 2011-12

The Queensland Budget for the 2011-2012 financial year was delivered on 14 June 2011.

A number of tax related measures and certain incentives were announced. The changes include:

- Removing the transfer duty concession for homebuyers purchasing homes from 1 August 2011, to fund the Queensland Building Boost Grant and the abolition of the Community Ambulance Cover levy.
- The introduction of new transfer duty rates to ensure transfer duty payable on a home remains lower in Queensland than under the standard rate in any other mainland state in Australia, effective from 1 August 2011.
- The introduction of the new landholder model to replace Queensland's land rich duty. It will apply from 1 July 2011 to the acquisition of 50 per cent or more of an unlisted company or 90 per cent or more of a listed company or listed unit trust holding land in Queensland worth $2 million or more.
- The introduction of a temporary Queensland Building Boost Grant of $10,000 in respect of eligible new homes up to $600,000 where contracts are made between 1 August 2011 and 31 January 2012 (and subject to construction conditions).
- The removal of the $113 Community Ambulance cover levy from 1 July 2011.

Removal of the stamp duty Home Concession

The Home Concession for transfer duty will end on 31 July 2011. The Home Concession currently applies when people who are not first home buyers are buying a home to live in as their principal place of residence. The concession currently provides assistance of up to $7,175 for homebuyers.

Introduction of new transfer duty rates

The transfer duty rate structure will be revised from 1 August 2011. The amount of duty payable at standard rates will decrease from 1 August 2011 for properties valued between $75,000 and $540,000. There will be no change to the standard duty payable for properties outside of this range. The table below contains the current and revised transfer duty rate schedules.

Revisions to Transfer Duty Rate Schedule

Current Schedule		Schedule from 1 August 2011	
Property Value	**Rate**	**Property Value**	**Rate**
Up to $5000	Nil	Up to $5000	Nil
$5,001 to $75,000	1.5%	$5,001 to $105,000	1.5%
$75,001 to $540,000	$1,050 + 3.5%	$105,001 to $480,000	$1,500 + 3.5%
$540,001 to $980,000	$17,325 + 4.5%	$480,001 to $980,000	$14,625 + 4.5%
Over $980,000	$37,125 + 5.25%	Over $980,000	$37,125 + 5.25%

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Introduction of new landholder duty model from 1 July 2011

From 1 July 2011, Queensland will move from a 'land rich' duty model to a 'landholder' duty model. Among other things, this will mean that the existing requirement under the land rich provisions that land comprise 60 per cent or more of the total 'countable property' will be abolished (see details below).

This is consistent with the models that have been introduced in New South Wales, Western Australia, the Australian Capital Territory and the Northern Territory. Victoria has previously announced that it will also move to a landholder model from 1 July 2012. Legislation to implement a landholder model in South Australia from 1 July 2011 is outlined above.

First Home Concession and Vacant Land Concession

First home buyers will continue to receive a First Home Concession on their transfer duty costs however the concession rates will change as of 1 August 2011 to account for the removal of the Home Concession. First home buyers will not pay any transfer duty on homes valued up to $500,000. They will also be eligible for the Queensland Building Boost Grant during the applicable period in addition to the First Home Owner Grant, totalling together up to $17,000 . For those purchasing a home valued at between $500,000 and $600,000 a partial First Home Concession will apply.

Queensland Building Boost Grant

The $10,000 Queensland Building Boost Grant will be available to any person or corporation buying or building a new home to live in, or to rent out for investment purposes for homes less than $600,000.

There are specific eligibility criteria for the grant. Generally it may be available where a contract is made between 1 August 2011 and 31 January 2012, however construction time limits may apply.

Community Ambulance Cover Levy removed from electricity accounts

From 1 July 2011, the $113 Community Ambulance Cover levy will be abolished. Queensland electricity payers will only pay the levy for the number of days in the account period up to and including 30 June 2011 (in their next electricity account).

Continuing measures

Continuing measures include:

- The $7,000 First Home Owner Grant. This is available to first home buyers purchasing a home with a value less than $750,000.
- The 50 per cent cap on the annual increase in land values for land tax purposes will continue to apply for 2011-2012 land tax assessments. The payroll tax rebate of 25 per cent of the eligible wages of apprentices and trainees has been extended to the 2011-2012 financial year.

Queensland landholder duty provisions

On 14 June 2011, the *Community Ambulance Cover Levy Repeal and Revenue and Other Legislation Amendment Bill 2011* (the Bill) was introduced into Queensland Parliament. The Bill was passed by the Queensland Legislative Council on 17 June 2011 and is currently awaiting Royal Assent. Part 7 of the Bill amends the *Queensland Duties Act 2001* by replacing the existing 'land rich' duty provisions with a new 'landholder' model. The new landholder rules will apply from 1 July 2011.

Key Features

The key features of the new landholder model include:

- The landholder rules will apply to acquisitions of interests of 50 per cent or more in unlisted corporations and interests of 90 per cent or more in listed companies and listed unit trusts.
- The threshold test for a landholder is underlying Queensland landholdings (as defined) with an unencumbered value of $2 million or more. There will no longer be a 60 per cent or more land ratio test.

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- In respect of listed companies and listed unit trusts, the duty will be imposed on a concessional basis of ten per cent of the duty that would be payable in respect of a private entity. The duty is applied in respect of 100 per cent of an entity's 'landholdings' once the 90 per cent threshold is reached. Any further acquisitions beyond 90 per cent are not subject to further duty unless the interest drops below 90 per cent before the further acquisition.
- All interests held or acquired by a person (and related persons) in a corporation or listed unit trust will be taken into account in determining whether or not a relevant acquisition has been made. However certain 'excluded interests' may be disregarded in calculating landholder duty.

For the purposes of private landholders, excluded interests include those acquired:

- more than three years before the acquisition, and
- at a time when the landholder did not hold land in Queensland.

For the purposes of public landholders excluded interests include those acquired:

- at a time when the landholder did not hold land in Queensland, and
- before 1 July 2011.

Landholder duty will still be calculated only by reference to Queensland landholdings (as defined) and generally does not extend to Queensland goods. This is unlike the position in New South Wales and Western Australia and the proposed new South Australian rules where certain goods are included in the dutiable base. However, it is important to note that the Queensland definition of 'landholdings' can extend to goods that are fixed to the land even if they are not 'fixtures' at law.

Transitional Provisions

The Bill contains transitional provisions. These need to be closely examined for transactions that straddle the 1 July 2011 introduction date.

Tasmania Budget 2011-12

The Tasmania Budget for the 2011-12 financial year was delivered on 16 June 2011.

Broadly, the Tasmanian Government announced the following:

- A predicted net operating deficit of $113 million;
- Growth domestic product (GDP) growth for 2011-12 is expected to be 1.75 per cent and unemployment steady at 5.75 per cent;
- Tasmania retains its AA+ credit rating.

Abolition of tax and duty concessions/rebates

The Tasmanian Government has decided not to introduce any new taxes or raise any existing tax. However, it has decided to remove or reduce a number of State taxation concessions and rebates as follows:

- The First Home Buyer Duty Concession ceased to be available from 16 June 2011 – saving $8.9 million in 2011-12, increasing to $10.1 million in 2014-15. Similarly the First Home Builder Duty Concession ceased to be available saving approximately $250,000 per annum.
- The land tax exemption for concession card holders will be abolished (bringing Tasmania into line with all other State jurisdictions). This measure will save approximately $1.6 million in 2011-12, increasing to $1.8 million in 2014-15.
- The exemption from land tax on holiday homes with land values less than or equal to $500,000 will be abolished – saving $3.2 million in 2011-12, increasing to $3.6 million in 2014-15.
- The Tasmanian Trainee and Apprentice Incentive Scheme will be abolished from 1 July 2011. In its place a new Employee Incentive Scheme Payroll Tax Rebate will be introduced to provide a pay-roll tax rebate for new positions created between 16 June 2011 and 30 June 2012 provided that they are maintained continuously until 30 June 2013.

Tasmanian State Tax Review

The review of the Tasmanian tax system announced in the 2010-11 Budget is still underway. A final draft report is expected to be released in October 2011. Further public consultation will occur prior to the final report in December 2011.

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OECD discussion paper on treaty issues applicable to trading emission permits

On 31 May 2011 the Committee on Fiscal Affairs (CFA) of the Organisation for Economic Co-Operation and Development (OECD) invited public comments on its preliminary analysis of the tax treaty issues related to the trading of emissions permits. The CFA's analysis addresses the application of the provisions of the OECD Model Tax Convention to the cross-border trading of emissions permits.

In the discussion paper the CFA notes that the typical tax treaty issue that would be associated with the trading of emissions permits is the treatment of the income from the alienation of such permits by a resident of a 'Contracting State'. As explained in the paper, the CFA considers that any income or gain from the alienation of property, which would include emissions permits, is covered by either Article 7 (Business Profits), Article 8 (Shipping, Inland Waterways Transport and Air Transport) or Article 13 (Capital Gains) of the OECD Model Tax Convention. In this respect the CFA states that "whilst one could theoretically query whether income could be derived from leasing or licensing emissions permits, which would raise issues under Articles 6 (Income from Immovable Property) and 12 (Royalties), emissions permits are designed as commodities to be consumed through their use as opposed to property or rights that could be leased or licensed."

The CFA invites interested parties to send their comments on this discussion draft before 30 October 2011.

New Zealand Budget

The New Zealand Budget for 2011-12 was delivered on 19 May 2011. PwC's analysis of the Budget is available at http://pwc.com.au/tax/federal-budget/index.htm

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Legislation update

Revenue measures introduced into Federal Parliament include:

Tax Laws Amendment (2011 Measures No 4) Bill 2011 which was introduced into the House of Representatives on 26 May 2011 contains the following amendments:

- Reduction in 2011-12 Pay As You Go (PAYG) instalments – the Bill proposes to amend the *Taxation Administration Act 1953* (TAA 1953) to set the gross domestic product (GDP) adjustment for PAYG instalment taxpayers who use the GDP adjustment method at four per cent for the 2011-12 income year, instead of eight per cent. The amendments will apply to PAYG instalment amounts for the 2011-12 income year that become due on or after the day the Bill receives Royal Assent. The amendment will not apply to taxpayers whose income year commenced prior to 1 April 2011.
- Low-income taxpayer rebate – the Bill proposes to amend the *Income Tax Assessment Act 1936* (ITAA 1936) to remove the ability of minors (children under 18 years of age) to use the low income tax offset (LITO) to reduce tax due on income subject to Division 6AA of Part III of the ITAA 1936, being unearned income such as dividends, interest, rent, royalties, trust distributions and other income from property. The LITO will continue to apply to reduce tax on other income of minors, such as work income. This measure commences on the day the Bill receives Royal Assent and applies to assessments for the 2011-12 income year and later income years.
- Disability superannuation benefits – the Bill proposes to amend the *Income Tax Assessment 1997* (ITAA 1997) to allow the percentage of insurance costs for certain total and permanent disability (TPD) policies that can be claimed as deductions by superannuation funds to be specified in regulations. The amendments also extend the current transitional relief for the deductibility of TPD insurance premiums to funds that self insure their liability to provide disability benefits to its members based on the expanded meaning of the concept of 'permanent disability'. These provisions will be enacted and inserted into the *Income Tax (Transitional Provisions) Act 1997* (IT(TP) 1997). The changes allowing the deductible proportion of insurance costs for certain TPD policies to be specified in regulations will have effect from the 2011-12 income year. The extension of transitional relief to self-insured funds will apply to the 2004-05 to 2010-11 income years. The amendments to the IT(TP) 1997 will be repealed on 1 January 2017.
- Amendments to reportable employer superannuation contributions definition – the Bill proposes to amend the TAA 1953 to exclude from the definition of 'reportable employer superannuation contributions' (RESC), certain employer contributions that are required to be made pursuant to an 'industrial instrument' or the rules of a superannuation fund the amount of which the taxpayer cannot influence. The amendment will apply from the 2009-10 income year and later income years.

Tax Laws Amendment (2011 Measures No 5) Bill 2011, which was introduced into the House of Representatives on 2 June 2011, proposes to:

- make changes to the taxation of trust income, as announced on 13 April 2011, by ensuring that, where permitted by the trust, the capital gains and franked distributions (including any attached franking credits) of a trust can be effectively streamed for tax purposes to beneficiaries by making them 'specifically entitled' to those amounts, and including specific anti-avoidance rules to address the potential opportunities for tax manipulation that can result from the inappropriate use of exempt entities as beneficiaries of a trust
- amend *the Fringe Benefits Tax Assessment Act 1986* as announced in the 2011-12 Federal Budget, to reform the current statutory formula method for determining the taxable value of car fringe benefits by replacing the current statutory rates with a single statutory rate of 20 per cent, regardless of kilometres travelled
- make changes to the primary producers' income averaging and farm management deposit rules in relation to trusts
- address technical issues which have arisen from the interaction between the tax law and the National Rental Affordability Scheme Act 2008, and
- phase out the dependent spouse tax offset.

The trust income measures apply to assessments for the 2010-11 and later income years where the 2010-11 income year of the trust did not commence before 1 July 2010. Trusts with a 2010-11 year commencing earlier than 1 July 2010, can elect that the provisions apply. The election must be in writing within two months of Royal Assent. For the 2010-11 and/or 2011-12 income year the provisions however do not apply to a 'managed investment trust' (MIT) (or a trust treated in the same way as a MIT for the purposes of Division 275 of the ITAA 1997) in relation to the income year unless the trustee elects that the provisions apply. The election must be in writing within two months of the later of Royal Assent and the end of the income year in relation to which the choice is made.

Taxation Administration Amendment Regulations 2011 (No 2) gives effect to the Federal Government's 2011-12 Budget measure to increase the proportion of the low income tax offset (LITO) that is delivered through workers' week-to-week pay from 50 per cent to 70 per cent. This change means that instead of being compensated on assessment of the tax return, lower income earners are taxed less during the year.

The *Income Tax – Temporary Flood and Cyclone Reconstruction Levy Exemptions 2011*, registered on the Federal Register of Legislative Instruments on 8 June 2011 outlines the classes of individuals who will be exempt from the temporary flood and cyclone reconstruction levy. The legislative instrument supports the *Tax Laws Amendment (Temporary Flood and Cyclone Reconstruction Levy) Act* 2011.

The *Customs Amendment (New Zealand Rules of Origin) Bill 2011* (the Amending Act), introduced into the House of Representatives on 16 June 2011, amends the *Customs Act 1901* to implement amendments to the rules of origin requirements under the *Australia-New Zealand Closer Economic Relations Trade Agreement*. The main amendments apply in relation to:

- goods imported into Australia on or after the commencement of the Amending Act, being the later of, the day the Act receives Royal Assent and the day on which the amendments of Article 3 of the Australia New Zealand Closer Economic Relations Trade Agreement, that were agreed to by Australia and New Zealand in 2010, enter into force (this day must be announced by the Minister administering the Customs Act by notice in the Gazette), and
- goods imported into Australia before the commencement of the Amending Act, where the time for working out the rate of import duty on the goods had not occurred before the commencement date.

The consequential amendments to the verification powers apply to goods exported to New Zealand on or after the commencement of the Amending Act.

Tax Laws Amendment (2011 Measures No 6) Bill 2011 which was introduced into the House of Representatives on 22 June 2011 contains the following amendments:

- amendments to the ITAA 1997 to ensure that the outer regional and remote payment made under the *Better Start for Children with Disability* initiative is not subject to income tax. It is proposed that this measure applies to payments made in the 2011-12 income year and later income years.
- Amendments to the s the *Fringe Benefits Tax Assessment Act 1986* to provide an exemption from fringe benefits tax for transport, from an employee's usual place of residence to their usual place of employment, where the employee is an Australian resident employed in a remote area overseas, under what is commonly known as a fly-in fly-out arrangement. It is proposed that these amendments apply to fringe benefits provided after 1 July 2009.
- Amendments to the ITAA 1997 to update the list of deductible gift recipients (DGRs) by adding two entities, (the New Zealand Government's Christchurch Earthquake Appeal Trust and the Cancer Australia Gift Fund) as DGRs, changing the name of one entity, and removing two other entities from the list. The listing of the New Zealand Government's Christchurch Earthquake Appeal Trust is to apply to gifts made after 21 March 2011 and before 22 March 2013. The listing of the Cancer Australia Gift Fund applies to gifts made after 8 June 2011. The Bionic Ear Institute was removed from the specifically listed DGR list and endorsed as a DGR under the general category of health promotion, effective from 10 November 2010. The National Breast Cancer Centre Gift Fund will be removed, effective from 1 August 2011.

Tax Agent Services Amendment Regulations 2011 (No. 1) which was registered on 20 June 2011 extends the deferral of the application of the tax agent services regime to holders of Australian Financial Services Licenses (registered financial planners) until 30 June 2012. The current deferral is in place until 30 June 2011. The regulations commence on 21 June 2011.

Other news

Proceeds of crime and superannuation funds

The Assistant Treasurer and Minister for Financial Services and Superannuation has released exposure draft regulations that would amend operating standards in the Superannuation Industry (Supervision) Regulations 1994 and the Retirement Savings Accounts Regulations 1997 to allow superannuation trustees and Retirement Savings Account providers to recognise Commonwealth, State and Territory forfeiture orders (however called) for the proceeds of crime.

The proposed regulations would also:

- amend the list of exempt public sector superannuation schemes (EPSSS) to remove schemes that have converted to regulation by the Australian Prudential Regulatory Authority (APRA) and to update legislative references
- provide that a public sector superannuation scheme ceases to be an EPSSS at the time it becomes registered with APRA, and
- insert a note that explains that information regarding investment strategies is usually provided to members in a Product Disclosure Statement (PDS) but that following the introduction of the short PDS requirements into the Corporations Regulations 2001 this information may be incorporated in a PDS by reference.

United States tornadoes declared a natural disaster

On 25 May 2011 the Assistant Treasurer and Minister for Financial Services and Superannuation declared the multiple tornadoes that hit Southern parts of the United States of America (US) on 28 April 2011 and 22 May 2011, a disaster for tax purposes.

On Thursday, 28 April 2011, Alabama and other Southern US states suffered a rare storm system in which more than 160 twisters hit within 24 hours. That system killed over 350 people across seven states, and injured 1,700 people with an inexact number of people unaccounted for.

As noted by the Assistant Treasurer, while this declaration allows Australian taxpayers to claim an income tax deduction for donations made to the relief effort during a two year period commencing 28 April 2011, Funds still need to apply to the Australian Taxation Office (ATO) for formal endorsement.

Not for profit (NFP) sector tax concessions

On 27 May 2011 the Assistant Treasurer and Minister for Financial Services and Superannuation released for public consultation a paper that seeks public views on possible approaches to implement the Government's 2011-12 Budget announcement to better target NFP tax concessions to the altruistic activities of NFPs.

The Government announced in the 2011-12 Federal Budget that it will reform the tax concessions provided to NFP entities to ensure they are targeted only at those activities that directly further an NFP's altruistic purposes.

Closing date for submissions is 8 July 2011.

Consultation on reporting regime in the building and construction industry

On 30 May 2011 the Assistant Treasurer and Minister for Financial Services and Superannuation released a consultation paper, *'Reporting of taxable payments for contractors in the building and construction industry'*. The introduction of a reporting regime requiring certain businesses in the building and construction industry (BCI) to report annually to the Australian Taxation Office (ATO) the details of payments made to contractors in the building and construction industry was announced in the 2011-12 Federal Budget.

The aim of the reporting regime is to improve compliance with taxation obligations of contractors in the BCI by providing the ATO with sufficient information to allow data matching for review and targeted audits. The information will also allow the ATO to focus their resources in order to provide assistance and education to those identified as having a problem with compliance, based on a lack of knowledge or awareness. The consultation paper seeks industry views on important aspects of the design of the reporting regime.

Inspector General examines improvements to the self assessment system

On 16 June 2011 the Inspector-General of Taxation (IGT) announced the terms of reference for his latest review entitled – *Improving the Self Assessment System" – and called for submissions*. Under the self assessment system generally the ATO assesses taxpayers on the basis of information included by the taxpayer in their tax return with the ATO then having a statutory period to consider in detail the taxpayer's return, and to make adjustments as are necessary to ensure that the assessment is based on the income tax law.

In releasing the terms of reference the IGT said that "in the current environment of ever increasing tax law complexity, real-time audits, pre-assessment agreements, disclosure requirements and the like, this review will test some of the fundamentals of the self assessment regime. In particular, it will examine whether the compliance burden is appropriately shared between the ATO and taxpayers and whether taxpayers are provided with appropriate certainty and timely guidance."

Terms of reference and submission guidelines for the review are available on the Inspector-General of Taxation website. Submissions are due by 21 July 2011.

Luxury car tax

The Australian National Audit Office (ANAO) has released an audit report on the administration of the Luxury Car Tax (LCT) by the ATO. The report makes one recommendation namely, that to support a more co-ordinated approach to administering the LCT, the ATO should enhance its planning and reporting of the LCT. The ATO agreed with this recommendation.

Reporting Tax file number (TFN) disclosure for closely held trusts

A TFN withholding regime has been in place from 1 July 2010 for 'closely held trusts' (including trusts which are 'family trusts' under the tax law). Under the measures, the trustee may be liable to withhold tax in respect of any distribution of income (or conferral of income entitlements) unless there is an applicable exemption for the relevant beneficiary, or the beneficiary has provided the trustee with the beneficiary's TFN.

One of the reporting requirements under the regime is the requirement for the trustee to report to the Commissioner at the end of each quarter, the TFNs notified to the trustee during the relevant quarter. For 30 June balancing trusts, the Commissioner has provided a general extension of time for reporting those TFNs notified to the trustee in the June 2011 quarter. Under a transitional concession, the Commissioner has advised that these can be reported to the Commissioner on or before 31 August 2011, which is a month extension to the deadline that would otherwise apply.

If you have any queries into these TFN withholding measures, contact your usual PwC adviser.

Hungary Social Security agreement

On 7 June 2011 the Minister for Foreign Affairs and the Minister for Families, Housing, Community Services and Indigenous Affairs, jointly announced the signing of a new Social Security Agreement between Australia and Hungary. According to the media statement the Agreement is expected to commence in mid-2012, following legislative and administrative processes in both countries, and will allow residents who have spent part of their adult lives in both Australia and Hungary to receive pensions from both countries.

In releasing the media statement the Ministers noted that Australia has Social Security agreements in place with 25 countries – Austria, Belgium, Canada, Chile, Croatia, Cyprus, Denmark, Finland, the former Yugoslav Republic of Macedonia, Germany, Greece, Ireland, Italy, Japan, Korea, Malta, the Netherlands, New Zealand, Norway, Poland, Portugal, Slovenia, Spain, Switzerland and the United States of America. Additionally, Social Security agreements with the Czech and Slovak Republics have also been signed and are expected to start on 1 July 2011 and 1 January 2012 respectively.

Super for low income earners

On 15 June 2011 the Assistant Treasurer and Minister for Financial Services and Superannuation released a consultation paper in relation to the Government's announcement of the low income earners Government superannuation contribution. Under this measure, the Government will provide a superannuation payment of up to $500 annually for eligible 'low income earners'. The proposal is aimed at effectively eliminating the flat 15 per cent tax cost payable on tax deductible contributions into a complying fund, in circumstances where the individual is taxable at a lower rate of taxation on the income that they derive.

The amount payable under this measure will be calculated by applying a 15 per cent rate to the 'concessional superannuation contributions' made by or for eligible individuals on adjusted taxable incomes (ATI) of up to $37,000 (not indexed), with an annual maximum amount payable of $500 (not indexed). Individuals with a taxable income of $37,000 are at the cut off point for the 15 per cent personal marginal tax rate.

It is proposed that concessional superannuation contributions made in the 2012-13 income year and later income years will be eligible for the payment, with the first payments expected to be made to the eligible individuals' accounts in the 2013-14 financial year.

It is further proposed that the measure will apply to all individuals except those who hold an eligible temporary resident visa at any time during the relevant income year, unless the individual is a New Zealand citizen at the time of holding such a visa.

To be eligible for the payment, an individual must have made or received a concessional contribution to their super fund or retirement savings account and have lodged an income tax return for the relevant income year. This means that, from the 2012-13 income year, eligible individuals who are not otherwise required to lodge an income tax return will be required to lodge an income tax return for the relevant income year in order to be eligible for the payment.

Interested parties are invited to make written submissions on the consultation paper by 15 July 2011.

FAF integrity rule not to apply for the 2010-11 year

On 29 June 2011 the Assistant Treasurer and Minister for Financial Services and Superannuation announced that as part of ongoing efforts to increase Australia's attractiveness to foreign investors, the foreign accumulation fund (FAF) integrity rule will not apply for the 2010-11 income year. The Assistant Treasurer said that the FAF rule will form part of a wider package of reforms to the foreign source income attribution rules, of which the modernised Controlled Foreign Company (CFC) rules will be the centrepiece. He further stated that the FAF rule will have application for income years starting on or after the date it receives Royal Assent.

Upcoming Events

Included below are some of our upcoming events.

City	Date	Contacts
Melbourne		
New Accounting Standards in relation to Joint Ventures/Arrangements	Tuesday, 19 July	**Anthony Duckworth** 02 8266 7214 or anthony.duckworth@au.pwc.com
TaxTalk Briefing – Quarterly Tax Update	Tuesday, 26 July	**Emily Griffis** 03 8603 3710 or emily.griffis@au.pwc.com
Sydney		
Stamp Duty National Legislative Update	Thursday, 21 July	**Anthony Duckworth** 02 8266 7214 or anthony.duckworth@au.pwc.com

Please click on the event name to be taken to the registration site for further information. Alternatively, phone the event contact provided, to find out more.

For a full list of our upcoming Tax and Legal events, please contact Sonya Domanski on +61 (3) 8603 4219.

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