Corporate Tax Update

1 May 2014

**Exposure draft legislation to deal with dividend washing**

On 24 March 2014 the Commonwealth Treasury released exposure draft legislation which proposes to amend the income tax law to deny an entity the benefits of any additional franking credits that it receives as a result of ‘dividend washing’. Dividend washing (also referred to as ‘distribution washing’) allows an entity to obtain multiple franking credit entitlements in respect of a single underlying economic interest in a corporate tax entity. To dividend wash, an entity sells an interest (usually shares) shortly after becoming entitled to receive a fully franked distribution in respect of that interest, then shortly after, purchases a new and substantially identical interest that also provides an entitlement to another fully franked distribution.

This draft legislation proposes to amend the tax law to deny an entity the benefits of any additional franking credits that an entity receives as a result of dividend (or distribution) washing. A distribution will be considered to be one received as a result of dividend (or distribution) washing, where the taxpayer has also received a corresponding distribution in respect of a substantially identical interest that the taxpayer sold before acquiring the current interest.

The amendments will have effect from 1 July 2013.

**Corporations law payment of dividends**

On 10 April 2014 the Commonwealth Government announced the release of exposure draft legislation which proposes, amongst other things, further amendments to the Corporations Act 2001 (Cth) to replace the current section 254T test for paying dividends.

The key issues dealt with in the exposure draft and explanatory material are:

- The exposure draft proposes to repeal current section 254T and replace it with an authorising dividend provision subject only to a single "solvency test". This should remove the uncertainty that has existed since the changes to the Act in 2010, as set out in Counsel opinion that was sought by the ATO to support its position in Taxation Ruling TR 2012/5.

- The exposure draft proposes a new provision that authorises a reduction of capital for a dividend which is not paid out of profits, but only in circumstances where a proportionate capital reduction would be available on ordinary shares. Based on the current drafting, this would not seem to extend this flexibility to dividends paid on other types of shares, including preference shares.

- The draft explanatory material notes that "the proposed amendments are not designed to change existing taxation arrangements".

Closing date for submissions on the Exposure Draft is Friday, 16 May 2014.

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**Taxpayer denied deduction for payment of Government licence fee**

In SPI PowerNet Pty Ltd v Commissioner of Taxation [2014] FCAFC 36, the Full Federal Court dismissed the taxpayer’s appeal against the decision of the Federal Court which found that fees in relation
to a licence to transmit electricity imposed under section 163AA of the Electricity Industry Act 1993 (Vic) were outgoings of capital or of a capital nature and thus not deductible under section 8-1 of the Income Tax Assessment Act 1997 (Cth) (ITAA 1997). The obligation to pay the fees arose under Victorian law on purchase of an electricity transmission business from the Government, albeit the sale and purchase agreement entered into by the taxpayer included a covenant pursuant to which the taxpayer agreed to assume liability to pay the fees the Government i.e. an obligation imposed under the contract separate from the obligation imposed by the law.

The Federal Court at first instance had also held in the alternative, that section 8-1 was not in any event satisfied as the fees were not incurred in gaining or producing assessable income or carrying on business for that purpose, but were payments out of profits to the Government after the calculation of the taxpayer’s taxable income. On appeal, the Full Federal Court agreed with the taxpayer that this alternative basis for denying a deduction under section 8-1 was wrong at law.

Nevertheless, the taxpayer was denied a deduction on the basis that the fees were incurred upon acquisition of the transmission business, and as such formed part of the cost of acquiring the business.

With respect to the Full Court’s decision that the fees were on capital account and therefore not tax deductible, Justice Davies delivered a dissenting judgement finding that the fees were an expense in the business operations of the taxpayer and on revenue account, and not a cost to the taxpayer of the right to conduct the transmission business. It remains to be seen whether the taxpayer will apply for leave to appeal the decision to the High Court. In Division 10B of the Income Tax Assessment Act 1936 (Cth) (ITAA 1936). The SPA did not however specify what part of the purchase price was paid for this copyright.

**Taxpayer denied deduction for payment of Government licence fee**

In SPI PowerNet Pty Ltd v Commissioner of Taxation [2014] FCA261, the Federal Court at first instance allowed the appeals against the Commissioner’s disallowance of deductions for the cost of acquiring copyright.

For the tax years 1998 to 2006, the SPI PowerNet Pty Ltd’s deduction claim depended upon the terms of Division 10B of the Income Tax Assessment Act 1936 (Cth) (ITAA 1936) (for the 1998 year), Division 373 of the Income Tax Assessment Act 1997 (Cth) (ITAA 1997) (for the 1999 to 2001 years) and Division 40 of the ITAA 1997 (for the 2001 to 2006 years). In this respect it is relevant to note that Division 10B was replaced by Division 373 which was then replaced by Division 40. Any ‘industrial property’ to which Division 10B applied was ‘transitioned’ into Division 373, and then subsequently ‘transitioned’ into Division 40.

For the 2007 to 2011 tax years, SP Australia Networks (Transmission) Ltd (SPANT), as the head company of tax consolidated group, claimed deductions under Division 40 of the ITAA 1997 in respect of the part of the ‘allocable cost amount’ allocated to the copyright.

Briefly, the SPI PowerNet Pty Ltd purchased an electricity transmission business from the Victorian Government. Included in the assets acquired was copyright in drawings, plans, and other works falling within the definition of ‘industrial property’ (IP) in Division 10B. However, the sale and purchase agreement (SPA) did specify what part of the total purchase price (paid for the business and assets) was paid for this IP. The cost of the IP for the purposes of claiming annual deductions was required to be determined under section 124R of Division 10B. Since as noted above, the SPA did not allocate an amount to the IP, the cost was to be “taken to be so much of the purchase price of the unit and the other property as the Commissioner determines” – see sub-section 124R(5).

The first issue to be determined by the Court was whether sub-section 124R(5) was a provision authorising the Commissioner to exercise a discretionary opinion. If so, the taxpayer’s ability to challenge the determination would require the taxpayer to show that the Commissioner had made an error of law in exercising the discretion. According to Justice Pagone, the provision was not to be so construed. In his Honour’s view, the proper construction of sub-section 124R(5) was that it required an objective determination (based on relevant facts) “of that amount of an actual purchase price which is to be taken as that paid for a discernable part of what
was acquired”. His Honour went on to say that the statutory task required “is, in effect, that of allocating or apportioning part of a known purchase price to part of what the total amount purchased”. In his Honour’s view the provision “is not directed to valuing the relevant asset except to the extent that the value may inform the task of allocation or apportionment”.

Having held that sub-section 124R(5) mandated an objective determination as to the amount paid for the IP, Justice Pagone held that in this case, the value of the copyright was a relevant consideration since the IP was critical to the business acquired and it was clear that part of the purchase price had been paid for the IP. Expert evidence as to the value of the copyright supported the amount allocated to the copyright by SPI PowerNet Pty Ltd and the appeal in favour of the taxpayer for the 1998 to 2006 year was therefore successful.

In respect of the 2007 to 2001 years SPANT, as ‘head company’ of the tax consolidated group (which had acquired SPI PowerNet Pty Ltd), ‘reset’ the cost of the IP by using a valuation obtained from PwC as an independent valuer. The appeal against the Commissioner’s refusal to accept the value allocated to the IP was upheld.

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**Let’s talk**

For a deeper discussion of how these issues might affect your business, please contact:

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