

# Corporate Tax Essentials



Chartered Accountants  
& Business Advisers

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## Henry Review – a work in progress

The Government has released the Henry Committee's report that contains 138 recommendations for changes to our Tax System. The proposals that apply to companies include:

- ▶ **Company Income Tax Rate** - the company income tax rate should be reduced to 25%. The Government has proposed the company tax rate be reduced as follows:

	Other company	Small business
2011-12	30%	30%
2012-13	30%	28%
2013-14	29%	28%
2014-15	28%	28%

- ▶ **Capital Allowances**

- (a) depreciating assets costing less than \$5,000 to be immediately written-off. The Government has announced it will allow a write off for assets costing less than \$5,000 from 1 July 2012; and
- (b) all other depreciating assets valued at \$5,000 or more (except buildings) to be pooled. The Government has accepted a single pool with a 30% DV rate from 1 July 2012.

- ▶ **Carry back Losses** – Companies should be allowed to carry back a revenue loss to offset it against the prior year's taxable income. The Government has not commented on this.
- ▶ **Trust rules to be rewritten** – The current trust rules should be updated and rewritten to reduce complexity and uncertainty around their application. The Government has not commented on this.
- ▶ **Introduce flow through taxation for closely held companies** – A flow-through entity regime for closely held companies and fixed trusts should be considered in the future. The Government has not commented on this.
- ▶ **Amendments to Fringe Benefits Tax** - Fringe benefits that are readily valued and attributable to individual employees should be taxed in the hands of employees through the PAYG system. Other benefits, including those incidental to an individual's employment, should remain taxed to employers at the top marginal rate.

- ▶ In addition, the formula for valuing car fringe benefits should be replaced with a single statutory rate of 20%, regardless of the kilometres travelled. The Government has not commented on these recommendations.
- ▶ **Removing the pre-CGT status of assets acquired before 19 September 1985** - This has been rejected by the Government.
- ▶ **Interest withholding tax paid by Australian ADIs** – Financial institutions operating in Australia should generally not be subject to interest withholding tax on interest paid to non-residents. This was subsequently dealt with in the Budget (refer to our later reference).
- ▶ **Interest withholding tax negotiated to zero in future tax treaties** – Consideration should be given to negotiating (or renegotiating) tax treaties with a zero rate of withholding tax on interest. The Government has not commented on this recommendation.
- ▶ **Australian managed funds and conduit income** – the provisions that currently apply to Australian managed funds (and related services) should be amended to provide greater certainty that conduit income will not be subject to Australian tax. The Government did not comment on this recommendation but has since released proposals on this matter, see below.
- ▶ **Dividend imputation and alternative arrangements** – Dividend imputation should be retained in the short to medium term. However, as part of an overall review of company income tax, consideration should be given to other alternatives. The Government has not commented on this recommendation.
- ▶ **Restrict imputation to Australian income tax and retain imputation integrity measures** – whilst dividend imputation is retained, imputation credits should continue to be provided only for Australian company income tax. Dividend streaming and franking credit trading should continue to be prohibited. The Government has not commented on this recommendation.

- ▶ *Harmonisation of Australian-NZ taxation* – If integration of the Australian and New Zealand economies is desired, an examination of the harmonisation of business income tax arrangements between Australia and New Zealand should be undertaken. The Government has not commented on this recommendation.
- ▶ *Resources Rent Tax* – The Henry Review contained numerous suggested amendments to the taxation of non-renewable resources. The cornerstone was the introduction of a 40% tax on profits derived from the exploitation of non-renewable resources (in addition to State royalties and income tax which mining companies currently pay). Controversially, this has been adopted by the Government with the announcement of the Resource Super Profits Tax (RSPT), which operates as follows:
  - Commencement date of 1 July 2012 on all mining operations not currently subject to the Petroleum Resource Rent Tax.
  - The RSPT will be imposed at 40% on a taxable amount derived after taking into account extraction costs and an appropriate recoupment of capital investment (proposed to be the 10-year bond rate).
  - Where the extraction project is operating at a loss, that loss may be carried forward to future RSPT calculations, or it may be transferred to other projects or members of a corporate group.
  - The RSPT will be in addition to the income tax and State royalties which mining companies currently pay. Allowances will be made for royalties paid, and the RSPT will be deductible in the mining company's income tax calculation.
  - In addition, the Government will introduce an exploration costs rebate, which could result in failed exploration projects attracting a refund of 40% of the costs incurred in the exploration project.

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## Internal Financier - Bad Debts

A recent Court decision has confirmed that deductions for bad debts will be available for internal corporate financiers that are in the business of lending money.

The case involved a company that was the internal financier for BHP Billiton. The company was incorporated specifically "for the purpose of borrowing funds to re-lend to group companies", and it was registered as a financial institution and money market operator.

The taxpayer raised finance through external borrowings that were on lent to other Group members at a higher interest rate. The company advanced \$2.5 billion for two projects to sister companies. The projects failed, resulting in a loss of the funds. As a result, the taxpayer wrote off the debts, and it claimed a deduction under the bad debt provisions on the basis it

was in the "business of money lending". The Tax Office denied the deductions on the basis there was insufficient evidence the taxpayer exercised an independent corporate mind in respect of its lending activities. It was also queried whether the debts were bad when they were written off.

The Court found the company was carrying on the business of lending money. The Court emphasised the taxpayer's activities, which consisted of borrowing money to lend to group companies, was carried on over a substantial number of years on a regular and systematic basis. The amounts involved were substantial and were on lent at a higher interest rate. The taxpayer also derived substantial amounts of income from these activities.

**Ref: Commissioner of Taxation v BHP Billiton Finance Limited [2010] FCAFC 25**

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## Accountant's concession

Under this concession, the Tax Office will generally not use their powers to access certain categories of documents, including advices prepared by external accounting advisors. However, in exceptional circumstances, the Tax Office reserves the right to access accountants' workpapers.

In a recent case, an adviser unsuccessfully tried to invoke this concession to prevent the Tax Office from accessing their workpapers. These had come into the Tax Office's possession following activities carried out

by the Australian Crime Commission under a Wickenby warrant.

The Court found the Tax Office was entitled to access the documents, especially as the concession was not a rule of law, and given that the Crime Commission was not bound by the concession. Furthermore, the Court found the concession could not operate to prevent the Tax Office discharging their public duties under the income tax legislation.

**Ref: Stewart v Commissioner of Taxation [2010] FCA 402**

# Federal Budget

## Managed Investment Trusts

The Government announced it will introduce a new regime for Australian managed investment trusts (MITs) with effect from 1 July 2011.

This measure will:

- ▶ allow MITs to use an attribution method of taxation (in lieu of the existing present entitlement to income method);
- ▶ include a 5% de minimis rule to allow MITs to carry forward under and over distributions into the next income year without adverse taxation consequences; and
- ▶ allow unit holders to make, in certain circumstances, adjustments (including upward) to the cost base of their unit holdings to eliminate double taxation that may otherwise arise.

In addition, the corporate unit trust rules will be repealed. These rules, which discourage the reorganisation of companies involving the transfer of assets into a public unit trust, will be replaced with an arm's length rule to be included in the public trading trust provisions. This measure will also amend the 20% tracing rule for public unit trusts so that it does not apply to super funds and exempt entities that are entitled to a refund of excess imputation credits.

This new regime is limited to MITs. Other trusts will still be subject to the current tax rules for trusts. Unfortunately, the Government has not yet announced much needed changes to the general rules for taxation of trusts.

## Capital Account Treatment

In last year's Budget, the Government announced a measure to allow eligible Australian MITs to make an irrevocable election to apply the CGT regime as the primary code for taxing disposals of assets. In this year's Budget, the Government announced further refinements to this proposal:

- ▶ expanding the definition of MIT to ensure that a broader range of widely held trusts, such as state-operated trusts and certain wholesale trusts, are able to make an election, with effect from the 2008-09 income year;
- ▶ expanding the scope of eligible assets, with effect from the 2008-09 income year;

- ▶ preventing the Tax Office from amending, without the consent of the taxpayer, prior year assessments in respect of a re-characterisation of gains or losses from eligible assets from capital to revenue or vice versa. This change will have effect from the 2008-09 income year;
- ▶ treating gains and losses on disposals of shares and units by eligible MITs that do not make an election on revenue account. Distributions or gains on 'carried interest' units in eligible MITs will also be treated on revenue account. These changes will have effect from the date of Royal Assent of the enabling legislation.

These measures have already been implemented by *Tax Laws Amendment (2010 Measures No. 1) Bill 2010*.

## Definition of Managed Investment trust

The Government has introduced a Bill to amend the definition of a MIT for all income tax purposes to include certain wholesale managed investment schemes and certain widely held pooled super trusts.

In particular, these changes will broaden the scope of the MIT withholding tax rules, the MIT deemed capital account treatment measures, and the new MIT tax regime.

The definition will also introduce tests to exclude trusts that are carrying on a trading business, are closely held, or where the trust's Australian assets are not managed in Australia. The operation of the rules will be clarified to make it clear that they can apply in cases where the trust has only one member and that member is itself a specified widely held entity.

These measures are contained in *Tax Laws Amendment (2010 Measures No. 3) Bill 2010*.

## Tax Payments for Consolidated Groups

For both consolidated groups and MEC groups, the consolidations rules will be amended to:

- ▶ ensure PAYG liabilities can be collected under the liability for payment rules with effect from 11 May 2010;
- ▶ ensure members of a consolidated group or a MEC group are able to leave their group without attracting any further income tax liabilities on behalf of the group where that exiting entity has paid all its contributions under a tax sharing agreement. These rules will have effect from 1 July 2004.

There are also amendments that relate solely to MEC groups:

- ▶ the liability for payment rules will apply to MEC groups from 11 May 2010; and
- ▶ where there is a change in the head company of a MEC group during an income tax year, and the exiting head company has made PAYG payments on behalf of the group during its time as head company, those payments will be credited to the benefit of the group. These rules will have effect from 1 July 2002.

## Earnout Arrangements

CGT amendments will be made to ensure earnout arrangements are treated as relating to the sale of the underlying business. Earnout arrangements are used to facilitate the sale of a business with the purchase price for the business usually being a fixed amount plus a contingent amount (or less a contingent repayment) that depends on the future performance of the relevant business.

The Australian Tax Office's interpretation of the current law is that an earnout arrangement results in the creation of separate earnout rights, which for capital gains tax (CGT) purposes have to be dealt with separately to the sale of the underlying business. This interpretation can result in inappropriate CGT outcomes with some entities paying double tax or, in other situations, entities obtaining inappropriate tax advantages. The proposed amendments appear to fix these inappropriate CGT outcomes.

The Federal Treasury has released a Discussion paper outlining some of the details of the proposed amendments. A number of submissions have been made on this discussion paper aimed at ensuring all the anomalies have been dealt with appropriately. This measure will have application from the date of Royal

Assent of the enabling legislation. There will be transitional rules in certain cases from 17 October 2007, the date the Australian Tax Office released Draft Ruling 2007/D10, which outlined the Australian Tax Office's interpretation of the tax law on earnouts.

## Interest Withholding Tax on Financial Institutions Phased Down

The Government will progressively phase down interest withholding tax (IWT) incurred by Australian subsidiaries and branches of foreign companies when they pay interest on related party borrowings.

The phase down will also apply to Australian-owned financial institutions borrowing from related parties overseas and any financial institution borrowing offshore retail deposits which they on-lend in Australia.

Currently, interest paid by financial institutions on offshore borrowings may be subject to IWT, generally at the rate of 10%. The proposed phase down will allow smaller banks access to cheaper funding, enabling them to provide cheaper loans to Australian borrowers. It will also allow funding choices to be based on commercial considerations rather than taxation.

For local subsidiaries of overseas parents, the IWT rate will be reduced from 10 per cent to 7.5% in 2013-14 and to 5% in 2014-15. Consideration will be given to reduce the rate to zero in the longer term in line with the recommendations from the Henry Review.

In addition, the IWT rate applying to borrowings by any bank branch from its overseas head office will be reduced from 5% to 2.5% in 2013-14 and to zero in 2014-15.

As an integrity measure, the phase-down will not apply to interest on non-resident retail deposits held in Australia. It will also not apply to offshore borrowings by entities that are not financial institutions.

Should you require assistance additional information, **contact your PKF tax adviser** or:

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