



## Banking on tax

### *Focusing on the core issues*

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#### Cash-pooling – interest income from a cash-pooling arrangement

In the article "*Banks and cash-pooling*" in issue #7, we outlined some issues associated with cash-pooling. Until recently, the ATO had published very little on cash-pooling.

In January 2013, the ATO released ATO Interpretative Decision 2013/2 (ATO ID 2013/2), *Withholding tax: interest derived by an Australian resident in carrying on business at or through a permanent establishment outside Australia*. ATO ID 2013/2 considers whether interest income derived by an Australian resident participating in a physical cash-pooling arrangement using funds obtained from a foreign branch, was derived in carrying on business in a country outside Australia at or through a permanent establishment (PE) of the Australian resident.

Essentially, the ATO states that the interest income would be derived in carrying on business in a country outside of Australia at or through the PE for the purpose of the withholding tax provisions. The scenario considered in ATO ID 2013/2 is slightly more complicated by the fact that the funds swept from the bank account were loaned to an Australian (presumably associated) entity. The ATO concludes in ATO ID 2013/2 that where none of the exemptions in section 128B of the *Income Tax Assessment Act 1936*

apply and all of the requirements of section 128B(2A) are satisfied, interest payments on the loans from the taxpayer to the Australian (presumably associated) entity would be liable to interest withholding tax.

The interpretations set out in ATO ID 2013/2 raise a number of issues around the ATO's analysis of the source of interest income and an implied apportionment approach.

#### Source of interest income

The ATO essentially relies on a transfer pricing-type analysis to assert that the interest on the loans is derived in carrying on a business at or through a PE in a foreign country, on the basis that the funding for the loans was initially derived from a foreign source.

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**The ATO does not seem to place any significance on the fact that the sweep was from an Australian bank account to an Australian entity that entered into the loan agreement in Australia.**

The ATO approach raises a number of issues:

- Firstly, the approach seems to ignore a body of authority that the source of interest is derived from the loan contract (rather than the source of the principal sum; see *FC of T v Spotless Services Ltd and Anor* 95 ATC 4775)
- Secondly, the ATO ID does not say that the interest income is “foreign income”, so presumably the ATO does not think that section 23AH applies to exclude the interest income from assessable income (assuming section 23AH would have otherwise applied)
- Thirdly, assuming that interest withholding tax is payable, section 128D may not apply to exclude the interest income from the taxpayer’s assessable income
- Fourthly, again assuming that interest withholding tax is payable and the interest income is not excluded from assessable income under either sections 23AH or 128D, Division 770 of the *Income Tax Assessment Act 1997* is not likely to apply to allow a taxpayer a foreign income tax offset, as “foreign income tax” does not include withholding tax (at least in the simple facts described in ATO ID 2013/2)
- Lastly, it is not apparent why the ATO would not simply take the view that the interest income was Australian-sourced income of an Australian resident and, therefore, subject to tax in Australia.

#### Implied apportionment approach

ATO ID 2013/2 does not address the situation where the funds deposited into the Australian bank account were not exclusively from a foreign branch (i.e. what if the funds represented a mixture of Australian-sourced and PE-sourced amounts?). The ATO seems to imply that an apportionment based on the source of the funds would be necessary. This approach, if that is what is being contemplated, has the potential to give rise to significant compliance issues in trying to track the source and use of funds.

#### An analysis of the amendments to Part IVA

Following several losses by the Commissioner in significant tax disputes involving Part IVA of the *Income Tax Assessment Act 1936*, most notably when the High Court refused the Commissioner’s application for special leave to appeal the decision in *RCI v Commissioner of Taxation* [2011] FCAFC 104 on 10 February 2012, the Commonwealth Government announced that it

would tighten key aspects of the general anti-avoidance rule effective from 1 March 2012. This was primarily to remove the ability of a taxpayer to argue that they would not have proceeded with the particular scheme or transaction if it would have resulted in the tax liability that the Commissioner was seeking to impose by applying Part IVA.

There was a great deal of debate and controversy surrounding the need for these changes and, following significant consultation, the Government subsequently released exposure draft legislation on 16 November 2012 giving effect to the announcement, effective to schemes entered into from that date. The Government finally introduced the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013* (the bill) into Parliament on 13 February 2013.

#### The key components of Part IVA

To understand the amendments, one needs to consider the key components of Part IVA when it was originally introduced in 1983, which have remained largely unchanged until now. Part IVA was originally introduced to deal with tax avoidance schemes that were blatant, artificial and contrived. The bill and explanatory memorandum (EM) preserve the key components of Part IVA, while incorporating new changes to strengthen the Commissioner’s hand and reduce the scope for a taxpayer to defend a Part IVA determination made by the Commissioner.

Part IVA applies where a taxpayer obtains a **tax benefit** in connection with a **scheme** and it would be concluded, having regard to numerous factors specified in the legislation, that a person who entered into or carried out the scheme did so for the **sole or dominant purpose** of enabling the taxpayer to obtain a tax benefit in connection with the scheme. Examples of tax benefits include an amount not being included in assessable income, an amount not being subjected to withholding tax, a deduction being allowed, or a foreign income tax offset being allowed.

Where the three requirements for Part IVA to apply are met, the Commissioner can cancel the tax benefit. For example, if the scheme resulted in a deduction for a taxpayer, the Commissioner could deny the deduction.

**The amendments – determining if there is a “tax benefit”**

The amendments are, for the most part, targeted at addressing weaknesses in the concept of “tax benefit” highlighted by recent court decisions. The definition of “tax benefit” has been interpreted by the courts as requiring a comparison of the tax consequences of the scheme in question with the tax consequences that either would have arisen, or might reasonably be expected to have arisen, if the scheme had not been entered into or carried out (known as the “alternative postulate”). In broad terms, it is generally concluded that the taxpayer has obtained a tax benefit where the most reasonable alternative postulate discloses a greater amount of tax payable than the tax payable under the scheme. The amendments would significantly change this analysis by creating artificial assumptions for the alternative postulate

the same amount, for the same period at a comparable risk and for a comparable return. An investment in ordinary shares, for example, is not considered to represent an investment of comparable risk and comparable return.

The result of the amendments, if passed, would be that the focus of a Part IVA analysis will be squarely on discovering the objective dominant purpose of entering into a tax benefit scheme. This is consistent with the newly stated object of Part IVA. The amendments would apply to schemes entered into, or commenced to be carried out, from 16 November 2012, which was the date when the draft legislation was released.

**TOFA bill introduced for 2010 announced changes**

The *Tax and Superannuation Laws Amendment (2013 Measures No. 2) Bill 2013* (the bill) was introduced into Parliament on 20 March 2013. The bill contains various refinements to the taxation of financial arrangement (TOFA) rules that were foreshadowed by the Assistant Treasurer in *Media Release No. 145 of 2010*, which was issued on 29 June 2010.

If enacted, the amendments, which would apply from the commencement of the TOFA rules almost three years ago, would affect the core rules, accruals and realisation methods, fair value method, hedging financial arrangements method, transitional balancing adjustment provisions, and requirements for making certain elections. Unfortunately, the amendments to the treatment of repurchase agreements/securities lending arrangements and short sale arrangements, that were canvassed in the media release are not contained in the bill.

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**The critical change is that in deciding whether a tax benefit exists in relation to a scheme, consideration of the alternative postulate is done assuming that the taxpayer would have acted without regard to the tax outcomes while still achieving all of the non-tax effects of the scheme.**

Accordingly, it could not be argued that a scheme would not have been entered into if, all else being equal, it would have resulted in a tax liability.

The EM gives the example of a company placing \$1 million on deposit for 12 months for a return of \$55,000, payable in arrears. For reasons that are not specified in the EM, this income is treated in the example as exempt for tax purposes. From the company’s perspective, the substance of the transaction is considered to be an investment for a fixed term carrying a right to a non-contingent return. The EM states that a reasonable alternative to this transaction would be an investment of

**Core rules**

The changes to the core rules in the bill would clarify that the cost attribution rules apply to both certain and uncertain financial benefits. Another change would remove the rule that prevents financial benefits from being attributed to interest and interest-like amounts. However, in most cases, it is expected that no cost would be attributed to such amounts.

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Such changes in the application of the attribution rules, insofar as they affect the timing of recognition of gains and losses, may be relevant to financial institutions that have made a financial reports election.

This is because one of the conditions for the election to apply to a financial arrangement requires that it be reasonable to expect that differences between the results of the accounting method and the TOFA method that would otherwise apply would not be substantial.

**Accruals and realisation methods**

The bill includes various amendments to the accruals and realisation methods. Some of the key changes are:

- The amendments would clarify that there can be sufficiently certain particular gains or losses even if there is no sufficiently certain overall gain or loss. Furthermore, precedence is to be given to the particular gains or losses method over the overall gains or losses method
- The amendments would also clarify that a gain or loss arising from a prepayment should be spread across the period to which it relates
- The amendments are intended to ensure consistency in the treatment of impairments and reversals of impairments. Currently, an impairment would not generally give rise to a deductible loss. This treatment would be maintained and would clarify that a reversal of an impairment cannot give rise to an assessable gain. Furthermore, the amendments would ensure that the accruals method applies appropriately to a gain or loss arising from the reversal of an impairment.

Again, these amendments may be relevant to the application of the financial reports election insofar as they affect the timing of gains and losses under the TOFA rules if that election was taken not to apply.

**Fair value method**

The fair value method would be extended to encompass financial arrangements that are assets and liabilities that are otherwise treated as at fair value through profit or loss even though not classified or designated as such for accounting purposes. Practically, this would provide for changes in the fair value of certain hedging instruments and some hedged items recognised in the profit or loss to be brought to account as gains or losses under TOFA. An example might be a fair value hedge of the interest rate risk on a fixed rate loan.

**Hedging method**

The changes to the hedging method are meant to ensure that, once adopted, the election would cover all financial arrangements that are hedging financial arrangements on a 'one-in all-in' basis (i.e. if the changes are enacted, once an election has been made, taxpayers would not be able to pick and choose arrangements to which it applies). Further, failure to meet the documentation requirements would preclude the method from applying to arrangements a taxpayer commences to hold from the time of failure unless the Commissioner determines a date from which the election recommences to apply.

In the context of the above, however, it should be noted that the documentation requirements for certain hedges would be removed, namely 'would-be' accounting hedges (e.g. hedges between entities that are members of the same accounting, but not tax, consolidated group) and hedges of anticipated dividends.

The Commissioner would also be granted a power to determine the basis for allocating gains and losses from a hedging financial arrangement where a taxpayer has not adopted an appropriate basis (e.g. one that does not fairly and reasonably correspond with the basis on which gains and losses on hedged items are allocated).

Finally, the rules applying to hedges of net investments in foreign operations would be changed, if the bill passes, to reflect the fact that the hedged item may be shares or other interests (e.g. a loan).

**Transitional balancing adjustments**

Where the financial reports election was made, there were two methods available to work out a transitional balancing adjustment on the making of a transitional election to bring pre-TOFA financial arrangements within the scope of the TOFA rules. The amendments seek to amend the 'short-cut method', which allowed the balancing gain or loss to be calculated by reference to the deferred tax assets or liabilities recognised in respect of financial arrangements.

However, the deferred tax balances for some financial arrangements, such as those that are cash flow hedges or available-for-sale assets, are not recognised through the profit or loss. The amendments are intended to ensure that, in working out a transitional balancing gain or loss, it would only be possible to take into account deferred tax balances that are recognised in the profit or loss.

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**Given that the change would have retrospective effect, taxpayers that used the short-cut method may need to revisit their transitional balancing adjustment calculations and, in some cases, amend prior years' tax returns.**

#### **Elective requirements**

The various tax timing elections, and certain other elections, require that the taxpayer have financial reports prepared in accordance with accounting principles and auditing standards. Due to the practical difficulties arising in the use of these reports for Australian branches of foreign authorised deposit-taking institutions, the bill includes amendments to enable these entities to use the Statement of Financial Performance and Statement of Financial Position that they provide to the Australian Prudential Regulation Authority.

#### **Board of Taxation review of tax arrangements applying to permanent establishments**

In May 2012, the Government commissioned the Board of Taxation to examine and report on the advantages and disadvantages of Australia adopting the OECD functionally separate entity approach to determining the profits attributable to a permanent establishment (PE) in its tax treaty negotiations and in domestic law.

The Board's review has involved an extensive public consultation process, including the release last October of a discussion paper inviting comment on a substantial number of questions and issues. For the financial services sector, the key issues raised include:

- The practical differences between the approach under current Australian law and the authorised OECD approach (AOA), and hence the implications of Australia's adoption of the AOA
- The appropriateness of retaining Part IIIB of the *Income Tax Assessment Act 1936* for foreign bank branches in Australia, and in particular the LIBOR cap limiting interest deductions under that provision
- Whether the AOA achieves appropriate tax outcomes for Australian insurance businesses, and the appropriateness of retaining Division 15 of the *Income Tax Assessment Act 1936*.

In summary, Deloitte's submission to the review made the following comments on these issues:

- Current Australian law (e.g. Subdivision 815-A of the *Income Tax Assessment Act 1997* and the 2008 OECD Commentary on the existing Article 7) incorporates a 'limited AOA'. There is little to no difference between the limited and full AOA for the financial services sector, as the limited AOA recognises the concept of economic ownership of financial assets and internal dealings, such as interest and risk transfers, for the purposes of attributing profit according to the arm's length principle and having regard to economic substance
- The LIBOR cap in Part IIIB should be removed. It causes significant issues as it is often significantly lower than the actual cost of funds. The arm's length principle (in conjunction with the existing thin capitalisation provisions) provides a better framework to determine deductible debt in Australia
- For insurance, the proper application of the principles set out in the AOA should lead to an appropriate arm's length allocation of profits to PEs involved in the operation of an Australian insurance business. It is timely that discussions occur on whether it continues to make sense to maintain Division 15 of the *Income Tax Assessment Act 1936*.

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## Deloitte's submission expressed its view that the Board of Taxation should provide a strong recommendation that Australia adopt the AOA in Australia's treaties and domestic law.

In the meantime, as part of its current process of reforming Australia's transfer pricing rules, the Government has recently introduced a bill into Parliament whose purpose is to 'modernise' (i.e. replace) Division 13 of the *Income Tax Assessment Act 1936*, including in respect of PE profit attribution. The proposed new law includes provisions (in Subdivision 815-C) whose stated intention is to codify the 'relevant business activity approach', so that "...Subdivision 815-C reflects the approach to the attribution of profits to permanent establishments that is currently incorporated into Australia's tax treaties". This is on the basis that the Government is yet to decide on whether to adopt the AOA (functionally separate entity approach) in Australia's tax treaties.

The Board of Taxation's report is due to Government by the end of April. We remain hopeful that it will recommend adoption of the AOA in Australia's treaties and domestic law. For multinational corporations (MNCs) straddling many borders, including Australian-owned MNCs, the AOA is the only internationally recognised and harmonious guidance on these matters. It is vital to have a common set of rules to allow businesses to run efficiently, promote investment into Australia and reduce the risk of double taxation.

### What to expect from the ATO's refined approach to risk identification, disputes and audits

The ATO has continued to refine its approach to risk identification, audits and disputes for the large market and the banking sector. On 6 December 2012, the ATO released the revised "*Large business and tax compliance booklet*", last published in July 2010.

#### Transparency, risk management and tax governance practices of taxpayers

The booklet re-states the mutual expectations between the ATO and taxpayers, with a heightened level of

governance and diligence expected from corporate taxpayers. The new approach increases the onus on corporate taxpayers to be transparent, to provide information on business events as they occur throughout the year and to provide more information relating to customers and clients. This is particularly important for banks as the ATO seeks increasingly more data for project-based reviews of smaller business and individual taxpayers with offshore links.

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## Importantly, the booklet puts large business taxpayers on notice that what they have been experiencing in practice in their dealings with the ATO for the last two years is set to continue.

There is an increased focus on the importance that the ATO gives to early engagement, transparency and providing taxpayers with practical certainty. This is squarely aimed at more timely engagement by the ATO and better use of real time information and data gathered by the ATO. Perhaps in response to the continued low take-up of annual compliance arrangements (ACAs), the revisions to the booklet also emphasise the ATO's view that the real-time engagement and certainty offered to taxpayers by these ACAs can also be achieved by the new reportable tax position (RTP) schedule and the ATO's pre-lodgement compliance reviews (PCR). The revised booklet contains new sections and chapters on both the RTP schedule and PCRs.

Compared to the previous edition, this booklet provides more detailed and rigorous information on the ATO's expectations of large business taxpayers as regards tax risk management and tax governance, and how taxpayers can best manage their tax risk. The booklet now includes tax risk management and governance checklists and additional information on the risk-differentiation framework (RDF), as well as increased focus on the role of the board in relation to strategic tax risk management.

#### Shifting the focus from audits to reviews

We expect to see the ATO continue to shift its focus from large, long audits that cover numerous back years to shorter and more focussed reviews that cover more recent

tax periods, with some of these reviews commencing in real time as transactions and events unfold. This will inevitably bring a stronger desire and use of Alternative Dispute Resolution strategies by the ATO, an area where we are expecting a large focus from the new Commissioner, Chris Jordan.

#### **Other highlights**

Other highlights of the ATO's approach to large corporate compliance in 2013 are:

- Further and better information on the RDF. Perhaps in response to taxpayer requests for greater clarity and transparency regarding their risk ratings under the RDF, the revised booklet provides further information on both the factors taken into account in the risk assessment process, and the application of the framework to taxpayers in each RDF quadrant. It also confirms the ATO's view that taxpayers should approach the RDF as an opportunity to engage with the ATO on a transparent and informed basis
- The ATO's pilot and rollout of the RTP schedule. Certain large taxpayers will need to prepare and include an RTP schedule when lodging their 2012 and 2013 tax returns, commencing in mid-January 2013. These schedules require reporting on:
  - Tax positions that are about as likely to be correct as incorrect, or less likely to be correct than incorrect
  - Tax positions disclosed in the financial statements where there is uncertainty about taxes payable or recoverable in respect of the position
  - Specified reportable tax positions (effectively a material CGT event)
- General Anti-Avoidance Rules (GAAR) Panel – the ATO has highlighted that it may refer matters to its GAAR Panel in advance of, or in the absence of, any taxpayer position paper response
- Collection of tax – the ATO has also highlighted its 'firmer action' approach to tax debt, including taking an 'early intervention' approach to tax debt and using certain 'stronger measures' available to the ATO to collect such debt.

#### **Foreign banks operating in Australia – liquidity charges and notional funding costs**

The ATO has continued its focus on the foreign banking sector by recently issuing three ATO Interpretative Decisions (ATO IDs) relating to the deductibility of liquidity reserves and notional funding costs in Australian operations of global banks. All three ATO IDs conclude that these costs are not deductible in Australia.

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**However, our analysis is that the ATO has taken quite a narrow approach to the facts and issues in these decisions and that these costs may be deductible in certain circumstances.**

#### **ATO ID 2012/90 – deductibility of notional funding costs**

ATO ID 2012/90 asks whether, in determining the profits attributable to a foreign bank's Australian permanent establishment under the business profits article of a relevant tax treaty, the bank can deduct an amount it estimates would be the funding cost if assets employed in its Australian branch operations had been funded under certain terms and conditions?

The ATO concludes that the answer is no, the bank cannot deduct such estimated (or notional) funding costs. Deloitte's view is that the ATO has reached this conclusion based on inferences it has drawn from a rather narrow set of facts, and that in some cases these costs may be deductible where it can be shown they are necessarily incurred for the business of the Australian branch.

#### **ATO ID 2012/91 – deductibility of "net loss" or "negative spread"**

ATO ID 2012/91 asks whether a "net loss" or "negative spread" can be a loss or outgoing incurred by a taxpayer within the meaning of section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) where the net amount is the excess of interest expense incurred by the taxpayer on borrowings to fund a particular asset (being a liquid reserve asset) over the income derived by the taxpayer from the asset?

The ATO states that the "net amount" cannot be the loss or outgoing incurred by the taxpayer within the meaning of section 8-1 of the ITAA 1997; rather, it is just the interest expense incurred by the foreign bank in calculating the "net loss" or "negative spread". In our view, the particular construction of what makes up income and expense would be critical to such an analysis.

**ATO ID 2012/92 – deductibility of liquidity charges**

ATO ID 2012/92 asks whether, in determining the profits attributable to a foreign bank's Australian permanent establishment under the business profits article of a tax treaty, interest expense incurred by the foreign bank on its borrowings that fund the bank's general reserve liquid assets, managed and controlled for use outside Australia (i.e. the liquid asset reserve is required by the home country regulator), is deductible by the bank under section 8-1 of the ITAA 1997?

Again the ATO says that the answer is no. The ATO's analysis takes the view that the liquid reserve assets are managed and controlled for use outside Australia, deriving income and incurring interest expenses that do not have the requisite connection with the business operations carried on through the Australian branch.

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**Deloitte adopts a wider view of these cases and believe that the costs may be deductible in Australia, particularly where a functional analysis shows that there is a commercial benefit in Australia that justifies the allocation of expenses and revenue to or from the Australian branch operations under transfer pricing legislation.**

Deloitte is of the view that the ATO has (correctly) left the door open to such analysis by saying that a foreign bank could be treated as having incurred some of the interest in the course of its Australian branch operations if, for example, it funded liabilities of its Australian branch operations from the proceeds of disposal of any of the liquid reserve assets.

**Practical implications for banks of the GST self-assessment regime**

Recent changes to the GST law will potentially make it more difficult for entities in the banking industry to revise the amount of input GST claimed from the ATO for past tax periods.

**Self-assessment regime for GST and other indirect taxes**

From 1 July 2012, all GST taxpayers became subject to a self-assessment regime, whereby GST and other indirect tax liabilities and entitlements are dependent on (i.e. are crystallised by) an assessment made by the Commissioner of Taxation. This change was made to replace the 'self-actuating' system (under which GST and other indirect tax liabilities and entitlements could exist independently of an assessment) with a system more closely aligned to the self-assessment regime for income tax.

**Summary of key changes for GST taxpayers**

For GST taxpayers, the changes made to the *Taxation Administration Act 1953* (by the *Indirect Tax Laws Amendment (Assessment) Act 2012*) now mean, among other things, that:

- A taxpayer is only liable to pay the GST liabilities or entitled to receive the entitlements stated in their assessment
- The Commissioner is taken to have made an assessment of an amount determined in a GST return on the day the return is lodged by the taxpayer. The return is treated as the notice of assessment and is conclusive evidence that the assessment is correct
- The Commissioner may make an assessment if the taxpayer fails to lodge a return
- Once the liability or entitlement has been assessed, there is no time limit imposed on the Commissioner to recover unpaid amounts or the taxpayer to be paid an amount
- Once an assessment has been made, a four-year period of review applies, during which time the Commissioner may amend a taxpayer's assessment, either at the taxpayer's request or at his own discretion. Multiple amendments may be made in the period of review
- An amendment to an assessment gives rise to a refreshed period of review for the "particular" that is amended (i.e. a further four years from when the taxpayer is given a notice of amended assessment for

the last amendment made to the "particular" during the period of review). The explanatory memorandum states that a particular is "*a constituent element that affects an increase or decrease in the assessable amount and in the context of GST, could be a single supply or a single acquisition provided it individually results in a change to the assessable amount*". The refreshed period of review for a particular cannot be extended. An assessment may be amended during the refreshed period of review only once in relation to a particular

- The four-year period of review can be extended in limited circumstances (but only on the Commissioner's initiative, and only because the Commissioner has begun an examination of the taxpayer's affairs that he will be unable to complete before the end of the review period)
- Taxpayers cannot use 'stop-the-clock' letters to preserve entitlements beyond the four-year limit, for entitlements relating to tax periods that start on or after 1 July 2012.

#### **Practical implications for banks**

For most GST taxpayers, at least for now, the move to the self-assessment regime has resulted in no practical change to what was required under the self-actuating system (i.e. lodgement of a monthly or quarterly GST return together with payment of the net amount calculated in the return - if a positive amount).

banks subject their apportionment methodology to ongoing review and revision to achieve the highest rate of input GST recovery, fairly and reasonably determined. The revised methodology may be applicable to prior tax periods. Banks would generally rely on a stop-the-clock notice to preserve entitlement to an increased level of input GST recovery, while the bank finalises the revised methodology, obtains the Commissioner's sign-off (often a very protracted process, potentially taking several years) and prepares the revised GST returns.

However, stop-the-clock notices are not a feature of the new self-assessment regime and, as they can now only be used to preserve pre-1 July 2012 entitlements, are of diminishing utility. Effectively, by 1 July 2016, unless a revised GST return that takes into account the revised apportionment methodology is lodged within the four-year review period for each affected tax period (or a private ruling application has been made within the four-year period), any increased entitlement will be lost.

#### **What should banks be doing?**

Entities in the financial services sector will be more greatly affected by the removal of the stop-the-clock notification process than entities in other sectors. Therefore, banks should now be focusing their efforts on determining whether an alternative, fair and reasonable apportionment methodology could give them an improved level of input GST recovery. If the methodology can be applied to past tax periods, steps should be taken to apply it appropriately. This would generally involve lodging a stop-the-clock notice for pre-1 July 2012 tax periods within the four preceding years, and working to ensure that the methodology is finalised and the Commissioner's sign-off obtained as soon as possible

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**For entities in the banking sector, however, the impact of the change is likely to become increasingly significant as time goes on.**

Banks and other financial institutions commonly make a mixture of 'input taxed' financial supplies, and supplies that are 'taxable' or 'GST-free'. The input taxed supplies generally limit the extent to which input tax credits can be claimed for the GST included in the cost of business inputs acquired by a bank. Banks typically determine the extent to which their acquisitions (and therefore the associated input GST incurred) relate to the making of input taxed supplies by designing and applying an 'apportionment' methodology. The apportionment methodology allows a bank to calculate the proportion of its input GST costs that are claimed back from the Commissioner in a GST return. In most cases however,

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**Into the future, banks will still benefit from continuing to review and revise their apportionment methodologies, but beyond 30 June 2016, it will not be possible to capture retrospective benefits beyond the four-year statutory limit.**

### Final FATCA regulations issued – where to from here for Australian banks?

On 17 January 2013, the U.S. Treasury Department and IRS released 544 pages of supplementary information and final regulations for the Foreign Account Tax Compliance Act (FATCA). The final FATCA regulations are a culmination of the series of interim guidance issued by the U.S. Treasury Department and the IRS, including a series of IRS Notices, the proposed regulations released on 8 February 2012, and Announcement 2012-42 released in October 2012. The final regulations take into account comments and consultation with industry stakeholders in limiting the institutions, obligations and accounts subject to FATCA and setting out detailed guidance for its implementation

The final regulations contain numerous changes from the draft regulations. Many of the changes are to provide additional detail for compliance with FATCA obligations, while other changes are more substantive. Importantly, the final regulations adopt the revised timeline included in Announcement 2012-42, which aligns the timing for phasing in FATCA obligations in the final regulations with the timing set out in the intergovernmental agreements (IGAs).

The first key dates are 25 October 2013 to register FFIs with the IRS and 1 January 2014 for several major processes to go live, including FATCA-compliant on-boarding of new customers.

#### Interaction of the final regulations with an Australian IGA

Australia continues to progress towards a Model 1 IGA on FATCA with the U.S., which will require all financial institutions resident in Australia (Australian FIs) to comply with a modified version of FATCA, although many aspects of the IGAs and the final regulations are now considered to be broadly consistent. Under a Model 1 IGA, Australian FIs that must report on U.S. accounts under the IGA will report to the Australian Taxation Office, which will then provide information to the IRS.

The final regulations will interact with an Australian IGA in a number of ways, including:

- Australian FIs that are in compliance with Australian laws to be implemented to identify and report U.S. accounts will be treated as satisfying the FATCA due diligence and reporting requirements for FATCA
  - Australian FIs will generally not need to apply the final regulations for the purposes of complying with and avoiding withholding under FATCA

- In certain cases prescribed in the IGA, Australian FIs may be able to elect to apply provisions of the regulations instead of the rules otherwise prescribed in the Australian IGA (although, this requires the election to apply for each full set of provisions – e.g. pre-existing individual accounts)
- The IRS and U.S. Treasury Department recently indicated that any definition that is available (or preferential) in the final regulations will also be available under an IGA
- The IRS currently contemplates that a Global Intermediary Identification Number (“GIIN”) may be used by reporting Model 1 FFIs (such as Australian FIs) to satisfy reporting requirements under local law and is discussing this possibility with Model 1 IGA partners, and as part of the OECD’s Treaty Relief and Compliance Enhancement (TRACE) program
- The IRS is also discussing with partner jurisdictions the possibility of adopting a single format for reporting FATCA information. One of the key features of the TRACE program recently approved for implementation by the OECD is standardisation of reporting and documentation and efforts are underway to align requirements for TRACE and FATCA
- The Australian IGA, rather than the final FATCA regulations, will determine whether a resident entity described in the Australian IGA is an FFI.

#### Where to from now until 1 January 2014

Some Australian FIs will be exempted or deemed compliant with FATCA under either an IGA or the final regulations. This status should be documented and dealt with in accordance with the FFI’s governance framework. Such FFIs will still need to register (refer below) and have a compliance program in place to ensure compliance with the exemption or deemed compliant category requirements.

Under an IGA, there will no longer be the ability for an Australian FI to choose not to comply with FATCA. The IGA will require all FFIs resident in Australia to comply (or be deemed to comply) with FATCA.

Australian FIs that are not exempted or deemed compliant will need to progress, or continue to progress, their FATCA projects during 2013 to meet the 1 January 2014 ‘go-live’ date under either an Australian IGA or the final regulations. Even if an Australian IGA is signed shortly, it may be some time before detailed guidance for Australian FIs is provided via Australian legislation, regulation or ATO rulings.

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In the meantime, the final regulations, along with guidance from other Model 1 IGA jurisdictions (e.g. the UK) provide direction and assistance for FATCA implementation by Australian banks.

**Link to additional information**

Please [click here](#) to access our global FATCA resource library, where you will find a copy of the final FATCA regulations.

Where Australian FIs may be able to elect to apply the final regulations rather than the rules prescribed in an Australian IGA, Australian FIs will need to be sufficiently familiar with those aspects of the final regulations to enable an informed decision as to whether such an election should be made or not.

With around nine months to go, Australian financial institutions should focus their FATCA projects on the following 'must-haves' that are required by 1 January 2014:

- Classify all entities for FATCA purposes, including deemed compliant entities
- Undertake financial counterparty due diligence and agree scope of responsibility with counterparties
- Put in place new account opening processes, which should be cross-referenced to anti money laundering and other account opening documentation requirements and will require consideration of approach (e.g. self-certification vs., search for U.S. indicia) and may require IT system changes
- Initiate a FATCA compliance program to comply with the IGA (or an FFI Agreement for entities in a group that are resident in jurisdictions outside Australia)
- Register with the IRS by 25 October 2013 to ensure a GIIN is issued by 31 December 2013. Provided an Australian IGA is signed and on the IRS list of IGAs, Australian FIs will need to register, even if the IGA is not ratified by the registration deadline.

## Contact us

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