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# Tax highlights

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## *Key developments this week*

**MRRT repeal bill now law:** On 1 September 2014, after being introduced into Parliament twice but having failed to pass through both Houses of Parliament, the House of Representatives laid aside the Minerals Resource Rent Tax Repeal and Other Measures Bill 2013 [No. 2]. The Minerals Resource Rent Tax Repeal and Other Measures Bill 2014 (the Bill) was then introduced into the House of Representatives, containing the same measures as those set out in the original Bill, with the exception of the rephrasing of the superannuation guarantee charge (SGC) percentage increase. Following passage of the Bill in the House on 2 September 2014, the Bill was introduced and passed the Senate with Government amendments (primarily concerning the rephrasing of the SGC percentage increase and the start date of certain other measures) and, on the same day, the House agreed to the amendments made by the Senate. The Bill received Royal Assent on 5 September 2014.

The date of effect of some of these measures is dependent on the commencement of the relevant schedule of the Bill that sets out the measure. Relevantly, the schedules for the repeal of the Minerals Resource Rent Tax (MRRT), the repeal of the loss carry-back rules and revision of small business capital allowance concessions commence on the earlier of the date fixed by proclamation or twelve months after Royal Assent – see further below.

Broadly, the measures contained in the Bill are:

- Repeal of the MRRT: see *MRRT – Residual compliance obligations* item below
- Repeal of the company loss carry-back measure: This measure is repealed with effect from the start of the income year before the income year in which the relevant schedule commences. For example, if the relevant schedule commences in the 2014-15 income year, the repeal of loss carry back would have effect from the start of the 2013-14 income year
- Revision of the capital allowance concessions previously granted to small business: With the exception of the amendments relating to low value pools, the amendments apply from 1 January of the income year before the income year in which the relevant schedule(s) commence. For low value pools, the amendments will apply for assessments for the income year before the income year in which the relevant schedule commences. For example, if the relevant schedule commences in the 2014-15 income year, the commencement dates set out below will apply:

| Deduction | New law | Previous threshold |
|---|---|---|
| Instant asset write-off for assets whose cost is under the threshold | To be reduced to $1,000 (with effect, broadly, for assets that are first used or installed ready for use on or after 1 January 2014) | Threshold of $6,500 |
| Second element of cost base where amount under threshold, and asset previously written off | To be reduced to $1,000 (with effect for amounts incurred on or after 1 January 2014) | Threshold of $6,500 |
| Deductions for low value pool if balance under the threshold | To be reduced to $1,000 (with effect for assessments for 2013-14 and following income years) | Threshold of $6,500 |
| New motor vehicles | No special treatment (with effect for motor vehicles first used or installed ready for use on or after 1 January 2014) | Deduction for first $5,000 plus 15% of additional value. 30% subsequent rate |

- Repeal of the immediate deduction available for geothermal energy exploration and prospecting expenditure (subject to transitional rules, generally applicable to expenditure incurred during the income year in which the relevant schedule commences or a later income year)
- Repeal of the low income superannuation contribution, income support bonus and the schoolkids bonus (with varying dates of effect)
- Rephasing of the superannuation guarantee charge (SGC) percentage increase as follows:

| Income years commencing | SGC percentage | |
|---|---|---|
| | New rate increase | Previous rate increase |
| 1 July 2014 | 9.5% | 9.5% |
| 1 July 2015 | 9.5% | 10% |
| 1 July 2016 | 9.5% | 10.5% |
| 1 July 2017 | 9.5% | 11% |
| 1 July 2018 | 9.5% | 11.5% |
| 1 July 2019 | 9.5% | 12% |
| 1 July 2020 | 9.5% | 12% |
| 1 July 2021 | 10% | 12% |
| 1 July 2022 | 10.5% | 12% |
| 1 July 2023 | 11% | 12% |
| 1 July 2024 | 11.5% | 12% |
| 1 July 2025 onwards | 12% | 12% |

**MRRT – Residual compliance obligations:** As mentioned above, on 5 September 2014, the Minerals Resource Rent Tax Repeal and Other Measures Bill 2014 received Royal Assent.

The Bill will have the following impact on MRRT compliance:

1. Although previously the MRRT repeal was to take effect from 1 July 2014, this has now been changed to the date fixed by 'proclamation', which must occur within 12 months of Royal Assent. A proclamation is a notice which is generally published in the relevant government gazette proclaiming the date(s) on which an Act, or a part of it, comes into operation. As the Bill has now received Royal Assent, we would expect that proclamation would follow shortly thereafter. The proclaimed repeal date could likely be the first day of the month following Royal Assent in order to simplify compliance obligations. As such:

   a) If the date fixed by proclamation is, say, 1 October 2014, this would result in another 3 months of potential MRRT payments
   b) In addition, some taxpayers would then need to lodge another return (and another instalment activity statement) covering the period from 1 July 2014 to the date fixed by proclamation

2. In certain forums, the ATO has previously suggested it would waive the requirement for low volume non-paying entities to lodge MRRT returns if the MRRT was repealed. Although the ATO update on its website is silent on this matter, we understand an exemption is likely to be announced now that the Bill has received Royal Assent

3. Lastly, from an accounting perspective, any deferred tax balances recognised in respect of the MRRT should be derecognised once a repeal date is fixed by proclamation.

As soon as all MRRT returns have been lodged in late 2014/early 2015, we understand the ATO will commence limited ATO compliance activities focussing on key taxpayers and key risks such as starting base valuations, mining revenue and mining expenditure.

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# *Weekly tax news*

### Business tax

**Bill to reduce net benefit of R&D introduced into Parliament:** On 4 September 2014, the Government introduced the Tax and Superannuation Laws Amendment (2014 Measures No.5) Bill 2014 (the Bill) into Parliament. The Bill is currently before the House of Representatives.

Amongst other measures, the Bill introduces the amending legislation that seeks to reduce the rate of both the refundable and non-refundable research and development (R&D) tax offsets by 1.5 percentage points. Although this matches the proposed cut in the company income tax rate to 28.5% from 1 July 2015, if enacted as introduced, the R&D tax incentive cut will occur one year earlier from 1 July 2014, when the refundable R&D tax offset will be set at 43.5% and the non-refundable tax offset set at 38.5%.

This means that for all companies there will be a temporary one year reduction in the net tax benefit of the refundable and non-refundable R&D tax offsets to 13.5% and 8.5% respectively for the 2015 income year. It also means that for taxpayers in a tax loss position, the immediate benefit of the refundable offset is permanently reduced to 43.5%.

This will revert back to a net tax benefit of 10% and 15% respectively from 1 July 2015. However should the proposed paid parental levy (PPL) of 1.5% take effect from 1 July 2015, the net tax benefit of the R&D tax offset will remain at 8.5% and 13.5% for companies with a taxable income of $5m or more.

Further issues arise in respect of the situations where a government grant clawback or a feedstock adjustment occurs since these represent a clawback of between 9.5% and 10%. The explanatory materials make a generalised statement that no changes have been made for the purposes of simplicity since the tax outcomes will largely be the same once the company income tax rate has also been reduced. However, the fact remains that for non-refundable R&D tax offset taxpayers who are subject to large feedstock adjustments and receive government grants, the clawback of 10% will exceed the net tax benefit of 8.5% of making the claim, a substantial disincentive in certain circumstances.

Aside from these clawback issues, these measures represent an effective 15% reduction in support for companies entitled to the non-refundable R&D tax offset and a 10% reduction for those claiming the refundable offset, an outcome significantly at odds with the aims and objectives of the government's current inquiry into innovation.

On R&D related matters, the proposed restriction to deny access to the R&D tax offset from 1 July 2013 to large groups with aggregate Australian assessable income in excess of $20 billion (Tax Laws Amendment (Research and Development) Bill 2013) is still currently before the Senate.

**Bill to give effect to revised tax treaty with Switzerland awaiting Royal Assent:** The International Tax Agreements Amendment Bill 2014 has passed both Houses of Parliament without amendment and is now awaiting Royal Assent.

**Development of Northern Australia – final report released:** On 4 September 2014, the Joint Select Committee on Northern Australia (the Committee) tabled its final report on its inquiry into the development of Northern Australia. The final report identifies taxation as an impediment to the development of Northern Australia and sets out evidence presented to the Committee highlighting the need for taxation reform to provide incentives or remove disincentives for growth in Northern Australia.

Broadly, the tax-related recommendations made by the Committee include:

- The Australian Government should explore reforms to the taxation system to better promote investment and development in Northern Australia
- The Australian Government should investigate the equity of the current application of the Zone Tax Offset arrangements
- The Australian Government should review the taxation treatment of fly-in fly-out work arrangements to ensure that they are consistent with the goal of promoting the development of regional and remote communities in Northern Australia.

The Committee's findings and recommendations will inform the White Paper process on the Development of Northern Australia, which is expected to be released early in 2015.

**Large mining taxpayer partially successful in former R&D tax concession claim:** In a decision in a long running former R&D tax concession case, which the Commissioner has apparently appealed to the Federal Court, the taxpayer has been successful in claiming a 125% R&D tax concession deduction for some disputed expenditure, with some claims disallowed on the basis of overlapping activities and expenditures.

In the income tax years between 2003 and 2007, the taxpayer conducted plant trials over a number of months to experiment with a number of potential improvements to its copper and lead concentrators and its copper smelter. The taxpayer sought to claim a large part of this expenditure as R&D at the premium deduction rate of 125% and, for each of the relevant tax years, the Commissioner disallowed many, but not all, of the items of expenditure claimed.

Under review, the Commissioner contended that the amounts were not eligible on the basis that the amounts related to "feedstock expenditure" being expressly excluded from the statutory definition of "research and development expenditure". Such excluded expenditure is that incurred to acquire goods and materials that will be the subject of transformation or processing in the R&D activities.

It was also contended that some expenditures overlapped because the product of the plant trials was fed into the copper smelter activities and as such became excluded "feedstock expenditure".

On a detailed analysis of the complicated scientific factual position, the Administrative Appeals Tribunal (AAT) held that on a correct application of the principles of statutory interpretation, the taxpayer was entitled to substantially succeed. It held that the term feedstock expenditure was a defined term that must be construed as defined, subject only to the proposition that the meaning of the definitions themselves may be informed by the context of the legislation read as a whole.

The AAT stated that things which are acquired to be the subject of some process cannot share a common identity with those acquired to subject them to that activity, and also recognised that such goods and materials must potentially be able to become 'products' as a result of the transformation or processing. It acknowledged that the feedstock scheme enacted is coherent and self-contained.

The AAT also addressed some of the Commissioner's specific considerations as follows:

- The submission that the construction of the legislation requires a "common-sense commercial approach" was rejected where the proposition would support an outcome otherwise than that expressed by the text of the legislation itself
- The mere argument that a disproportionate benefit may arise compared to the risk incurred cannot displace the meaning of the statute as expressed by its text
- The compound phrase "expenditure incurred by the company in acquiring or producing materials or goods to be the subject of processing or transformation by the company in research and development activities" must be read as a whole.

However, the AAT also accepted the Commissioner's argument on the overlapping expenditures on the basis that the R&D plans that were developed independently of each other and the timing of the scheduling of the R&D activities.

Given that the definition of feedstock expenditure is substantially similar under the current R&D tax incentive, many aspects of this case will remain relevant in the interpretation of those provisions – click to view *GHP 104 160 689 Pty Ltd and Commissioner of Taxation* [2014] AATA 515 (29 July 2014).

**Draft Emissions Reduction Fund methods released:** On 5 September 2014, the Government released for public consultation the first draft emissions reduction fund method determinations for projects under the Emissions Reduction Fund (ERF). The ERF method determinations set out the rules for estimating emissions reductions from proposed activities. The three draft ERF method determinations cover projects for landfill gas recovery, alternative waste treatment and cleaning up emissions from coal mining. Submissions on the draft ERF method determinations are due by 1 October 2014.

**Taxpayer liable for withholding tax for royalties:** The Full Federal Court has dismissed the taxpayer's appeal against the Federal Court decision in *Task Technology Pty Ltd v Commissioner of Taxation* [2014] FCA 38 and held that a taxpayer, who was a distributor of software that was developed by a Canadian resident entity, was liable for withholding tax on payments made to the Canadian entity for a percentage of the software and template fees as the payments were not excluded from being 'royalties' by Article 12(7) of the Australia/Canada Double Tax Agreement (DTA).

In reaching its decision, the Full Court found that for the payments to be excluded from being royalties under Article 12(7) of the DTA, two limbs must be satisfied:

- First, the payments made by the taxpayer to the Canadian entity had to be made as consideration for (a) the supply of source code in a computer software program or (b) the right to use source code in a computer software program
- Second, if there was a supply, or a right to use, source code, the use of the source code had to be limited to such use as is necessary to enable effective operation of the program by the user.

The Full Court had regard to the terms of the agreement between the parties and concluded that the taxpayer was not granted a supply, or given the right to use, source code in the relevant program. Further, the taxpayer did not demonstrate any connection between the payments and the alleged supply, or right to use, source code in the program so that a payment could have been said to have been made as consideration for one or both of those rights. Accordingly, the taxpayer failed to satisfy the first limb and it was therefore unnecessary to consider the second limb – click to view *Task Technology Pty Ltd v Commissioner of Taxation* [2014] FCAFC 113 (5 September 2014).

**Performance rights – class rulings – Westfield restructure:** The ATO has issued the following class rulings:

- CR 2014/70 - Income tax: Westfield Group Plans - Westfield Corporation employees
- CR 2014/71 - Income tax: Westfield Group Plans - Scentre Group employees.

**General interest charge (GIC) and shortfall interest charge (SIC) rates:** The schedule of GIC rates and SIC rates have been updated by the ATO for the October to December 2014 quarter.

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## Individuals and family groups

**Entry into settlement deed triggers a CGT event:** The Administrative Appeals Tribunal (AAT) has affirmed the Commissioner's objection decision that the taxpayer was liable to capital gains tax (CGT) in respect of an amount received under a deed of settlement executed to settle proceedings brought by the taxpayer (and her husband) in the NSW Supreme Court for negligence and breach of contract.

The AAT found the causes of action pleaded by the taxpayer were CGT assets and upon execution of the settlement deed those causes of action were released, giving rise to CGT event C2.

The AAT dismissed the taxpayer's contention that "damages by definition cannot be a capital gain since the purpose of damages is to return the plaintiff to his or her pre-damage position" - click to view *Coshott and Commissioner of Taxation* [2014] AATA 622 (2 September 2014).

**Marriage or relationship breakdown – dividends and deemed dividends:** The ATO has released a fact sheet that discusses when an amount is taxed as a dividend or a deemed dividend in circumstances where it is received from a private company because of a marriage or relationship breakdown.

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## Indirect taxes

**Korea-Australia FTA customs bills introduced:** On 4 September 2014, the Government introduced two bills that will contribute to giving effect to the Korea-Australia Free Trade Agreement (KAFTA):

- Customs Amendment (Korea-Australia Free Trade Agreement Implementation) Bill 2014 (Customs Amendment Bill)
- Customs Tariff Amendment (Korea-Australia Free Trade Agreement Implementation) Bill 2014 (Customs Tariff Amendment Bill).

The Customs Amendment Bill amends the *Customs Act 1901* by inserting:

- Rules of origin for goods imported into Australia from Korea. Imported goods that satisfy the new rules as 'Korean originating goods' will be eligible for preferential rates of customs duty under the *Customs Tariff Act 1995*
- Rules relevant to the exportation of goods to Korea. These rules concern record keeping and other obligations and will apply to persons exporting goods to Korea and wanting to obtain preferential treatment for them in Korea, and on producers of such goods.

The Customs Tariff Amendment Bill amends the *Customs Tariff Act 1995* to, among other things, provide 'free' rates of customs duty for certain Korean originating goods, and to provide for the phasing of preferential rates of customs duty to 'free' by 2021 for certain other Korean originating goods.

The KAFTA was signed on 8 April 2014, following lengthy negotiations. It is a wide-ranging agreement that provides Korea and Australia with more liberal access to one another's goods, services and investment markets. The amendments contained in the customs bills will become operative from the later of 1 December 2014 and the day on which the KAFTA comes into force for Australia. Both Australia and Korea are currently aiming for entry into force before the end of 2014.

Implementation of KAFTA will also require changes to other legislation, including the *Copyright Act 1968*, the *Foreign Acquisitions and Takeovers Regulations 1989* and the *Life Insurance Regulations 1995*.

The Customs Amendment Bill and Customs Tariff Amendment Bill have been referred to the Senate Legal and Constitutional Affairs Legislation Committee and a report is due by 2 October 2014.

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## International tax

**Treasurer's speech on "G20-OECD Tax and Transparency":** The Treasurer issued a Ministerial Statement regarding "G20-OECD Tax and Transparency". The Treasurer reiterated that "Australia is open for business" and that companies should pay tax in the country where they have earned a profit. The Treasurer expressed concern about "a small portion of multinational businesses that set up sophisticated arrangements to avoid Australian tax". The three key aspects of the speech are as follows:

- **Australia's tax integrity rules:** Australia's transfer pricing rules, thin capitalisation rules, controlled foreign company (CFC) rules and general anti-avoidance rule are seen as being some of the strongest anti-avoidance laws in the world. The Treasurer also referred to the recent changes to section 23AJ of the *Income Tax Assessment Act 1936* and its interaction with the thin capitalisation rules as an example of addressing remaining areas of concern. As regards the repeal of section 25-90 of the *Income Tax Assessment Act 1997* (ITAA 1997) as proposed by the former Labor government, this was described as a "flawed proposal" and "poor public policy". The Coalition government has already indicated that it will not proceed with the repeal. No further comment was made by the Treasurer regarding the previously announced targeted integrity measure in connection with section 25-90 of the ITAA 1997
- **Australia's tax administration:** the Treasurer stated that he is working with the ATO to create the "best tax administration system in the world" including use of extensive investigative powers. The ATO is to double its efforts by undertaking more extensive enquiries and audits of multinational companies and in applying transfer pricing rules. These comments were in the context of Australian consumers often paying much higher prices compared to US consumers for identical goods and services, whilst some companies selling these products pay little tax in Australia
- **Global action:** the Treasurer reiterated the need for multilateral cooperation and for Australia, in its capacity as the current President of the G20, to lead this process. An important theme for the G20 Finance Ministers meeting in Cairns later this month is tax transparency and information exchange. A new common reporting standard for the automatic exchange of information has previously been endorsed by the G20 and further details on the implementation can be expected during the upcoming meeting in Cairns. As regards the OECD 15 point base erosion and profit shifting (BEPS) action plan, it appears that this will be reviewed at the Cairns meeting, but no major G20 announcements on BEPS items appear likely at this stage.

**Dbriefs Bytes:** Deloitte Dbriefs Bytes is a short weekly video summary of the significant international tax developments impacting the Asia Pacific region – click to view the latest Dbriefs Bytes.

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