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Tax highlights

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Contents:

Key developments this week

Exploration development incentive – exposure draft: The Government has released exposure draft (ED) legislation and explanatory material to provide an exploration development incentive (EDI) for Australian-resident investors in small mineral exploration companies. Broadly, the EDI will allow eligible exploration companies to convert a portion of their tax loss to exploration credits which can be provided to shareholders (and other holders of equity interests) to entitle them to an equivalent tax benefit. The EDI is proposed to be provided to investors in the form of:

- A tax offset which is available to certain Australian resident investors that receive exploration credits, and
- Additional franking credits for corporate tax entities that receive exploration credits.

The measure is proposed to apply to greenfields minerals expenditure for the 2014-15, 2015-16 and 2016-17 income years, allowing the issue of credits up to a capped amount (based on the company's exploration expenditure and tax loss for the relevant income year adjusted by a modulation factor) so that the total value of credits provided in respect of an income year does not exceed $25 million for 2014-15, $35 million for 2015-16 and $40 million for 2016-17.

Companies that issue exploration credits in excess of their maximum entitlement will be subject to excess exploration credits tax on the amount of the excess.

Submissions on the ED legislation are due by 24 October 2014.

Reforming the Superannuation Excess Non-concessional Contributions Tax – ED released: On 10 October 2014, the Government released exposure draft legislation which proposes to give effect to the 2014-15 Federal Budget measure allowing individuals the option of withdrawing superannuation contributions in excess of the non-concessional contributions cap made from 1 July 2013 and associated earnings, with these earnings to be taxed at the individual's marginal tax rate.

Submissions on the exposure draft are due by 24 October 2014.

Back to top

Weekly tax news

Business tax

Functional currency and FRE 4 – draft TD withdrawn: The ATO has withdrawn Draft Taxation Determination TD 2014/D10 with effect from 8 October 2014.

TD 2014/D10 expressed the ATO's preliminary view that forex realisation event (FRE) 4 happens to a debtor on repayment of a loan taken out prior to the effective date of a choice to use the applicable functional currency and denominated in the same non-AUD currency that later becomes the applicable functional currency. The withdrawal follows comments received by the ATO as part of the public consultation process on the draft TD.

The ATO has indicated that TD 2014/D10 will be replaced by a new draft determination which will provide that forex realisation event 4 does not happen in the circumstances outlined in TD 2014/D10.

ADIs – exception to franking requirements – TD withdrawn: The ATO has withdrawn Tax Determination TD 2012/19 with effect from 8 October 2014. TD 2012/19 provides guidance as to when a non-share equity interest is 'issued at or through a permanent establishment' under paragraph 215-10(1)(c) of the *Income Tax Assessment Act 1997* (ITAA 1997).

Section 215-10 of the ITAA 1997 provides an exception to franking requirements for Australian resident Authorised Deposit-taking Institutions (ADI) issuing Tier 1 capital at or through a permanent establishment. To satisfy paragraph 215-10(1)(c), the relevant capital raising must be a transaction 'of' the business of the bank that is carried on at or through the relevant permanent establishment. The TD seeks to explain that concept.

The ATO has withdrawn the TD following recent consultation with banking industry representatives that indicated the TD was causing significant and unintended practical problems for banks in legitimately gaining access to the concession. Following a review of the TD, the ATO no longer considers that the views expressed represent the better view of the law.

The ATO intends to issue a replacement determination in due course. The ATO notes that, in the meantime, questions as to the correct application of section 215-10(1)(c) will be addressed on a case-by-case basis.

ATO releases Class Rulings: On 8 October 2014, the ATO issued the following Class Rulings:

- CR 2014/81 - Income tax: demerger of OMI Holdings Limited by Donaco International Limited
- CR 2014/82 - Income tax: Dell Australia Pty Limited Restricted Stock Units
- CR 2014/83 - Income tax: Bendigo and Adelaide Bank Limited - allotment of convertible preference shares
- CR 2014/84 - Income tax: The Imperial Tobacco Australia Limited Voluntary Early Retirement Scheme 2014 (VRS 2014).

Appeals update – *RCF III* and *ATS Pacific*: The High Court is scheduled to hear the following special leave applications on 17 October 2014:

- ***RCF III*:** Special leave application brought by the taxpayer against the decision of the Full Federal Court in *Commissioner of Taxation v Resource Capital Fund III LP* [2014] FCAFC 37. In that case, the Full Federal Court held that a Cayman Islands limited partnership was an independent taxable entity that is liable to tax for Australian tax purposes and the Australia/United States double tax agreement does not preclude the limited partnership's liability to tax
- ***ATS Pacific*:** Special leave application brought by the taxpayer against the decision of the Full Federal Court in *ATS Pacific Pty Ltd v Commissioner of Taxation* [2014] FCAFC 33. In that case, the Full Federal Court held that the taxpayer (an inbound tour operator) made one supply only to its non-resident travel agent clients, and that this supply was properly characterised as the supply of a promise to the non-resident travel agent to ensure that the components of tour packages were supplied to the non-resident tourists travelling in Australia. The Court found that this supply was wholly taxable, and that no part of the supply was GST-free.

Back to top

Individuals and family groups

Response to Parliamentary report on family businesses: The Government has released a response to the report of the Parliamentary Joint Committee on Corporations and Financial Services on *Family businesses in Australia – different and significant: why they shouldn't be overlooked*. The report made 21 recommendations on a wide variety of matters relating to Australia's family businesses including the following:

- As part of the Board of Taxation's inquiry into the private company deemed dividend provisions (Division 7A), the Board consider the effect of those provisions on the family business sector. The Government notes that it has extended the terms of reference and reporting date for the Board's review of Division 7A and under the extended terms of reference, the Board is examining the broader taxation framework in which Division 7A operates and within this context the tax implications of private business structures
- The Government should release the Board's report on the operation of Division 7A. The Government has indicated that the Board will report to it by 31 October 2014 and the Government will make a decision regarding whether to release the report at that time
- Treasury should review the evidence gathered during the Committee's inquiry and consult with stakeholders identified about the family business sector's concern regarding the effect of the operation of the employee share scheme (ESS) provisions in the tax law on their capacity to engage suitably qualified executives. The Government agrees with this recommendation and issues raised in relation to ESS are being considered within the context of the Taskforce established to develop a National Industry Investment Competitiveness Agenda.

The Taxpayers and Commissioner of Taxation – DIS released: The ATO has released a Decision Impact Statement (DIS) about the decision of the Administrative Appeals Tribunal (AAT) in *The Taxpayers and Commissioner of Taxation* [2014] AATA 572 which concerned audit adjustments made in relation to goods and services tax (GST) payable, superannuation and interest deductions claimed, deemed dividends and undeclared income.

As to whether the base penalty should be remitted, the AAT noted that a penalty being harsh in all of the circumstances of a taxpayer will be a proper basis on which the discretion to remit the penalty could be exercised. In this case, the AAT found that the penalties imposed ought to be remitted to reflect the extent to which any one entity's "shortfall amount" did not actually result in a loss to revenue.

The DIS broadly outlines that:

- The ATO accepts that the decision on income tax and GST was reasonably open to the AAT on the facts as found
- It is not clear whether the AAT's decision to reduce all of the penalties imposed under section 284-75 of Schedule 1 to the *Taxation Administration Act 1953* to nil was influenced by the conclusion that there was no loss to the revenue. However, the Commissioner notes that the Full Federal Court in *Dixon v FCT* (2008) 167 FCR 287 made it clear that absence of loss of revenue is not a relevant consideration in relation to the exercise of the discretion to remit a penalty for a false statement
- The Commissioner also notes that the Full Federal Court in *Sanctuary Lakes Pty Ltd v FCT* [2013] FCAFC 50 said that the correct question when remitting a penalty for a false statement is not expressed in terms of 'harshness', but rather as to whether the decision maker is satisfied, having regard to a taxpayer's particular circumstances, that it is appropriate to remit the penalty.

Back to top

International tax

UK announces intention to implement anti-hybrid rules: On 5 October 2014, the UK Treasury announced it will publish a consultation document on the implementation of anti-hybrid rules.

The announcement follows on from the recently finalised OECD Base Erosion and Profit Shifting (BEPS) Action 2 paper, which recommends the introduction of rules targeting hybrid mismatch arrangements. This reaffirms the UK Government's commitment to the OECD BEPS project and makes the UK one of the first countries to take concrete steps towards the implementation of the recommendations of the BEPS project.

The consultation document will be released at the Autumn Statement on 3 December 2014.

UK committed to "Patent Box" regime: In a speech on 5 October 2014, David Gauke MP, the United Kingdom Financial Secretary to the Treasury discussed the UK Patent Box regime, its impact on the UK economy and BEPS. Mr Gauke said, "Let me be clear here: categorically, it does not create an opportunity for businesses to reduce their taxes without increasing their value to the UK economy."

In his speech, Mr Gauke raised a number of issues relating to the interaction of the Patent Box regime and BEPS:

- The UK has raised concerns over the proposed use of the "nexus approach" raised in the recent BEPS Action 5 paper which deals with countering harmful tax practices
- The UK believes this approach may not be compatible with EU law, is overly restrictive and

will place a heavy compliance burden on UK businesses

- The UK prefers the use of “well-understood and accepted transfer pricing principles”.

BEPS Central: For a one-stop shop for information on the OECD BEPS Project, with links to all the official documents and Deloitte’s comments, visit Deloitte BEPS Central.

World Tax Advisor (WTA): The latest edition of the Deloitte WTA discusses the release of Canadian draft legislation to implement previously announced cross-border back-to-back financing proposals and to revise draft amendments to the foreign affiliate “dumping” rules. Click to view the World Tax Advisor, the World Tax Advisor archive, or subscribe.

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.

Back to top

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