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Tax highlights

3 February 2014

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Key developments this week

Second Draft Tax Determination issued on market support payments: On 29 January 2014, the ATO released draft Taxation Determination (TD) 2014/D7 in relation to the deductibility of capital support payments.

Comment: *TD 2014/D7 is an update to TD 2013/D3 (first released in April 2013) which addressed the ATO's preliminary view that support payments made by a parent company to a subsidiary are capital in nature and not tax deductible. Uncertainty regarding the ambit of TD 2013/D3 was compounded by the fact that the TD was effectively silent with respect to transfer pricing. This meant that even true-up adjustments made pursuant to the application of profit-based transfer pricing methods were potentially at risk of being treated as non-deductible based upon a literal interpretation of TD 2013/D3.*

Following extensive comments to the ATO from interested parties and consultation meetings to shape a revised TD, the ATO has released far more balanced guidance in the form of TD 2014/D7, which:

- *Takes into account transfer pricing arrangements between parties, making reference to arm's length terms and conditions/arm's length consideration*
- *Recognises that capital support payments do not include payments which have the character of an adjustment to the price of an asset or service; and*
- *Includes examples which clarify that payments (price adjustments) for goods/services/intangibles, made pursuant to the application of the Transactional Net Margin Method, or as part of a wider market-penetration strategy, are not considered to be capital support payments.*

Notwithstanding the above, concern remains regarding the potential lack of symmetry between outbound and inbound cross-border support payments. Perhaps the most contentious aspect of the TD is the fact that it still has a prospective and retrospective date of effect. The ATO has, however, confirmed that existing Private Binding Rulings and Advance Pricing Arrangements shall continue to apply in accordance with their terms.

Overall, TD 2014/D7 is a clear improvement on predecessor versions of the draft TD, distinguishing payments for assets or services from payments made to preserve or increase the capital value of a parent's investment in a subsidiary. However, in order for the amount not to be characterised as a

capital support payment, the onus will now be on taxpayers to ensure they have agreements and transfer pricing documentation that provide for these types of payments and that the payment is, in substance, a price adjustment.

Comments on TD 2014/D7, including the proposed date of effect, are due to the ATO by 28 February 2014. Please contact our transfer pricing team or your Deloitte Client Service Team, should you wish to discuss any aspect of the TD or would like to provide input on a response to the ATO.

Investment Management Regime (IMR) third element – exposure draft (ED) legislation released: On 31 January 2014, Treasury released further ED legislation for the third element of the IMR. Previous EDs relating to the third element of the IMR were released on 31 July 2013 and 4 April 2013. This ED is designed to remove tax impediments to foreign investment into or through Australia by foreign managed funds. As well, the gains of qualifying foreign funds from the disposal of certain financial arrangements will be exempt from Australian tax. Submissions are due 14 February 2014.

Reforms to the offshore banking unit (OBU) regime – start date announced: The Assistant Treasurer has announced that the reforms to the OBU regime will have a start date of 1 July 2015. The reforms were originally announced in the 2013-14 Federal Budget (with a start date of 1 July 2013) and a discussion paper was released on 28 June 2013 extending the start date to 1 October 2013. The Assistant Treasurer later announced that the reforms would not proceed with the start date of 1 October 2013 but did not specify a new start date. The OBU regime is a concessional tax regime that allows entities registered as OBUs a reduced rate of taxation on certain non-resident to non-resident transactions.

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Weekly tax news

Business tax

Resumption of Parliament: Parliament will resume the 2014 Autumn sittings next week (11-13 February 2014). For a list of bills outstanding at the conclusion of the 2013 Spring sittings, refer to *Tax highlights 16 December 2013*.

Taxpayer liable for capital gains tax on transfer of land: The Federal Court has dismissed the taxpayer's appeal from the Commissioner's objection decision and found that CGT event E1 (Creating a trust over a CGT asset by declaration or settlement) applied on the transfer of land from the taxpayer to a land trustee set up to facilitate a joint venture development of its land.

The taxpayer formed a joint venture with two other landholders in 1998 for the purpose of developing the land and a separate land trust to hold the land on behalf of the landholders. The taxpayer then transferred the land to the land trustee, Victoria Garden Development Pty Ltd (VGD) in accordance with the requirements of the JV agreement and the trust deed, Under the JV agreement and deed, after transferring the land, the landholders were "not entitled to a transfer back of their respective portions of their land" for purposes of development and the distributions of cash on sale of the land to third parties by the JV were to be made in accordance with a set formula in clause 6 of the JV agreement.

The taxpayer filed its tax return for the 1999 income year on the basis that its transfer of the land to VGD did not result in a CGT event. For the 2000 and 2002 income years, losses were carried forward from the 1999 income year, which ultimately allowed the taxpayer to return a reduced taxable capital gain from the sale of its portion of the land to third parties. The main issue before the Federal Court was whether CGT events, E1, E2 or A1 applied to the transfer and what would be the market value of the land if one of these events occurred. The Federal Court decided that CGT events E1 and A1 occurred with CGT event E1 the most relevant.

In reaching its decision, the Federal Court held that for the purposes of determining whether CGT event E1 occurred (section 104-55 of the *Income Tax Assessment Act 1997*) (ITAA1997), it was necessary to consider whether the transfer of the land to the Land Trustee would be a settlement. The Court referred to substantial case law and determined that there were sufficient "indicators" of a settlement to warrant the conclusion that the taxpayer created a trust "by settlement" within the meaning of s 104-55 of the ITAA 1997. The Court also found that the exception to CGT event E1 under section 104-55(5) of the ITAA 1997 did not apply as it was clear that the taxpayer was not the sole beneficiary of the trust and was not absolutely entitled to the land as opposed to the trustee. The argument that CGT event E2 (transferring a CGT asset to an existing trust) occurred was rejected by the Court, on the basis that the trust was not completed until the land trustee had registered all three executed transfers of land and there was no trust "existing" at the date when the taxpayer executed the transfer.

In considering the market value of the land, the Court found that that taxpayer's valuation did not take into account all the 'advantages and deficiencies' of the land at that time, and should have applied the 'highest and best' use test. The taxpayer was not able to deduct against the market value any additional contamination costs for the land as there was no evidence that there was any material change in the market's appreciation of the condition of the soil and the likely extent of the contamination and /or the need for remediation at the time of the transfer.

In respect of penalties, the Federal Court considered that the taxpayer did not make reasonable attempts to comply with the taxation law given its knowledge of the Court of Appeal judgement in the taxpayer's related stamp duty case, which considered whether a transfer of beneficial ownership had occurred for stamp duty purposes on transfer of the land (*Commissioner for State Revenue v Victoria Gardens Developments Pty Ltd* [2000] VSCA 233 (12 December 2000)) – click to view *Taras Nominees Pty Ltd as Trustee for the Burnley Street Trust v Commissioner of Taxation of the Commonwealth of Australia* [2014] FCA 1 (14 January 2014).

Appeals update – *Australian Pipeline:* The taxpayer has lodged a notice of appeal to the Full Federal Court against the decision of the Federal Court in *Australian Pipeline Limited as Responsible Entity for the Australian Pipeline Trust v Commissioner of Taxation* [2013] FCA 1372. In that case, the Federal Court dismissed the taxpayer's appeal from the Commissioner's objection decision regarding an adverse private ruling that a joining entity was an associate of the taxpayer "just before the joining time" within the meaning of section 705-47(5)(b)(i) of the ITAA 1997. As a result, the tax cost setting amount for certain depreciating assets held by the joining entity, including a high-pressure gas transmission network and a liquid natural gas storage facility that were subject to the operation of Division 58 of the ITAA 1997, would be reduced under section 705-47(2) to the joining entity's terminating value of the assets. For more information, refer to *Tax highlights 14 January 2014*.

Local Government Payments Data Matching Program: On 28 January 2014, the Commissioner published a gazette notice containing details of a local government payments data matching program to be conducted by the ATO. The ATO will acquire details of entities receiving taxable payments from local government authorities in the 2010-11, 2011-12, 2012-13 and 2013-14 income years. These details will be electronically matched with certain sections of ATO data holdings to identify non-compliance with lodgment and payment obligations under taxation law.

Tax Expenditures Statement (TES) 2013: Treasury has released the TES for the 2013-14 income year which provides a description of the tax expenditures provided to taxpayers by the Australian Government and, where possible, the estimated value or order of magnitude of the tax expenditure.

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Non-profit organisations

Not-for-profit sector pre-budget submissions: In response to the Government's invitation for submissions from individuals, businesses and community groups on their priorities for the 2014-15 Federal Budget, the Community Council for Australia has released its submission which sets out recommendations to reduce red tape and improve productivity for the not-for-profit sector over the coming three years.

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Indirect taxes

Customs Infringement Notice Scheme (INS) Guide issued: The new Customs INS came into effect on 1 February 2014, with the commencement of the Customs Amendment (Infringement Notices) Regulation 2013. On 30 January 2014, the Australian Customs and Border Protection Service (ACBPS) published a new INS Guide to explain the ACBPS approach to issuing infringement notices and to set out the amount payable under an infringement notice for each of the 70+ offences prescribed by the Regulation. Different penalty amounts apply to natural persons and body corporates under the new INS, due to the introduction of a 'corporate multiplier'. Corporate offenders are subject to three times the penalty imposed on a natural person for the same contravention, although there is scope for Customs to increase this multiplier to 'four times' or 'five times' in the future if the current multiplier proves to provide inadequate deterrence. The new INS and INS Guide apply where the alleged offence occurs on or after 1 February 2014. The former Customs INS and Guide apply to alleged offences that occurred before 1 February 2014, even if the infringement notice is issued on or after 1 February 2014.

The INS is an administrative enforcement remedy available to Customs in certain circumstances where Customs has reasonable grounds to believe that an entity has contravened particular provisions in the customs law. The recipient of an infringement notice has the option of resolving the matter immediately by paying the specified penalty or having the matter determined by a court. Infringement notice penalties are significantly less than the penalties that a court could otherwise impose for the particular offence (i.e. 25% of the maximum court penalty).

Good and services taxation determination (GSTD) scheduled for release on 5 February 2014:

- GSTD 2014/2: Where real property is acquired following the exercise of a call option, does the call option fee form part of the consideration for the acquisition for the purposes of section 75-10(2) of the *A New Tax System (Goods and Services Tax) Act 1999*?

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State and Territory taxes

NSW: Snack food company not liable for payroll tax on payments to restocking contractors: The NSW Court of Appeal has ruled that the taxpayer is not liable for payroll tax in relation to payments made to independent contractors who restock and service the taxpayer's snack food and drink vending machines.

The taxpayer engaged the contractors under an annual 'Goods Distribution Agreement' (GDA). Under the GDA, the contractors were obliged to distribute the taxpayer's products (i.e. by storing, conveying and restocking machines), collect cash from the machines, remove spoiled products, and clean and otherwise maintain the machines. The contractors were required to supply their own vehicle.

Under the *Payroll Tax Act 2007* (and its predecessor), payroll tax is charged on all taxable 'wages' which are defined to relevantly include amounts paid by an employer for, or in relation to, the performance of work relating to a 'relevant contract'. At issue was whether the GDA was a 'relevant contract', as defined by section 32 (i.e. by being one under which the taxpayer, in the course of business carried on by the taxpayer, was supplied with the services of a contractor for or in relation to the performance of work). A further issue was whether the GDA was exempted from being a 'relevant contract' by the exemption in section 32(2)(d). This depended on the services that the taxpayer was supplied with being "ancillary to the conveyance of goods by means of a vehicle provided by" the contractor.

At first instance, Gzell J in *The Smith's Snackfood Company Ltd v Chief Commissioner of State Revenue (NSW)* [2012] NSWSC 998 and 1116, found that the GDA was partly a 'relevant contract' and partly not a 'relevant contract', and that the exemption to the definition of 'relevant contract' only applied to the extent that a contractor supplied the taxpayer with services ancillary to the conveyance of the products by vehicle. To the extent that the GDA was partly a 'relevant contract' because certain services were not ancillary to the conveyance of the products, and therefore that amounts paid by the taxpayer were taken to be 'wages', his Honour went on to find that the taxpayer was entitled to more than the 25% reduction in taxable wages that the Commissioner had allowed under the apportionment provisions in section 35 of the Act (i.e. for the non-labour component).

The Court of Appeal found that the GDA was not a 'relevant contract' due to the operation of the section 32(2)(d) exemption. The Court ruled that the exemption cannot apply to only some parts of a 'relevant contract' (finding that Gzell J had erred in dividing the GDA into exempt and non-exempt parts). The Court found that the exemption's focus is on an entire and indivisible 'relevant contract', and was directed in the present case to whether the GDA answered the description of a contract "under which" the taxpayer was supplied with services ancillary to the conveyance of goods by means of a vehicle provided by the contractor. The Court rejected the Chief Commissioner's contention that

certain services provided under the GDA were not ancillary to the carriage of the products. Those services included ordering and storing goods to be conveyed in the contractor's vehicle, collecting spoiled goods from the machines and disposing of them, and maintaining the vehicle to the required standard. Although the Court found that these services were outside the process of loading, unloading, conveying and delivering the products, it concluded that it was appropriate, having regard to the terms of the GDA, to characterise them as ancillary to the conveyance of the products – click to view *Smith's Snackfood Company Ltd v Chief Commissioner of State Revenue (NSW)* [2013] NSWCA 470.

ACT: Transfer duty overcharged on interdependent land and dwelling transactions: The ACT Court of Appeal has ruled in relation to the amount of duty properly payable by the taxpayer under section 20 of the Duties Act 1999 (ACT) on a transaction involving two separate but interdependent contracts – one being a contract with the ACT Land Development Agency for the conveyance of land; the other a contract with a construction company for the construction of a dwelling on the land. The contracts were executed on the same day and were required to be completed simultaneously. Following completion, the Commissioner for ACT Revenue assessed stamp duty for the transaction based on the combined value of the land and dwelling.

The Court dismissed the Commissioner's appeal against the decision of the court below (*Commissioner for ACT Revenue v Araghi and Dorsett* [2013] ACTSC 43), finding that duty should only be assessed on the consideration provided for the transfer of the land, being the purchase price paid under the land contract. The Court found that the Commissioner's reliance on the interdependence of the land sale contract and the building contract was misplaced. The construction of the dwelling, it said, did not 'move' the conveyance in the sense described in *Archibald Howie Proprietary Limited v Commissioner of Stamp Duties (New South Wales)* (1948) 77 CLR 143, but instead simply operated as a pre-condition to the transfer of the land. The Court relied on the reasoning of the Victorian Court of Appeal in *Lend Lease Development Pty Ltd v Commissioner of State Revenue* [2013] VSCA 207, which emphasised the need to appreciate that an interdependence of mutual promises is not sufficient to determine whether a payment is made 'for' a dutiable transaction – click to view *Commissioner for ACT Revenue v Araghi & Anor* [2013] ACTCA 54 (20 December 2013).

In response to the Court of Appeal's decision, the ACT Revenue Office has published a statement indicating that the Commissioner accepts the outcome and has changed the way transactions of this kind are assessed. Further, having regard to the existence of many other similar transactions that have previously been assessed, the Revenue Office is accepting applications for reassessment, subject to the 5-year limitation period on reassessments imposed by section 9 of the *Taxation Administration Act 1999* (ACT).

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International tax

OECD releases discussion draft on transfer pricing documentation and country-by-country reporting: On 30 January 2014, the OECD released an initial discussion draft on transfer pricing documentation and country-by-country reporting. Comments on the discussion draft are due by 23 February 2014. A public consultation event will be held at the OECD in Paris at the end of March 2014 with specifically invited persons selected from among those who provide written comments. An open

discussion of the draft with all interested persons will take place at a future date to be determined in April or May.

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