



International Tax

Australia Tax Alert

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Government announces fate of outstanding tax measures

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On 14 December 2013, the Australian government announced the outcome of the review on whether 64 unlegislated tax measures would proceed. The recently elected government had announced on 6 November that of 92 unlegislated tax measures, 18 measures would proceed, three would be amended and seven would not proceed. (For details on the 18 measures to proceed and the three to proceed with amendment, see the alert [dated 14 November](#).)

The remaining 64 measures were to be subject to an expedited review involving consultation between the Board of Taxation, its advisory panel and stakeholders to determine whether or not they should proceed. Although the government had earlier indicated “a disposition not to proceed” with all of those 64 measures, the government has now announced that 16 of the measures will proceed and the remaining 48 will not.

This alert discusses the implications of the government’s decision on the key measures that may be relevant to Australian inbound investment.

Key measures to proceed as announced

The government will proceed with the following measures:

- **Debt/equity tax rules:** The scope of an integrity rule that can have the effect of recharacterizing “debt interests” as “equity interests” for tax purposes will be revised, and it is expected that its role will be limited. Where the rule applies, it results in the loss of interest deductions in Australia. The rule currently is drafted broadly enough that it potentially applies to many inbound acquisitions, so any limitation of its scope would be a welcome change.
- **Functional currency rules:** Trusts and partnerships will be allowed to use functional currency rules when preparing their Australian income tax returns, which potentially will simplify compliance with their Australian tax obligations.
- **Treatment of earn outs:** Currently, the buyer of a target who grants an earn-out right may not obtain tax basis in the shares of the target for the actual payments made under the earn-out arrangement. Instead, the market value of the right is added to the tax basis of the shares, which

may be more or less than the actual earn-out payments made. A “look through” approach is proposed that will address this issue

- **Strengthening of certain integrity provisions in the scrip-for-scrip rollover:** The law will be tightened to make it harder for companies and trusts to avoid capital gains tax when they sell subsidiary companies, other than as part of a genuine merger or restructure of a business.
- **Loss recoupment rules, multiple classes of shares:** This measure will improve the operation of the tax loss rules in a limited range of circumstances. Currently, one test to allow tax losses to be carried forward is that there must be continuity of majority ownership in the target. Testing this can be problematic where the target has multiple classes of shares with different dividend, voting or capital rights. In an inbound investment context, this could make the availability of tax losses in a target less certain, which could influence the pricing of the transaction.

Key measures not to proceed

The government has decided to not proceed with 48 measures which include (among others) the following:

- **Reform of the foreign source income attribution regimes:** Unfortunately, the government has decided not to proceed with the modernization of Australia’s controlled foreign company rules.
- **Sovereign immunity rules:** These changes would have formalized taxation exemptions for foreign governments and their investment bodies for dividend and interest income derived from passive investment.
- **Measures enhancing taxation arrangements in respect of venture capital:** These changes, which were announced in May 2014, were, among other things, intended to extend tax concessions currently available to international investors in venture capital funds to domestic investors, which would have facilitated venture capital investment.

Comments

The decision of the government to proceed with many of the unenacted measures is welcome. The changes to limit the scope of the debt/equity integrity rule, in particular, should provide more certainty for inbound investors. On the other hand, it is disappointing that some changes such as the proposed sovereign immunity rules will not proceed, as these would have provided certainty to particular classes of investors.

Actions for business

Many of the 48 unlegislated tax measures that the government has decided not to proceed with have been outstanding for some time and may have been taken into account in the preparation of income tax returns and financial statement positions. As part of the 6 November 2013 announcement, the government acknowledged this and indicated that there will be legislative protection for taxpayers that have self-assessed (e.g. to reduce their income tax liability) in accordance with announced changes that will not proceed. Further, taxpayers that have complied with previous announcements that will no longer proceed, and have paid additional tax, will be entitled to a refund.

Taxpayers should review their prior year tax returns and financial statements to determine if they have relied upon any measures that the government is no longer proceeding with to determine if additional tax is payable or if they are entitled to a refund.

Notably, the previously announced changes to the thin capitalization rules will proceed for years of income commencing on or after 1 July 2014. Where relevant, consideration should be given to the impact of these new rules, especially the tightening of the safe harbor.

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