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No. 88 2003–04

Taxation Laws Amendment Bill (No. 9) 2003

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Taxation Laws Amendment Bill (No. 9) 2003

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1 March 2004

Contents

The following abbreviations and acronyms are used throughout this Bills Digest.

Abbreviation	*Definition*
ATO	Australian Taxation Office
BAE	balancing adjustment event
CGT	capital gains tax
Commissioner	Commissioner of Taxation
FBT	fringe benefits tax
FBTAA 1986	*Fringe Benefits Tax Assessment Act 1986*
GST	goods and services tax
GST Act	*A New Tax System (Goods and Services Tax) Act 1999*
ITAA 1936	*Income Tax Assessment Act 1936*
ITAA 1997	*Income Tax Assessment Act 1997*
IVS	indirect value shift
IT(TP) Act 1997	*Income Tax (Transitional Provisions) Act 1997*
Life Insurance Act	*Life Insurance Act 1995*
MEC group	multiple entry consolidated group
PSE	personal services entity
PSI	personal services income
R&D	research and development
SIRP	sugar industry reform program
SIEG	sugar industry exit grant
STS	simplified tax system
TAA 1953	*Taxation Administration Act 1953*
UCA	uniform capital allowance

Taxation Laws Amendment Bill (No. 9) 2003

Date Introduced: 4 December 2003

House: House of Representatives

Portfolio: Treasury

Commencement: Formal provisions of the Bill commence on Royal Assent. The various measures contained in the Bill have various application dates, which are detailed in the Main Provisions section.

Purpose

There are 8 Schedules to this Bill and the main purpose of each Schedule is set out below.

1. **Schedule 1** will amend the GST Act to enable the supplier of an education course that is an eligible life saving course to treat the supply as GST-free if the supplier uses instructors for the course that are suitably qualified.

2. **Schedule 2** will amend the IT (TP) Act 1997 to modify the General Value Shifting Regime to ease compliance costs on the transition to consolidation.

3. **Schedule 3** will insert section 61G in the FBTAA 1986 to reduce the taxable value of a fringe benefit by the same amount as is made non-deductible to the provider by virtue of the personal services income provisions.

   Schedule 3 will also amend the PSI provisions in Part 2-42 of the ITAA 1997 to ensure that an individual, working through a PSE, can deduct a net personal services income loss in an income year.

4. **Schedule 4** will amend the ITAA 1997 to specify the taxation treatment of sugar industry exit grants made under the Sugar Industry Reform Program. The amendments will:

- exempt from income tax sugar industry exit grants that are paid to taxpayers who leave the agricultural industry altogether; and
- include in assessable income sugar industry exit grants that are paid to taxpayers who leave the sugar industry but continue to carry on another agricultural enterprise.

5. **Schedule 5** will amend the TAA 1953 so that the foreign resident withholding rules will apply to alienated personal services payments that are payments of a kind prescribed in the regulations to be covered by foreign resident withholding.

6. **Schedule 6** will amend the ITAA 1936 to ensure that mutual friendly societies that are life insurance companies can benefit from the taxation framework that applies to other mutual life insurance companies that demutualise.

7. **Schedule 7** will amend Division 328 of the ITAA 1997 to allow, under certain circumstances, balancing adjustment roll-over relief for partnerships that are in the STS.

8. **Schedule 8** to this bill:

- amends the consolidation provisions in the IT(TP) Act 1997 to allow certain choices already made to be revoked before 1 January 2005
- amends the provisions in the ITAA 1936 dealing with eligibility for the R&D tax offset to ensure that they apply appropriately to consolidated groups, and
- makes minor technical amendments to the ITAA 1997 and the IT(TP) Act 1997.

Background

As there is no central theme to the Bill, the background to the various measures will be discussed under the Main Provisions section.

Main Provisions

Schedule 1 – Amendment of the GST Act to provide a new definition for first aid or life saving course

The supply of an education course, which includes an eligible 'first aid or life saving course', is GST-free under section 38-85 of the GST Act if the supplier is registered or approved by a relevant State or Territory body or authority to provide such courses. However, as at present there are no State or Territory bodies or authorities that register or approve suppliers of life saving courses, the supply of a life saving course cannot be treated as a GST-free supply.

To make good this deficiency it is proposed that the supply of a first aid or life saving course will be GST-free if it uses an instructor that holds a training qualification issued by either Austswim Limited, Surf Life Saving Australia Limited or The Royal Life Saving Society – Australia. To give effect to this proposal the definition of a first aid or life saving course in section 195-1 of the GST Act will be amended by **item 5** of **Schedule 1** to recognise the training qualification issued by these three organisations in **subparagraphs (b) (iii), (iv)** and **(v)** respectively.

In addition to the above changes in the definition of a first aid or life saving course, **items 1** and **3** of **Schedule 1** substitute the term 'body' within the definition with the term 'entity'. An entity is defined in section 184-1 of the GST Act and includes individuals, partnerships and others that may not constitute a body. In consequence any entity type that makes a supply of an education course that is an eligible first aid or life saving course may be able to treat the supply as a GST-free supply.

Application

Item 6 of **Schedule 1** provides that these amendments are taken to have applied for tax periods starting on or after 1 July 2000.

Schedule 2 – Value shifting: transitional exclusion for certain indirect value shifts relating mainly to services

Division 727 of the ITAA 1997 which deals with the General Value Shifting Regime is intended to prevent value shifting between two related entities because of dealings between them which are not at arm's length. It:

(a) prevents losses from arising, because of the value shift, on realisation of direct or indirect equity or loan interests in the losing entity, and

(b) within limits, prevents gains from arising, because of the value shift, on realisation of direct or indirect equity or loan interests in the gaining entity.

However, it does so only for interests that are owned by entities in the value shift.

On 6 March 2003, the Minister for Revenue and Assistant Treasurer announced in Press Release No. C14/03 that the Government will introduce a transitional rule to exclude certain value shifts arising in 2002-03 year from the General Value Shifting Regime with a view to reducing compliance costs on entry to the consolidation regime. This measure was initially proposed in Schedule 2 of Taxation Laws Amendment Bill (No. 6) 2003 (TLAB No 6 – 2003) and was subsequently deleted from that Bill as the Labor Party required further time to scrutiny these measures.

When the TLAB No 6 – 2003 was debated in the Senate on 26 March 2003, Senator Marshall stated:

> However, there is one measure that Labor is not prepared to support without further scrutiny, and that is the transitional arrangement for the consolidation regime with

> respect to value shifting. That transitional arrangement relieves companies that are consolidating from complying with some aspects of the value shifting rules. This is intended to reduce compliance costs but it means that the tax office will have to rely on the general anti-avoidance provisions of Part IVA to deal with any abuse in this area.
>
> Value shifting provides particular opportunities for tax avoidance in the area of services. These transitional arrangements will increase that risk. Labor wanted to refer the bill to the Senate Economics Legislation Committee to examine the extent of that risk. However, because there are other measures contained in the bill that are time sensitive, Labor has reached agreement with the government to delete the transitional value shifting provisions and pass the rest of the bill. The government will bring them back in another bill, presumably in the next session[1].

Item 1 of **Schedule 2** inserts **proposed subsection 727-230** in the IT(TP) Act to provide that most indirect value shifts involving services, where at least 95 per cent of the market value of the benefits provided by the losing entity are services, will be excluded from the consequences of the general value shifting regime if those value shifts occur before:

- the beginning of a losing entity's 2003-2004 income year, or
- if a losing entity's 2002-2003 income year ends before 30 June 2003, the beginning of the losing entity's 2004-2005 income year.

Application

The application is as described in the previous paragraph.

Schedule 3 – Amendments relating to personal services income

Schedule 3 includes two amendments relating to personal services income which were announced by the Treasurer on 13 May 2003 with the 2003-04 Federal Budget.

Amendments to prevent double taxation of certain payments

Under the PSI provisions in Division 86 in Part 2-42 of the ITAA 1997, income from rendering personal services by an individual is treated as assessable income of that individual if it is the income of a PSE and is not promptly paid as salary to that individual. However, this does not apply if the individual is conducting a personal service business. The PSI provisions also deny an individual or PSE a deduction for certain payments relating to PSI that would not be deductible if the individual derived the PSI as an employee. Such payments may also be fringe benefits under the FBTAA 1986 and give rise to an FBT liability. Consequently such payments are currently subject to double taxation.

Item 1 of **Schedule 3** inserts **proposed section 61G** in the FBTAA 1986 which will allow the individual or PSE to reduce the taxable value of a fringe benefit if:

- a fringe benefit is provided in relation to the employment of an employee, and
- the payment cannot be deducted under sections 85-15, 85-20 or 86-60 of the ITAA 1997.

Sections 85-15, 85-20 and 86-60 of the ITAA 1997 limit the extent to which a person can deduct payments to associates that relate to personal services income.

Application

Item 5 of **Schedule 3** makes this amendment applicable to fringe benefits provided after 30 June 2000.

Personal services income losses

Item 3 of **Schedule 3** inserts **proposed sections 86-27** to the ITAA 1997 to ensure that an individual working through a PSE can deduct a net PSI loss in an income year from the individual's other income, or, in the case where the individuals current income cannot absorb the loss, it can be carried forward and deducted against future income.

Item 4 of **Schedule 3** inserts **proposed section 86-85** to the ITAA 1997 to ensure that a PSE will not be able to deduct the net PSI loss for an income year from other income in that year or take it into account in working out any carry forward tax losses.

Application

Item 6 of **Schedule 3** makes these amendments apply to assessments for the year 2000-01 income year and each subsequent income year.

Schedule 4 – Tax treatment of sugar industry grants

As part of a comprehensive Sugar Industry Reform Program (SIRP) announced by the Minister for Agriculture, Fisheries and Forestry on 5 February 2003[2], the Commonwealth Government proposed assistance for cane growers who wish to leave the sugar industry. The assistance consists of a one-off payment, a sugar industry exit grant (SIEG), of up to $45,000 for growers who satisfy certain income and assets tests.

Under the current tax law sugar industry exit grants are included in assessable income either under the ordinary income provisions or under the CGT provisions. The amendments in **Schedule 4** will exempt the SIEG from income tax provided an undertaking is given not to become an owner or operator of an agricultural enterprise within 5 years after receiving the SEIG.

Tax consequences of undertaking not to own or operate an agricultural enterprise for 5 years

Item 5 of **Schedule 4** inserts **proposed table Item 4B** in section 53-10 of the ITAA 1997 to exempt the SIEG if as a condition of receiving it an undertaking was given not to become the owner or operator of any agricultural enterprise within 5 years after receiving the SIEG. Section 53-10 includes a table which states the exemptions from income tax of various types of payments and the special conditions for such exemption.

Item 8 of **Schedule 4** inserts **proposed paragraph 118-37(1) (f)** in the ITAA 1997 to disregard any capital gain or capital loss from a CGT event relating to the receipt of the SEIG. This ensures that the SEIG is not included in assessable income as a capital gain as well.

Tax consequences of breaching the undertaking by re-entering the sugar industry

Under the SIRP if a taxpayer becomes an owner or operator of a sugar industry enterprise within 5 years in breach of the undertaking given, the SIEG will be repayable to the Commonwealth as stated in the note to **proposed subsection 15-65(3)** to be inserted to the ITAA 1997 by **item 4** of **Schedule 4**.

Section 59-10 of the ITAA 1997 provides that an amount received and repayable in a later income year is not assessable income and is not exempt income if the repayment cannot be deducted for any income year. In consequence if the SEIG is repaid subsequently, section 59-10 will exclude it from assessable income as well as from exempt income. If the SIEG had been treated as exempt income and applied against a taxpayer's tax losses, the taxpayer will be able to seek amended assessments under section 170(10AB) of the ITAA 1936.

Tax consequences of breaching the undertaking by re-entering the agricultural industry other than the sugar industry

Note 2 to be inserted to section 53-10 of the ITAA 1997 by **item 7**of **Schedule 4** provides that the SIEG is included in assessable income if the recipient becomes the owner or operator of an agricultural enterprise, except a sugar industry enterprise, within 5 years after receiving the grant.

Application

Item 9 of **Schedule 4** provides that the amendments made by **Schedule 4** apply to SIEGs received on or after 1 February 2003.

Schedule 5 – Foreign resident withholding rules – application to alienated personal services payments

Division 12 of Schedule 1 of the TAA 1953 deals with the pay as you go (PAYG) withholding provisions. Section 12-7 provides that the PAYG withholding provisions do not apply to alienated personal services payments. An alienated personal services payment is a payment received by an entity that relates to an amount that is included in the assessable income of an individual under Division 86 of the ITAA 1997.

To ensure that certain withholding rules can apply to these payments, section 12-7 is amended by **items 1** and **2** of **Schedule 5** of the Bill. **Proposed subsection 12-7(2)** inserted by **item 2** specifies that the foreign resident withholding rules in Subdivision 12-FB shall apply to alienated personal services payments.

Application

The amendments commence on Royal Assent and will apply to payments made after commencement as indicated in **subclause 2(1)** of the Bill.

Schedule 6 – Demutualisation of friendly societies – Deferral of CGT liability and establishing cost base for the demutualised shares

Demutualisation is the conversion of financial or other institutions owned by their members into companies owned by shareholders. Some mutual friendly societies that qualify as life insurance companies have restructured by demutualising. However, due to technicalities in the law relating to the definition of a mutual insurance company in subsection 121AB (1) in Division 9AA of Part III of the ITAA 1936 they are unable to benefit from the taxation framework provided therein. This taxation framework:

- ensures the deferral of any CGT liability until a subsequent CGT event happens to the demutualised shares, and
- establishes a cost base for the demutualised shares for CGT purposes that broadly reflects the market value of the demutualised shares.

These provisions ensure that tax considerations are not an impediment to mutual insurance companies demutualising.

The definition of mutual insurance company in subsection 121AB (1) will be modified by the insertion of **proposed paragraph 121AB (1) (c)** by **item 2** of **Schedule 4** so that it includes an insurance company that:

- was a friendly society as at 7.30 pm (by legal time in the Australian Capital Territory) on 9 May 1995
- was an insurance company on 1 July 1999, and
- does not have capital divided into shares.

The amendments will ensure that these special provisions apply to taxpayers who receive shares in connection with the demutualisation of friendly societies that principally carry on life insurance business and that have never issued shares.

This measure was announced in the Minister for Revenue and Assistant Treasurer's Press Release No C97/03 of 16 October 2003.

Application

The amendments will commence on 1 July 2000 as provided in the table in **subclause 2(1)** of the Bill.

Schedule 7 – Roll-over relief for partnerships that are simplified tax system taxpayers

The STS, a recommendation in the Ralph Review of Business Taxation, commenced on 1 July 2001. The STS allows eligible small businesses with simpler depreciation rules as an alternative to the uniform capital allowance (UCA) regime, a cash basis for recognising income and deductible expenses, and simpler trading stock rules. The STS was introduced to reduce the disproportionate compliance burden that falls on small business.

Roll-over relief is not currently available for reconstitutions of partnerships which are in the STS. This has discouraged taxpayers from joining the STS. The amendments proposed in Schedule 7 will allow optional roll-over relief for STS partnerships in accordance with the measure announced by the Minister for Revenue and Assistant Treasurer's Press Release C13/03 of 4 March 2003.

Subdivision 328-D of the ITAA 1997 deals with capital allowances for STS taxpayers. **Item 8** of **Schedule 7** inserts **proposed section 328-240** to provide roll-over relief for depreciating assets when there is a partial ownership change of an STS partnership resulting from a variation in the constitution of a partnership or in the interests of the partners. **Proposed paragraph 328-240(1)(c)** requires the partnership immediately before the change and the partnership immediately after the ownership change to jointly elect for roll-over relief. The election must be made in writing as required by **proposed paragraph**

328-240(2)(a) and be made within 6 months after the end of the transferee's income year in which the balancing adjustment event occurs as provided in **proposed paragraph 328-240(2)(c)**.

The reader is referred to Chapter 7 of the Explanatory Memorandum to the Bill for further details of the changes to give effect to roll-over relief for partnerships that are STS taxpayers.

Application

The amendments proposed by **Schedule 7** apply to balancing adjustment events occurring on or after 1 July 2001 as provided in **item 9** of **Schedule 7**.

Schedule 8 – Consolidation – Amendments to enable revocation of certain choices and rectify certain anomalies in working out the R&D tax offset

Revocation of certain choices made under the consolidation regime

The consolidation regime provides for a number of irrevocable choices that may be made by a head company in relation to the tax cost of its assets or determining its ability to deduct losses. To give taxpayers a further opportunity to reconsider and revoke certain choices in the interest of effecting a smooth transition to the consolidation regime, the amendments in Part 1 of Schedule 8 allow the following choices to be revoked before 1 January 2005.

1. The choice made by a head company to retain the existing tax cost of a chosen transitional entity may be revoked before 1 January 2005 by **proposed subsection 701-5(2)** to be inserted into the IT(TP) Act 1997 by **item 2** of **Schedule 8** in substitution of the existing subsection.

2. The choice made by the head company of a consolidated group to cancel the transfer of a loss under section 707-145(1) of the ITAA 1997 may be revoked before 1 January 2005 by **proposed section 707-145** to be inserted into the IT(TP) Act 1997 by **item 3** of **Schedule 8.**

3. The choice made to increase the available fraction of a bundle of losses under section 707-325 of the IT (TP) 1997 may be revoked before 1 January 2005 under **proposed new subsections 707-325(5)** and **(6)** to be inserted into the IT (TP) Act 1997 by **item 4** of **Schedule 8** in substitution of the existing subsections which are to be repealed. Section 707-315 of the ITAA 1997 states that a bundle of losses at the initial transfer time consists of every loss transferred to the head company under Subdivision 707-A of the ITAA 1997 by entities in the consolidated group.

4. The choice made to treat value donor's loss as included in a bundle of losses under section 707-327 of the IT(TP) Act 1997 may be revoked before 1 January 2005 under **proposed new subsection 707-327(5)** to be inserted by **item 5** of **Schedule 8** in substitution of the existing subsection which is to be repealed.

5. The choice made to waive the capital injection rules under section 707-328A of the IT(TP) Act 1997 may be amended or revoked before 1 January 2005 under **proposed new subsection 707-328A(4)** to be inserted by **item 6** of **Schedule 8** in substitution of the existing subsection which is to be repealed.

6. The choice made to utilise certain losses over three years under the alternative regime in section 707-350 of the IT(TP) 1997 may be revoked before 1 January 2005 under **proposed new subsections 707-350(5)** and **(6)** to be inserted by **item 7** of **Schedule 8** in substitution of the existing subsections which are to be repealed.

7. The ongoing head company of a multiple entry consolidated group (MEC Group) is allowed under subsection 719-325(1) of the ITAA 1997 to elect to cancel all the losses in its group loss bundle and any of its existing bundles. This election if made may be revoked under **proposed new section 719-310** to be inserted to the IT (TP) Act 1997 by **item 8** of **Schedule 8.**

Research and development tax offset

Under the consolidated regime, R&D expenditure of a subsidiary company during the period it was a member of a consolidated group is treated for income tax purposes as R&D expenditure of the head company. The amendments proposed in Part 2 of **Schedule 8** deal with issues that arise when an entity joins or leaves a consolidate group part-way through an income year. Under the existing consolidation entry-history rule in section 73BABA of the ITAA 1936 a joining entity's turnover and R&D aggregate for the pre-consolidation part of the year will be treated as having been incurred by the head company to determine the head company's eligibility. This would result in double counting in cases where the joining entity was already grouped with the head company under the R&D grouping rules in section 73L of the ITAA 1936. The amendments proposed by **item 9** and **10 of Schedule 8** modify the operation of the consolidation entry-history rule for the purposes of determining a head company's eligibility for the R&D offset.

Likewise, the amendments proposed by **item 11** of **Schedule 8** ensure that an entity that leaves a group will not have its history double counted.

The reader is referred to Chapter 8 of the Explanatory Memorandum to the Bill for further details of the amendments proposed in **Schedule 8** as well as the ATO publication *Consolidation in brief*[3] for the basic concepts underlying consolidation.

Application

Item 14 provides that that the amendments made by **Schedule 8** apply on or after 1 July 2002, the date when the consolidated regime commenced.

Concluding Comments

Relief for SMEs in the transition to the Consolidated Regime

The amendments proposed in **Schedules 2** and **8** of the Bill relate to the consolidation regime and recognise that taxpayers, particularly small and medium enterprises (SMEs), will require further time in the transition period to make informed choices. The consolidation regime had initially provided for a number of irrevocable choices that a head company may make in relation to the tax cost of its assets or the ability to deduct losses. These choices had been made irrevocable to minimise compliance costs and provide certainty for taxpayers. It would be a welcome relief to these taxpayers and their advisers that they have been given time till 31 December 2004 to revoke certain choices already made as provided in **Schedule 8.**

However, the consolidation regime is a piece of complex tax legislation which will require SMEs in particular to incur costs in obtaining appropriate advice as to its impact on them and also costs in obtaining valuations if they are to obtain the full benefits of consolidation. This was emphasised in an article titled *Clock Ticking for SMEs*[4] in the June 2003 issue of the Australian CPA as follows:

> The cost element is pivotal. Not only is there the cost of getting advice on what the legislation means, how it works and how it will affect a particular group of companies, there's the additional cost of implementing that advice. Be warned. The legislation is extremely complex, and tax consolidations bear no resemblance to accounting consolidations. The two are quite different beasts.

The first report of the Inspector-General of Taxation[5] to the Minister for Revenue and Assistant Treasurer, released on 9 February 2004, listed the broad themes of taxpayer unease. These themes included apprehension of the complexity of the tax laws and apprehension about the capability of tax administration officers in both the private and public sector. These apprehensions may be pertinent to SMEs when deciding to revoke certain choices already made for which more time has been given by the measures in **Schedule 8**.

Financial Impact of Measures in the Bill

	2003-04	2004-05	2005-06	2006-07
Schedule 1 GST- free first aid or life saving course	-$9m	-$3m	-$3m	-$3m
Schedule 2 Value shifting exclusions	-$5m	Negligible cost to revenue	Negligible cost to revenue	Negligible cost to revenue
Schedule 3 Personal Services income measures	Nil	Nil	Nil	Nil
Schedule 4 Sugar industry exit grant tax measures	-$1m	-$3m	-$3m	-$2m
Schedule 5 Foreign resident withholding measures	Nil	Nil	Nil	Nil
Schedule 6 Demutualisation of friendly societies tax concessions	Insignificant impact on revenue	Insignificant impact on revenue	Insignificant impact on revenue	Insignificant impact on revenue
Schedule 7 Roll-over relief for partnerships in STS	-$1m	-$2m	-$2m	-$2m
Schedule 8 Consolidation: revocation of certain choices and R&D tax offset	Insignificant effect on revenue	Insignificant effect on revenue	Insignificant effect on revenue	Insignificant effect on revenue

Note: Negative figures indicate the cost to revenue

Source: Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 9) 2003

Endnotes

1 Senate Hansard; 26 June 2003; p. 12765.

2 Media Release by the Hon Warren Truss MP Federal Minister for Agriculture, Fisheries and Forestry; 5 February 2003 – *Commonwealth sugar industry exit assistance set to start.*

3 *Consolidation in brief – taxing wholly owned corporate groups as single entities;* ATO 2 December 2002.

4 *Clock ticking foe SMEs*; Roger Timms – Australian CPA – June 2003; p. 65.

5 Attachment to Press Release No COO3/04 of the Minister for Revenue and Assistant Treasurer of 9 February 2004.