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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAXATION LAWS AMENDMENT BILL (NO. 2) 1995

SUPPLEMENTARY EXPLANATORY MEMORANDUM

Amendments and new items to be moved on behalf of the Government

(Circulated by the authority of the Treasurer,
the Hon Ralph Willis, M.P.)





General outline and financial impact

State and Territory bodies

- Makes two minor technical amendments to the provisions relating to tax benefit transfers. These amendments will change the date of effect of the amendments to section 51AD and Division 16D from 1 July 1994 to 1 July 1995. This amendment will ensure that the amendments have their intended effect.
- Introduces two new consequential amendments. The first will ensure that taxpayers who receive grants in relation to, or recoupments of, research and development expenditure from State and Territory bodies (STBs) are treated in the same way as taxpayers who receive such recoupments or grants from governments and government authorities.

The second consequential amendment is part of a package of safeguards on the use of losses and deductions by STBs which are remaining in the Commonwealth tax net because they will be soon privatised. The amendment will ensure that superannuation contributions made after the STB is privatised will not be deductible to the extent that those contributions are in respect of unfunded liabilities that accrued during the period from 1 July 1995 until the STB is privatised.

- Exempts State and Territory superannuation funds from sales tax, if they fall within the terms of the exemption for STBs.
- Makes a technical amendment to the transitional provisions for the sales tax exemption, to ensure that 'excluded' STBs do not have access to the transitional credit ground.

Financial impact: Nil.

Employee share schemes

Makes a number of minor changes to the employee share scheme provisions. One amendment introduces an anti-avoidance measure to

ensure that the provisions have their intended effect. Other amendments correct some minor drafting errors.

Financial impact: The nature of the amendments is such that a reliable estimate cannot be made.

State and Territory bodies

Explanation of the amendments

The following amendments relate to *Schedule 1* of the Bill.

Amendment 1: No deduction for unfunded superannuation contributions

The Bill introduced safeguards on the use of tax losses and deductions by State and Territory bodies (STBs) which remain in the Commonwealth tax net after 1 July 1995.

This amendment ensures that superannuation contributions made after such an STB is sold to private interests are not tax deductible to the extent that they are in respect of liabilities that had accrued during the period from 1 July 1995 until it is sold to private interests [*new section 24AYA*]. This is achieved in two steps. First, no deduction at all will be allowable to the body under section 82AAC of the *Income Tax Assessment Act 1936* (the Act) unless it obtains a certificate from an actuary, stating the actuarial value of any unfunded superannuation liabilities which had accrued from 1 July 1995 until the time of the sale [*new subsections 24AYA(2) and (3)*]. The certificate must be obtained before the body lodges its tax return for the year in which it ceases to be an STB or within such further time as the Commissioner allows [*new subsection 24AYA(4)*].

Secondly, if there is an amount of unfunded liabilities, deductions for superannuation contributions will be denied until, in total, they exceed the amount of the unfunded liabilities [*new subsections 24AYA(5) and (6)*]. This is achieved by providing for a threshold amount of superannuation contributions that must be made in a year before a deduction will be available. The threshold is called the 'unfunded liability limit' [*new subsection 24AYA(7)*]. In its first year of operation the limit will be the certified amount of unfunded liabilities. If the limit is not exceeded in the first year, it will be reduced in the second year by the amount of superannuation deductions denied under *new section 24AYA* in the first year. The limit will be progressively reduced in this way until it is extinguished.

Because it is possible to make more than one contribution in a year and each separate contribution is potentially deductible, where the sum of all superannuation contributions in a year exceeds the deduction limit *new subsection 24AY(6)* allocates a part of the deduction limit to each superannuation contribution made in the year. This has been done purely as a technical matter and simply has the effect of allowing a deduction for the amount of contributions, in total, that exceeds the deduction limit. (The alternative, of denying deductions for contributions in a year until the deduction limit is reached, would be more complex and would be likely to produce undesirable timing and apportionment difficulties.)

Amendment 2: Definition of 'prescribed excluded STB'

Several provisions affect STBs which are remaining in the Commonwealth tax net after 1 July 1995. For convenience sake such entities are called 'prescribed excluded STBs' because they are excluded STBs which are prescribed as taxable by regulation. This amendment inserts a definition of 'prescribed excluded STB' into proposed new section 24AZ.

Amendments 3,4,6,7 and 8: Tax benefit transfers

One of the safeguards introduced on the use of tax losses and deductions by STBs which remain in the Commonwealth tax net after 1 July 1995 was to treat prescribed STBs as exempt entities for the purposes of section 51AD and Division 16D.

The agreement between the Commonwealth and the States and Territories is that those provisions shall apply from 1 July 1995, the date from which only bodies due for privatisation by 1 July 1997 will be listed as taxable. Due to an oversight the provisions have a date of effect of 1 July 1994. Those provisions are to be amended to change the date of effect to 1 July 1995.

The definition of 'exempt public body' in subsection 159GE will be amended to include an STB (within the meaning of Division 1AB) the income of which is exempt from tax *[item 9A]*. This a necessary consequential amendment in order to ensure that Division 16D has its intended effect.

Item 10 will be amended so the new section 159GEA will refer to a 'prescribed excluded STB' instead of 'an STB (within the meaning of Division 1AB)'.

Item 5 will be amended to omit the definition of 'prescribed excluded STB' as the definition has been moved to proposed new section 24AZ.

The item will also be amended to cross reference section 51AD to Division 1AB.

The date of effect of *Item 5* (which ensures that 'prescribed excluded STBs' are treated as exempt entities for the purposes of section 51AD) and *Item 10* is amended to 1 July 1995.

Amendment 5: Research and development expenditure

Because STBs which used to claim income tax exemption under paragraph 23(d) will now claim exemption only under new section 24AM, paragraph 23(d) will have limited application. The Bill made several consequential amendments to the Act to ensure that provisions continued to have the effect that they were intended to have. One provision which was omitted was section 73C.

Section 73C reduces a deduction for research and development expenditure where the taxpayer claiming the deduction receives or becomes entitled to receive a recoupment of or grant in respect of the whole or any part of that expenditure by or from the Commonwealth, a State or Territory or an authority constituted by or under a law of the Commonwealth, a State or a Territory. To ensure that the provision has its intended effect it is necessary to amend paragraph 73C(2)(b) to include an STB as a potential source of such a recoupment or grant. [*Item 6A*]

Amendment 9: Sales tax exemption for superannuation funds

This amendment will amend proposed new subsection 3D(6) of the *Sales Tax (Exemptions and Classifications) Act 1992* (the Act). Proposed section 3D is contained in *item 17* to the Bill.

The Bill provides for certain STBs to be exempt from sales tax, unless they are 'excluded STBs'. 'Excluded STBs' are defined in proposed subsection 3D(6). As the Bill was introduced, State and Territory owned superannuation funds were 'excluded STBs' and were to be denied sales tax exemption.

This amendment will remove superannuation funds from the definition of 'excluded STBs'. Consequently, State and Territory superannuation funds which fall within the terms of the new exemption, and which are not 'excluded STBs' on the basis that they were prescribed by regulation, will be eligible for sales tax exemption.

Amendments 24 to 27: Sales tax - amendments to the credit provisions

These are technical amendments to ensure that the transitional credit ground operates as intended.

Item 11 of Schedule 9 of the Bill contains a transitional credit ground (TCR2) which applies to dealings with goods occurring between 1 July 1994 and the date that the Bill receives the Royal Assent. The credit ground is available to bodies which would have been able to claim the new sales tax exemption for STBs, if it had been in force at the time of the dealing. The exemption applies from the date of Royal Assent.

Certain bodies are 'excluded' from the exemption. These include bodies which are prescribed by regulation. It was also intended that prescribed bodies would be 'excluded' from the transitional credit ground; however, no mechanism was provided for doing this.

TCR2 will therefore be amended to deny credits to STBs which are listed in regulations, for the period from 1 July 1994 to 30 June 1995. A new credit ground, TCR3, will operate to deny credits to prescribed STBs for the period from 1 July 1995 to the date of Royal Assent. The two credit grounds are needed because different STBs will be prescribed for the periods 1 July 1994 to 30 June 1995, and 1 July 1995 to the date of Royal Assent.

Credits will not be paid until the regulations have been made.

Employee share schemes

Explanation of the amendments

The following amendments relate to *Schedule 2* of the Bill.

Amendments 10 and 12: Anti-avoidance

These amendments ensure that shares or rights provided to employees by a company group through investment companies are not taxed concessionally. This is done by adding an anti-avoidance provision stating that, under certain conditions, the share or right of an investment company will not be a qualifying share or right.

These conditions are:

- the taxpayer receiving the shares or rights is employed by the investment company and by another company; and
 - the investment company and the other company are part of the same group; and
 - the predominant business of the investment company was to acquire, sell or hold shares, securities or other investments.
- [Item 1]*

A holding company that holds shares in operating subsidiaries that are not investment companies will not itself be an investment company.

Amendment 11: Provider deductions

Under the proposed section 139DC an employer can, under certain conditions, claim a deduction for the imputed cost of qualifying shares or rights provided to employees. Proposed subsection 139DC(2) limits this deduction to the market value of the shares or rights or to \$500, whichever is less. This amendment to the Bill further limits the deduction to the discount given to the person receiving the shares or rights. Without such

an amendment, an employer could claim a deduction under this concession even where the employee has received no benefit (eg. where the employee pays full market price for the shares or rights). **[Item 1]**

Amendments 13 and 14: Approved stock exchange

These amendments define what is 'an approved stock exchange' for the purposes of the new employee share scheme provisions. **[Item 1]**

Amendment 15: Foreign investment funds

Some shares which fall to be taxed under the new employee share scheme provisions may also, in some circumstances, be subject to tax under the foreign investment fund provisions. To avoid any double taxation, and to ensure that the deferral concession of the employee share scheme provisions remains available, this amendment exempts the shares or rights from the foreign investment fund provisions for the period prior to the time at which those shares or rights are taxed under the employee share scheme provisions. **[Item 7A]**

Amendments 16, 18, 21 and 23: Transitional provision election

Item 10 provides three transitional arrangements for the new provisions. These are contained in subitems 3, 4, and 5. While the transitional arrangement in subitem 5 requires a taxpayer to make an election for it to apply, subitems 3 and 4 apply automatically. This amendment provides for those taxpayers who fall within subitems 3 and 4 to elect that those subitems not apply.

Amendment 17: Transitional provision - subitem 10(3)

The transitional arrangement of subitem 10(3) currently applies only to shares or rights of the employer company. This amendment extends this arrangement to shares or rights of the holding company of the employer. **[Item 10]**

Amendments 19 and 20: Transitional provision - subitem 10(4)

In the transitional arrangement of subitem 10(4) there is a requirement that the employee share scheme be approved by shareholders before the date the new employee share scheme arrangements were announced. As some overseas jurisdictions may not require their employee share schemes to be approved by shareholders, this amendment ensures this requirement is not necessary in these cases. **[Item 10]**

Amendment 22: Public company

Also in Item 10, the term public company has been given the same meaning as in the *Corporations Law* (subitem 7). It is possible that, in some situations, the term 'public company' in this provision may exclude foreign holding companies and companies which have been established by statute. This amendment defines the term to include companies listed on approved stock exchanges and companies which have been established by statute. **[Item 10]**



