

1990-91

THE PARLIAMENT OF THE COMMONWEALTH OF
AUSTRALIA

HOUSE OF REPRESENTATIVES

TAXATION LAWS AMENDMENT BILL (NO.3) 1991

SUPPLEMENTARY
EXPLANATORY MEMORANDUM

(Circulated by the authority of the Treasurer,
the Hon. J. Kerin, M.P.)





General Outline and Financial Impact of the Amendments

The amendments will amend the Taxation Laws Amendment Bill (No. 3) 1991 to:

- simplify the calculation of provisional tax for 1991-92 for those taxpayers who are within the provisional tax system because of a shortfall in pay-as-you-earn tax deductions from salary or wages income received in 1990-91 [*amendment (6)*];
- reduce the franking credit that arises to a non-mutual life assurance company for an initial or subsequent payment of tax, and the franking debit in the case of a refund, by the application of a formula that uses the current year's tax liability [*amendments (1), (2), (3), (4) and (7)*]; and
- include a provision in the capital gains tax (CGT) legislation to enable shareholders in companies in liquidation to realise capital losses on valueless shares [*amendment (5)*].

The amendments will have no significant impact on the revenue.

Summary of proposed amendments

A number of amendments to the Bill are to be moved on behalf of the Government. These amendments relate to the calculation of provisional tax in respect of 1991-92 for certain taxpayers and the changes to the imputation system proposed by the Bill.

The amendments also include an amendment to the CGT provisions of the Income Tax Assessment Act 1936 (the Principal Act) to enable taxpayers to realise capital losses on valueless shares held in companies in liquidation.

Provisional tax amendments

The changes proposed to the provisional tax amendments in the Bill will simplify the calculation of provisional tax for those taxpayers with a shortfall of at least \$3000 in pay-as-you-earn tax deductions from 1990-91 salary or wages income.

Imputation changes

The effects of the proposed amendments to the imputation arrangements are:

- when an assessment is made, life assurance companies will receive further franking debits and credits in respect of -
 - initial payments of tax,
 - further payments of tax and
 - refunds of initial payments of tax.

Capital gains tax amendment

The proposed amendment will allow shareholders in companies in liquidation to realise capital losses on their shares if the liquidator has indicated that there is no likelihood of shareholders receiving a distribution in the course of winding up the company.

Notes on the proposed amendments

Provisional tax amendments

The provisional tax amendments proposed in the Bill are explained in Chapter 13 of the explanatory memorandum to the Bill.

The amendments proposed in clause 71 of the Bill would have resulted in taxpayers being liable to provisional tax on salary or wages if they satisfied the following tests which are contained in paragraphs 221YAB(a) and (b) of the Principal Act:

- their balance to pay on assessment was \$3000 or more; and
- the PAYE tax deductions made from that salary or wages income were under-deducted by \$3000 or more;

where the balance to pay on assessment was determined disregarding any provisional tax credit for the preceding year in respect of salary or wages.

The existing legislation allows the whole of the previous year's provisional tax credit in determining the balance to pay on assessment. These arrangements are not equitable for the reasons explained in paragraph 13.3 of the explanatory memorandum.

The technical precision of clause 71 in the Bill would have required taxpayers to split the provisional tax credit into the following two components:

- (a) provisional tax on income other than salary or wages; and
- (b) provisional tax on salary or wages income.

This calculation would have confused and imposed an unacceptable burdens on taxpayers.

To overcome this potential problem, amendment (6) now being moved will exclude the whole provisional tax credit from the calculation of the first test contained paragraph 221YAB(a) of the Principal Act. [*Clause 71 - paragraph 221YAB(a)*]

Imputation changes and timing of franking credits

The Bill contains amendments to the dividend imputation provisions of the Act to change the basis on which companies receive franking credits from the assessment to the payment of company tax. This measure was announced in the 1991-92 Budget on 20 August 1991 and applies to payments of tax made under assessments and amended assessments made after that date.

One feature of this change is that the franking credits that arise when initial and subsequent payments of company tax are made are not offset by franking debits when these payments are applied in the assessment. The franking capacity of most companies will not be affected by this change. However, this is not the case for non-mutual life assurance companies.

Non-mutual life assurance companies receive franking credits and use franking debits in the same way as other companies that have shareholders. However, most of these companies are prevented by the *Life Insurance Act 1945* from distributing their profits exclusively to shareholders. The franking credits and debits derived by life assurance companies are therefore reduced, by the application of formulae, to take into account the tax paid on income that cannot be distributed to shareholders.

Franking credits and debits of life assurance companies are generally reduced by 80% of the tax assessed on the statutory fund component of taxable income for the current year of income. However, when a company makes an initial or subsequent payment of tax, or part of the initial payment is refunded, this apportionment basis cannot be used because the tax liability of the company for the current year is not known at that time. The payment is therefore apportioned between statutory and non-statutory fund income on the basis of the previous year's tax liability.

Under the assessment based imputation system, the reducing franking debits for initial and subsequent payments are apportioned on the basis of the previous year's tax liability. This achieves the right result because these debits are written back and replaced by reducing franking debits based on the tax assessed for the current year when the assessment issues. This does not occur under an imputation system based on the payment of tax.

When the company's franking capacity is based on tax paid the right result is not achieved if the reducing franking debits incurred by life assurance companies for initial and subsequent company tax payments are calculated on the basis of the taxable income of the previous year. Although no change can be made to the basis for reducing the franking credits when initial and subsequent payments of company tax are made, the right result will be achieved if the reducing franking debits are recalculated on the basis of the company's tax liability for the current year when the assessment is made. A similar adjustment is also necessary when a company receives a refund that relates to its initial payment.

The franking account will reflect the right franking capacity of a life assurance company, after taking into account the tax paid on income that cannot be distributed to shareholders, if the following entries are made to the franking account when the assessment is served or deemed to be served:

- a franking credit to reverse the franking debit that arose when the company made an initial (or subsequent) payment of tax; and
- a reducing franking debit for the initial (or subsequent) payment that is recalculated using a formula that apportions the payment on the basis of the company's tax liability on statutory and non-statutory fund income for the current year of income.

In the case of refunds of the whole or part of an initial payment, the franking account will reflect the right franking capacity of a life assurance company if the following entries are made to the franking account when the assessment is served, or deemed to be served:

- a franking debit to reverse the reducing franking credit that arose when the refund was made; and
- a reducing franking credit that is recalculated using a formula that apportions the refund on the basis of the company's tax liability on statutory and non-statutory fund income for the current year of income.

Initial payment of tax

When a company makes an initial payment of tax a franking credit arises (section 160APMA). Where the company is a life assurance company a reducing franking debit, calculated on the basis of the preceding year's tax liability, arises (section 160AQCD).

Where the assessment for the year of income to which the initial payment relates is served or deemed to be served after 20 August 1991, the life assurance company receives a further franking credit and franking debit. These are:

- a franking credit equal to the franking debit that arose under subsection 160AQCD(1) when the initial payment was made [*Clause 57A - new section 160APVF*], and
- a new reducing franking debit calculated using the formula provided. This formula will calculate the franking debit on the basis of the tax liability for the year of income to which the initial payment relates.
[*Clause 61A - new subsections 160AQCD(3) and (4)*]

Subsequent payments of tax

When a company makes a subsequent payment of tax a franking credit arises (section 160APMB). Where the company is a life assurance company a reducing franking debit, calculated on the basis of the preceding year's tax liability, arises (section 160AQCE).

Where the assessment for the year of income to which the subsequent payment relates is served or deemed to be served after 20 August 1991, the life assurance company receives a further franking credit and franking debit. These are:

- a franking credit equal to the franking debit that arose under subsection 160AQCE(1) when the subsequent payment was made [*Clause 57A - new section 160APVG*], and
- a new reducing franking debit calculated using the formula provided. This formula calculates the franking debit on the basis of the tax liability for the year of income to which the subsequent payment relates [*Clause 61B - new subsections 160AQCE(3) and (4)*].

Refunds of company tax

When a company receives a refund of an initial payment of tax a franking debit arises (section 160APYB). Where the company is a life assurance company a reducing franking credit, calculated on the basis of the preceding year's tax liability, arises (section 160APVC).

When the assessment for the year of income to which the refund of the initial payment relates is served, or deemed to be served, after 20 August 1991, the life insurance company receives a further franking credit and franking debit. These are:

a franking debit equal to the franking credit that arose under subsection 160APVC(1) when the refund was made; *[Clause 62 - new section 160AQCM]* and

a new reducing franking credit calculated using the formula provided. This formula calculates the franking credit on the basis of the tax liability for the year of income to which the refund relates.

[Clause 57 - new subsections 160APVC (3) and (4)]

Capital gains tax amendment

The CGT provisions of Part IIIA of the Principal Act allow a taxpayer to realise a capital loss on the *disposal* of an asset. However, where a company is placed in liquidation, the *Corporations Act 1990* restricts the transfer of shares in the company. This means that shareholders whose shares have become valueless are unable to dispose of their shares and realise a capital loss.

To overcome this problem **clause 63A** proposes an amendment to the CGT provisions to ensure that where:

- a taxpayer owns a share in a company in liquidation; and
- the liquidator makes a written statement that there are reasonable grounds to believe that there is no likelihood that the shareholders will receive any distribution in the course of winding up the company;

the taxpayer may elect to have the share treated as having been disposed of (and immediately reacquired) for nil consideration at the time the liquidator's statement was made.

[Clause 63A - new section 160WA]

The amendment also operates where there is more than one class of shares in a company and the liquidator makes the declaration in relation to a particular class of shares only. In this situation the amendment applies solely to that class of shares.

An election by a taxpayer has the effect of deeming the taxpayer to have disposed of the shares for no consideration, thereby crystallising any capital loss. The shares are deemed to be immediately reacquired by the taxpayer for no consideration which ensures that, if a distribution is subsequently received, the distribution is subject to the existing provisions of the Principal Act.

The amendment will apply after 11 November 1991 (i.e. the date of introduction of this amendment) to shares owned by taxpayers in companies in liquidation, whether the liquidation commenced before or after that time. However, the taxpayer's election and the liquidator's statement must be made after 11 November 1991.

1

2

3









