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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

SENATE

TAXATION LAWS AMENDMENT BILL (NO. 3) 1994

SUPPLEMENTARY EXPLANATORY MEMORANDUM

Amendments and New Clauses to be Moved on Behalf of the Government

(Circulated by authority of the Treasurer, the Hon Ralph Willis, MP)

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General Outline and Financial Impact

Reportable payments system

Amends the reportable payments provisions of the Bill to defer the commencement of the system from 1 November 1994 to 1 December 1994.

Date of effect: 1 December 1994

Amendment announced: Not previously announced.

Financial impact: The amendment will have a minimal effect on revenue.

Social security payments

Amends the home child care allowance and dependent spouse rebate provisions of the Bill to allow taxpayers the choice of claiming the 'without child' dependent spouse rebate instead of claiming for the home child care allowance.

Date of effect: 29 September 1994

Amendment announced: Foreshadowed by the Assistant Treasurer in the Second Reading Speech in the House of Representatives on 23 August 1994.

Financial impact: The introduction of the option will transfer existing revenue costs from the social security to the tax system. If taxpayers choose to their best advantage there would be a small additional cost to the revenue.

Eligible investment income of registered organisations

Omits from the Bill the provisions designed to include in the assessable income of registered organisations income derived on or after 1 July 1994 from certain assets.

Date of effect: No longer relevant.

Amendment announced: Not previously announced.

Financial impact: None.

Superannuation: Reasonable benefits limits

Amends the reasonable benefits limits (RBL) provisions of the Bill to make a minor technical change to the formula used to determine the excessive component of an eligible termination payment (ETP) arising from the commutation of a pension or annuity so that, when making an RBL determination, the rebatable proportion is applied only to that part of the ETP that is counted for RBL purposes rather than the whole of the ETP.

Date of effect: 1 July 1994

Amendment announced: Not previously announced.

Financial impact: None.

Taxation of Australian branches of foreign banks

Amends the provisions of the Bill relating to the taxation of Australian branches of foreign banks to make a number of technical corrections. The amendments will clarify the operation of the proposed provisions, and in particular their interaction with Australia's double tax agreements, to ensure that the measures have the intended effect.

Date of effect: The amendments do not change the dates of effect as set out in the Bill as introduced.

Amendment announced: Not previously announced.

Financial impact: None.

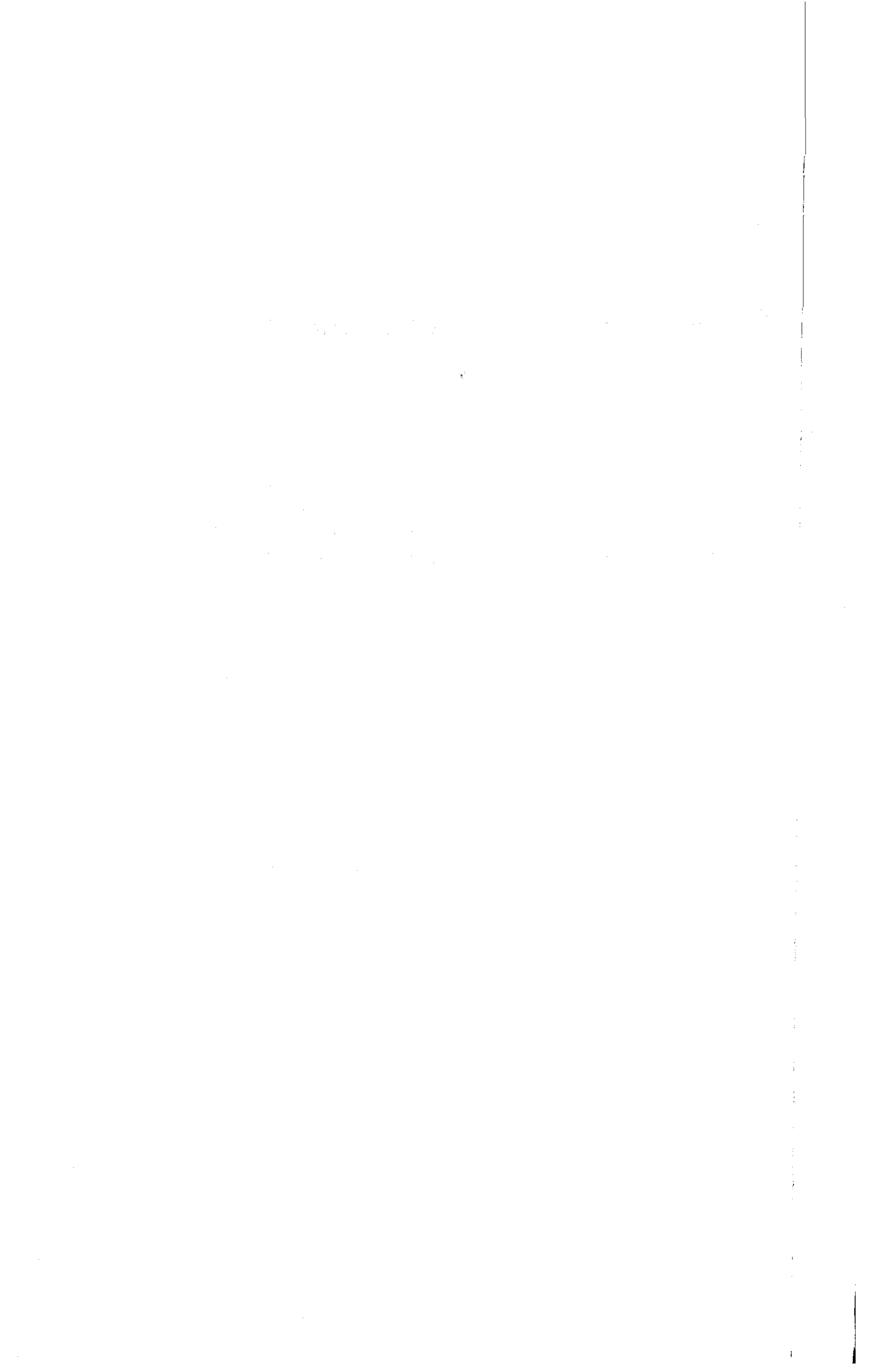
Sales tax - Incentives for regional headquarters

Amends the Bill to change the definition of 'pre-approved company' so as to extend the application of the credit provisions to companies which obtain approval on or after 15 December 1993 and before the Bill receives the Royal Assent.

Date of effect: The credit will apply to dealings after 14 December 1993 and before Royal Assent.

Amendment announced: Not previously announced.

Financial impact: Given the nature of the measure, a reliable estimate of the financial impact cannot be provided.



Chapter 1

Amendments 1 and 2

Reportable payments system

Overview and explanation of the amendments

Amendments 1 and 2 will defer the commencement of the reportable payments system from 1 November 1994 to 1 December 1994. The deferment will allow more leadtime for the provisions to be explained and taxpayers affected by the new arrangements to understand their obligations.

Chapter 2

Amendments 3 to 9

Social Security payments

Home child care allowance and dependant rebate

Overview

2.1 These amendments, which were foreshadowed by the Assistant Treasurer in his Second Reading Speech, will allow taxpayers the choice of claiming the 'without child' dependent spouse rebate instead of claiming for the home child care allowance (HCCA).

2.2 The amendments will also simplify the arrangements and remove any adverse consequences for a family choosing the HCCA payments in lieu of the taxpayer claiming the 'without child' dependent spouse rebate.

2.3 This is achieved by allowing taxpayers to calculate their dependent spouse rebate entitlement by determining the notional rebate they would have been entitled to and then, subtracting from that notional rebate, any HCCA payments received during the relevant period.

2.4 Amendments are also required to the 1994-95 transitional year arrangements to ensure entitlement to the 'with child' dependent spouse rebate for the period from 1 July to 29 September 1994 is retained.

Explanation of the amendments

Amendment 3

2.5 This amendment will amend the object clause ***[clause 51]*** to make it clear that a taxpayer's entitlement to a dependent spouse rebate is now reduced, in addition to the normal reductions, when their dependent spouse is actually paid HCCA.

Amendment 4

2.6 This amendment replaces ***clause 57*** with a new clause containing the following paragraphs:

- ***paragraph (a)*** removes the 'with child' dependent spouse rebate as is the case in the Bill;
- ***paragraph (b)*** introduces ***new subsection 159J(5E)*** which provides that, in calculating the dependent spouse rebate, a taxpayer will reduce the rebate otherwise calculated (if any) by any HCCA paid to their dependent spouse during the year of income. The rebate otherwise calculated could have been reduced because of the spouse's separate net income [under subsection 159J(4)] or the fact that the taxpayer maintained the spouse for part of a year of income [under subsection 159J(3)]; and
- ***paragraph (c)*** excludes HCCA from the definition of 'separate net income' as is the case in the Bill.

Amendment 5

2.7 This amendment replaces proposed subparagraph (pa)(iii) of the definition of "Qualifying reductions" ***[clause 58, paragraph (c)]***, so that a taxpayer whose spouse was not being paid HCCA in respect of 30 June of the preceding year of income is entitled to a reduction, in his or her provisional tax calculation for the current year of income, in respect of a dependent spouse rebate. This compares with the arrangements in the Bill which rely on the period when the taxpayer's spouse did not qualify for the HCCA.

Amendments 6 to 9

2.8 These amendments make the necessary adjustments to the transitional clause ***[clause 60]*** to accommodate the new approach outlined above.

2.9 The explanatory memorandum to the Bill contained examples, at pages 86 to 88, demonstrating the application of the transitional year formula to a taxpayer entitled to the dependent spouse rebate (with or without child).

2.10 While the amendments proposed will not affect the comparisons made between the current and proposed arrangements, the method of calculating the rebate entitlement under the proposed arrangements is based on the HCCA payments received compared to the period when the spouse qualified for HCCA.

2.11 The proposed arrangements for example 1 are reworked below:

Example 1

A taxpayer has a dependent spouse and child during 1994-95. HCCA payments are made from 29 September 1994. The spouse's separate net income, and income for HCCA purposes, is $3120 ($60/wk) earned evenly throughout the year.

Proposed arrangements

For the transitional year, a taxpayer's maximum rebate entitlement is $1270 [$1452 * 90/365 + $1211 * 275/365]. The part year thresholds for applying the separate net income test to the Pre and Post September rebate components will be $70 and $212 respectively.

The Post-28 Sep component (new law) is nil because the rebate of $380, which is calculated after applying the part year separate net income test, is less than the HCCA payments of $654 received during the period from 29 September to 30 June 1995. The $380 rebate represents $912 [$1211 * 275/365] less $532 [(2340-212)/4].

The total rebate and HCCA under the amendments proposed of $835 ($181 + $654) compares to the rebate of $743 that would have been the rebate entitlement under the existing arrangements.

Chapter 3

Amendment 10

Eligible investment income of registered organisations

Overview and explanation of the amendment

3.1 This amendment will remove ***clauses 60, 61, 62 and 63*** from the Bill.

3.2 These clauses were introduced to include in the assessable income of registered organisations income derived from certain assets.

3.3 The clauses have been omitted to allow consultation with industry on the amendments.

3.4 The provisions will be reintroduced in another Bill in the current sitting period.

3.5 The amendments when reintroduced will still apply to income derived on or after 1 July 1994 by a registered organisation from certain assets.

Chapter 4

Amendments 11 to 13

Superannuation - Reasonable benefits limits

Overview

4.1 These amendments will make a minor technical change to the formula used to determine the excessive component of an eligible termination payment (ETP) arising from the commutation of a pension or annuity so that, when making an reasonable benefit limit (RBL) determination, the rebatable proportion is applied only to that part of the ETP that is counted for RBL purposes rather than the whole of the ETP.

Background to the amendments

4.2 ***Clauses 96 and 97*** of the Bill propose to insert new subsection 140R(1A) and subsection 140T(2B) to ensure that where a person is paid an ETP resulting from the commutation of a pension that was in excess of the person's RBL, the ETP will similarly be determined to be in excess of the person's RBL.

Why are changes being made?

4.3 The formulae in proposed new subsection 140R(1A) and subsection 140T(2B) apply the rebatable proportion worked out when a pension or annuity is first measured for RBL purposes to the whole of the ETP received on the commutation of that pension or annuity entitlement to work out the extent to which the ETP is within the recipient's RBL. This potentially results in amounts that are not counted for RBL purposes being treated as excessive component.

Explanation of the amendments

Amendments 11 and 12

4.4 The amendments change the formulae in subsection 140R(1A) and subsection 140R(2B) so that they refer to the **RBL amount of the ETP** rather than the **Amount of ETP**.

4.5 The RBL amount of the ETP is defined in section 140C to have the meaning given by the applicable provision in Subdivision H. The RBL amount identifies that part of the ETP which is counted for RBL purposes.

Amendment 13

4.6 A consequential amendment is being made to section 140ZI to ensure that the RBL amount of an ETP paid by a life assurance company or registered organisation is properly determined. ***[New clause 98A]***

Example

4.7 Margaret receives an ETP of $550 000 from a taxed superannuation fund. $50 000 of this amount represents undeducted contributions. Margaret rolls over the whole of the amount received to purchase an allocated annuity from a life assurance company (which is measured for RBL purposes against the lump sum RBL).

4.8 The rebatable proportion of Margaret's allocated annuity worked out under section 140ZQ is based on the RBL amount of the ETP used to purchase the annuity. The RBL amount under section 140ZM is the amount of the ETP reduced by undeducted contributions. Therefore, the RBL amount is $500 000 and the rebatable proportion is 80%. If the benefit had been taken as a lump sum the excessive component would have been $100 000.

4.9 Several months later Margaret decides to commute the pension and receives an ETP of the same amount (ie, $550 000). She has not used up any of her undeducted contributions as undeducted purchase price. The RBL amount of the ETP received under amended section 140ZI will be $500 000. The RBL determination under section 140R(1A) as amended will be show that Margaret's ETP contains an excessive component of:

$$\$500\,000 \times [1 - 0.8] = \$100\,000.$$

Chapter

5 Amendments 14 to 30

Taxation of Australian branches of foreign banks

Overview

These amendments will make a number of technical corrections to proposed Part IIIB which contains new measures for the taxation of Australian branches of foreign banks. The amendments clarify the operation of the proposed Part, and in particular its interaction with Australia's double tax agreements, to ensure that the measures have the intended effect.

Explanation of the amendments

Amendment 14: Object and Application of Part IIIB

Purpose of Part IIIB

5.1 This amendment will insert ***new section 160ZZVA*** into the Income Tax Assessment Act (the Act). Broadly speaking, the new section explains that the object of the new Part is to treat Australian branches of foreign banks as though they were separate entities in order, firstly, to recognise certain intra-bank transactions so as to assist in calculating the taxable income of the branch and secondly, to ensure that withholding tax will be payable in respect of notional interest treated as paid by the branch to the bank.

5.2 The section also confirms that the separate legal entity fiction will only apply where specifically provided for in the Part. ***[Clause 114]***

Application of Part IIIB

5.3 The second part of this amendment ***[new section 160ZZVB]*** clarifies the interaction between Australia's double taxation agreement obligations (DTAs) and the new Part.

5.4 The new Part assists a foreign bank in calculating the taxable income from its Australian branch by identifying certain amounts of

income and expenditure that are properly to be regarded as attributable to the branch. If, however, a DTA is applicable in relation to the bank and if in relation to the calculation of the taxable income of the bank for a particular year of income the outcome for the bank would be more favourable under the DTA than if the Part taken overall applied, then the bank will be free to choose that the new Part not apply in respect of the calculation of its taxable income for that year.

5.5 Although a bank may choose not to apply proposed Part IIIB in calculating its taxable income, the proposed new section makes it clear that withholding tax will nevertheless apply to interest which is taken by the Part to have been paid by the branch to the bank.

Amendment 15: Definition of Accounting Records

5.6 Proposed ***section 160ZZV*** of the Bill, as originally introduced, defined "accounting records" by reference to their meaning in the *Corporations Law.* To assist readers so they will not have to refer to another statute, this amendment will now include in new Part IIIB a specific definition of "accounting records".

5.7 The amendment will also make it clear that the accounting records referred to are those basic records in which transactions are originally recorded and from which accounts are prepared.

Amendments 16 and 18: Branch is a wholly owned subsidiary

5.8 Proposed ***subsection 160ZZW(3)*** of the Bill provides that the branch is to be taken to be a separate company which is a "wholly-owned subsidiary" of the bank. As introduced, the Bill defined the term "wholly-owned subsidiary" by reference to the meaning of that term in the *Corporations Law.*

5.9 To assist readers, proposed ***subsection 160ZZW(3)*** will now refer directly to the ownership of the share capital instead of requiring reference to another statute.

Amendments 17 and 19: Treating an Australian branch as if it were a separate legal person

5.10 These amendments to proposed ***section 160ZZW***, which are of a technical nature, will confirm that where, for the purposes outlined in proposed Part IIIB, the Australian branch is treated as a separate company it must also be treated as a non-resident which is not a permanent establishment of the bank in Australia.

Amendment 20: Deduction for foreign tax

5.11 Under the foreign tax credit system, a foreign tax credit is available only to residents for foreign tax paid on foreign income. However, for the purposes of the Act and new Part IIIB, the branch is a non-resident of Australia. Moreover, the new Part provides that all the income derived by the bank through the branch is to be treated as having an Australian source. Accordingly, a foreign tax credit will be not be available for offset against Australian tax payable in relation to income attributable to the branch.

5.12 Instead, as a measure of double tax relief, a tax deduction will be available in a year of income for the amount of foreign tax paid in that year of income. This amendment to proposed ***section 160ZZY*** will ensure, however, that the deduction will be restricted to foreign tax on interest income.

Amendment 21: Intra-bank loans

5.13 Proposed ***section 160ZZZ*** recognises, by way of legal fiction, borrowings by the Australian branch from the foreign bank which are recorded in the branch's accounting records as having been provided by the bank to the branch.

5.14 This amendment, which inserts ***new subsection 160ZZZ(2)***, simply ensures that a repayment of the borrowings, together with any foreign exchange gain or loss on repayment, is recognised when the transaction occurred.

Amendments 22, 23, 24, and 25: Technical amendments

5.15 The first three amendments, which are of a minor technical nature, will change the way proposed ***paragraph 160ZZZA(1)(c)*** is drafted to ensure that it has its intended effect. The provision, in simple terms, restricts the intra-bank interest which is recognised under the new Part to an amount of interest calculated using the interest London inter-bank offer rate (LIBOR). That means that if intra-banks funds are provided at a rate that is in excess of LIBOR the branch will be denied a deduction for the excess. In addition, interest withholding tax will not apply to the excess.

5.16 Amendment 23 will omit a reference to a paragraph in proposed ***section 160ZZZB*** which is no longer required.

Amendment 26: Thin capitalisation

5.17 Thin capitalisation is a term that refers to companies that are funded by an excessive amount of debt or borrowings and very little share or equity capital. The thin capitalisation rules contained in the Act are,

essentially, an anti-avoidance measure. The rules impose, in relation to related parties, a foreign debt to equity ratio.

5.18 Proposed ***section 160ZZZD***, as introduced, provides the foreign bank with an exemption from the thin capitalisation rules in relation to foreign debt provided to the Australian branch by non-resident associates of the bank.

5.19 This amendment will ensure that the exemption from the thin capitalisation rules is restricted to branches of the bank which are engaged in banking business.

Amendment 27: Notional derivative and foreign exchange transactions between branch and bank

5.20 Proposed ***section 160ZZZE*** recognises, for Australian taxation purposes, derivative product transactions between a foreign bank and its Australian branch. Proposed ***section 160ZZZF*** is a mirror provision which recognises foreign exchange transactions between the bank and the branch.

5.21 Both sections have been redrafted to ensure that only amounts which are shown in the branch's accounting records as payments or receipts in respect of the notional transactions are treated as if they were payments or receipts between separate entities. Payments and receipts thus recognised will be subject to the same tax accounting rules for the recognition of income and deductions which apply when similar amounts are paid and received by the branch in respect of derivative and foreign exchange transactions entered into with third parties.

Amendments 28 and 29: Withholding tax on interest paid by an Australian branch of a foreign bank to the foreign bank

5.22 These two amendments will correct a drafting oversight by including a reference to section 221YL in proposed ***subsections 160ZZZJ(1) and (2)***.

5.23 Proposed ***section 160ZZZJ*** sets out the method for determining the amount of interest withholding tax payable in respect of interest that is treated as paid by the Australian branch of the foreign bank to the bank.

5.24 The Bill, as introduced, correctly makes reference to section 128B, which is an operative provision which sets out the general rules relating to liability to withholding tax. However, a reference to section 221YL, which sets out the general rules relating to the collection of withholding tax, is also required.

5.25 These amendments will give the relevant provision its intended effect.

Amendment 30: Payment of insufficient or excess withholding tax

5.26 Proposed ***subsection 160ZZZJ(4)*** was originally included in the Bill to assist with the withholding tax reconciliation process at year's end when the branch's accounts were finalised. It provided a mechanism for dealing with discrepancies.

5.27 Because the general withholding tax collection provisions deal quite adequately with the reconciliation process and provision already exists for the payment of insufficient or excess withholding tax the proposed new provision is not needed.

5.28 This amendment will, therefore, omit the subsection as originally introduced.

Chapter 6

Amendment 31

Sales tax - Incentives for regional headquarters

Overview

6.1 The Bill provides for sales tax credits in certain circumstances to companies setting up regional headquarters in Australia, where the companies were approved for that purpose before 15 December 1993. This amendment will extend the application of the credit provisions to companies which obtain approval on or after 15 December 1993, and before the Bill receives the Royal Assent.

Explanation of the amendment

6.2 The amendment will replace the existing subclause 155(6) of the Bill, which contains the definition of 'pre-approved company'. The new definition of 'pre-approved company' will cover:

- companies which, before 15 December 1993, were granted written approval by the Treasurer, or another Minister, for either sales tax exemption or compensation for the cost of sales tax, on imported equipment which was owned by the company for at least 9 months before importation; and
- companies which, on or after 15 December 1993 and before the day that the Bill receives the Royal Assent, the Treasurer agreed in writing to give conditional approval as an 'RHQ company'.

6.3 A 'pre-approved company' or a group company of a 'pre-approved company' will be entitled to claim the credit on a dealing, if the dealing satisfies the terms of the credit ground.

6.4 The credit ground applies to dealings by a 'pre-approved company' which take place on or after 15 December 1993 and before the Royal Assent. However, a company cannot make a claim for a credit until after the Bill commences, namely the date that it receives the Royal Assent.