1990

THE PARLIAMENT OF THE COMMONWEALTH

OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAXATION LAWS AMENDMENT BILL (NO. 4) 1990

EXPLANATORY MEMORANDUM

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

13801/90 Cat. No. 90 4858 7

9 780644 150200

Printed by Authority by the Commonwealth Government Printer

TABLE OF CONTENTS

INDEX OF SPECIFIC MEASURES

* Main notes on clauses commence on this page

GENERAL OUTLINE

The Bill will amend the Income Tax Assessment Act 1936 -

- to amend the thin capitalisation rules:

  - .. to exempt certain nostro and vostro account balances (short-term clearance accounts) from the thin capitalisation calculations;

  - .. to exempt from the thin capitalisation foreign equity calculation certain securities that qualify for the section 128F withholding tax exemption;

  - .. to exempt short-term (not more than 30 days) trade credit from the thin capitalisation controls;

  - .. to allow the equity of certain foreign-owned resident holding companies in resident banks to be treated as foreign equity;

  - .. to provide an alternative method of measuring excess foreign debt.

- to modify the transitional arrangements accorded to gold miners in respect of the removal of their income tax exemption to:

  - .. provide by way of an option an alternative method to calculate residual eligible gold mining expenditure;

  - .. extend the transitional capital gains tax (CGT) treatment to all assets, whose disposal on or after 1 January 1991 falls within the CGT provisions, to ensure that any such gains or losses are only calculated prospectively from 1 January 1991;

  - .. enable gold miners to bring trading stock on hand at 1 January 1991 into account for the purposes of determining taxable income;

- to amend the dividend imputation rules to:

  - .. to provide for franking debits to arise when:

    - ... a company's liability to pay franking deficit tax is waived or reduced because the company has made an initial payment of tax under the new company tax collection system on the basis of its estimated tax liability;

... any part of an initial or subsequent payment of tax is refunded because it exceeds the company's tax liabilities;

... to change the way a franking debit arises when a subsequent payment of tax (other than a final payment) is credited or refunded by the Commissioner of Taxation;

.. to provide that the franking credit for an initial payment of company tax made during the year of income to which the payment relates arises in the following franking year;

. to ensure that any unrecouped excess exploration and prospecting expenditure incurred in relation to quarrying operations can be carried forward once the mining right to which the expenditure relates is sold.

. to introduce changes to the zone rebate arrangements by:

.. including Lord Howe Island and Nhulunbuy in the special area in Zone A and King Island and the Furneaux Group of islands in Zone B; and

.. increasing the dependants' component of the rebate for the special area in Zone B to the same level as that applying for the special area in Zone A (proposal announced in the Budget on 21 August 1990).

. to make a minor technical amendment to the provisions dealing with the disposal of contaminated live stock;

. to reflect changes in the names of organisations (the Australian College of General Practitioners and the Australian Sports Aid Foundation) currently listed in the income tax gift provisions;

The Bill will also make a minor technical amendment to Taxation Laws Amendment Act (No.2) 1990.

FINANCIAL IMPACT

The revenue effect of the thin capitalisation amendments, which are concessional in nature, is unquantifiable and not substantial.

The nature of the transitional arrangements for gold miners and the amendments to the imputation provisions are of such a nature that a reliable estimate of the potential revenue effect cannot be made.

The amendment relating to quarrying is not expected to produce any additional cost to the revenue over and above that previously estimated in August 1989 when the mining provisions were extended to include quarrying. This cost was estimated at $10 million in 1990-91 and 1991-92 and is expected to peak at $20 million later in the decade. There will be no cost to revenue in the 1989-90 year.

The amendments in relation to the zone rebate arrangements will have an estimated cost to revenue of $1 million in 1990-1991 and $3 million in subsequent years.

The amendments to the gift provisions to reflect chang s in the names of the Australian College of General Practitioners and the Australian Sports Aid Foundation will have no impact on revenue.

The other amendments proposed in the Bill will have no impact on revenue.

MAIN FEATURES

The main features of this Bill are as follows -

Thin Capitalisation Amendments

Amendments proposed in this Bill introduce amendments (announced 30 March 1989) to the thin capitalisation rules in Division 16F of Part III of the Income Tax Assessment Act 1936.

Nostro accounts
(Clauses 9, 10, 11, and 31)

Certain amounts owing that relate to nostro account balances are to be excluded from the measurement of foreign debt and foreign equity of a taxpayer who qualifies as a "financial institution" in terms of section 159GZA of the Income Tax Assessment Act 1936.

Financial institutions maintain foreign currency denominated accounts with related foreign banks, termed nostro accounts, for the purpose of clearing international transactions. There may be a delay of a day or more between a deposit into a nostro account and settlement of the relevant debt. Sometimes, due to error, deposits may not be received on time, requiring an overdraft advance by the foreign bank to settle a third party debt.

Under the existing legislation, a credit balance in a financial institution's nostro account cannot be offset against an amount of foreign debt owing to a foreign controller or non-resident associates prior to settlement. Any overdraft advances on a nostro account, at interest, to settle a third party debt would be foreign debt. A credit balance in such an account at the end of a financial institution's income year will be an equity loan back, as an amount owing by a foreign controller to an Australian financial institution.

Under the proposed amendments, where deposits to, and overdrafts on, a nostro account, termed "nostro amounts" are cleared within 10 days, these amounts will be excluded from the measurement of foreign debt of a financial institution. That is, the foreign debt is treated as being settled where a deposit has been made and settlement takes place within 10 days. Where an overdraft is raised to settle a third party transaction this is likewise excluded from the calculation, if the overdraft is repaid within 10 days.

A credit balance in a nostro account, pending settlement, at the end of a financial institution's income year, will not be treated as an equity loan back provided settlement takes place within 10 days of deposit.

It will be a condition for that treatment that the nostro account must be used for the sole purpose of settling international transactions. The exemption is to apply from the 1987-88 year of income.

Vostro accounts
(Clauses 9, 11 and 31)

Certain amounts owing that relate to vostro account balances are to be excluded from the measurement of foreign equity of a taxpayer who qualifies as a "financial institution" in terms of section 159GZA of the Income Tax Assessment Act 1936.

Offshore banks maintain Australian dollar accounts with resident financial institutions, called vostro accounts, for the purpose of settling international transactions. Settlement may not occur for a day or more after a deposit is made to a vostro account. An overdraft advance to settle third party debt may be required where, due to error, a deposit is not received on time.

Under the existing legislation, a related foreign bank's credit balance in a vostro account cannot be offset against an amount owing by it to the resident financial institution. If this occurs at the end of the financial institution's income year, its foreign equity in the resident financial institution will be reduced by the amount outstanding.

Under the proposed amendments, where deposits to, and overdrafts on, vostro accounts, termed "vostro amounts", are cleared within 10 days, these amounts will be excluded from the measurement of foreign equity, of a financial institution. That is, these debts are treated as being settled where a deposit has been made and settlement takes place within 10 days. Where an overdraft is advanced to settle a third party transaction this is likewise excluded from the calculation if the overdraft is repaid within 10 days.

This treatment will apply providing a vostro account is used for the sole purpose of settling international transactions. The exemption is to apply from the 1987-88 year of income.

Section 128F securities
(Clauses 9, 11, 12 and 31)

This amendment will exclude from the thin capitalisation foreign equity calculation certain debentures issued overseas that attract the section 128F withholding tax exemption. The exclusion will be limited to circumstances where such debentures are held for short periods by a related non-resident entity as dealer, manager or underwriter for the purpose of distribution overseas.

Under the current law, the amount borrowed under those debentures is, in the hands of the associate dealer etc., "an amount owing" to the resident company by the associate, in terms of section 159GZG of the Income Tax Assessment Act 1936. If this amount owing is outstanding at the end of the company's year of income, the foreign equity will be reduced by that amount.

The definition of foreign equity in section 159GZG will be amended to provide a limited exclusion for debentures that qualify for the section 128F withholding tax exemption. The exclusion will only operate if the debentures are placed in the market within 30 days of issue.

The amendment is to apply from the 1987-88 year of income.

Exemption for short-term trade credit amount
(Clauses 9, 11, 12 and 31)

The existing provisions for the measurement of "foreign equity" require that the equity be reduced by the balance outstanding at the end of the year of income on all amounts owing to a resident company, a trust, or a partnership by the foreign controller and non-resident associates, or by non-resident associates of a foreign investor.

The definition of foreign equity in section 159GZG of the Income Tax Assessment Act 1936 will be amended to exclude short-term trade credit arising from the export of goods or services. The credit period must not be more than 30 days from the date of invoice to qualify as short-term trade credit.

The amendment is to apply from the 1988-89 year of income.

Resident holding companies
(Clauses 13 and 31)

This amendment provides that a resident foreign-owned holding company which partly owns a resident bank will, in certain circumstances, be treated as being offshore for the purpose of measuring the equity of the bank.

The existing thin capitalisation rules enable wholly-owned company groups to consolidate their group debt and their foreign equity for the purpose of the debt:equity ratio test. However, because a partly foreign-owned bank and its resident holding company do not qualify as a resident company group in terms of section 159GZI of the Income Tax Assessment Act 1936, those companies are unable to consolidate their group debt and their foreign equity for the purpose of the debt:equity ratio.

As a consequence, a partly foreign-owned bank with direct borrowings from its foreign parent and non-resident associates has foreign debt but no foreign equity. The net result, under the present law, is that no deduction would be allowed for the interest expense of the bank in relation to the foreign debt.

The proposed amendment will allow the holding company's equity in the resident bank to be treated as foreign equity. A precondition for the application of this amendment will be that the holding company does not have any interest bearing debt. The notional "foreign equity" of the resident bank will be reduced by any interest free debt owing by the holding company to its foreign controller or associates.

The amendment will apply from the 1987-88 year of income.

Alternative measurement of excess foreign debt
(Clauses 14, 15, 16, 17, 18 and 31)

Sections 159GZS to 159GZX of the Income Tax Assessment Act 1936 operate to reduce the amount of the deduction that would otherwise be allowable for "foreign debt interest" of a resident company, a partnership, a trust estate or a foreign investor respectively, where the debt:equity ratio prescribed by Division 16F has been exceeded for the year of income.

Under the existing rules foreign debt for a year of income is measured as the greatest total of foreign debt at any time throughout the year of income.

The thin capitalisation rules will be amended to provide an alternative measurement of excess foreign debt. The alternative test will calculate excess foreign debt by applying a weighted average for those days of the year in which the permitted debt:equity ratio is exceeded.

Taxpayers will have the option to use the alternative method of measurement of foreign debt for each year of income. An election to adopt the alternative method may be made at the time of lodgment of the taxpayer's return of income or within such further time as the Commissioner of Taxation allows. Only one method of excess foreign debt measurement may be used for a year of income, or for a part year of income to which section 159GZR of the Income Tax Assessment Act 1936 applies.

Where a taxpayer fails to notify the Commissioner of Taxation of the method of measurement of excess foreign debt, the calculation will be made under the method currently set out in Subdivision C of Division 16F of the Income Tax Assessment Act 1936.

The amendment will apply from the 1988-89 year of income.

Gold mining transitional arrangements
(Clauses 19, 20, 23 and 31)

The Bill will modify the application of the transitional arrangements for gold miners, contained in Division 16H of the Income Tax Assessment Act 1936 which removes their income tax exemption with effect from 1 January 1991. The transitional arrangements provide certain concessional relief to ease the impact of the removal of the exemption. The Bill will amend these arrangements to provide an alternative method to calculate residual eligible gold mining expenditure, extend the application of capital gains tax (CGT) transitional provisions and make provision for the treatment of trading stock.

The Bill proposes that, for the purposes of determining the residual eligible gold mining expenditure, a taxpayer be given an option, in respect of all eligible gold mining expenditure on the mining property, to use the actual number of years the mine has been in operation plus the estimate of the future life of the mine held at the end of the 1991 year of income. The existing transitional provisions will continue to enable a taxpayer to use the estimates of the mine life held in the relevant earlier years of income. This is consistent with the treatment accorded to such expenditure in the general mining provisions.

The Bill will also extend the general application of the CGT transitional arrangements to ensure that gold mining assets generally, other than certain exempt mining rights, qualify for the concessional treatment. This treatment allows gains to be determined prospectively from 1 January 1991 in respect of disposals of certain gold mining assets after 31 December 1990. The existing arrangements only apply in respect of certain eligible gold mining and eligible gold transport assets.

Consistent with the treatment of capital gains, the Bill also proposes an amendment which will calculate certain capital losses prospectively from 1 January 1991 where the disposal of the asset is subject to the CGT provisions, i.e. purchased after 19 September 1985 and disposed of on or after 1 January 1991.

To ensure that gold miners are able to calculate their net taxable income for the changeover year of income on a realistic basis, the Bill proposes amendments which will enable taxpayers to utilise the existing trading stock provisions. Gold miners will be able to bring stock on hand at the end of 31 December 1990 into account for the purposes of determining taxable income in a similar way as other taxpayers, either at cost, market or replacement value. The amendments will also ensure that these stock values are used in the calculation of net exempt income for the part of the changeover year of income prior to 1 January 1991 so that it is consistent with the calculation of taxable income for the remaining period.

An anti-avoidance measure is also proposed which will apply in respect of the first year of income and will ensure that no manipulation of stock values occurs. Where the closing stock of the taxpayer includes an item which was brought into account at 1 January 1991, the value adopted at that date will be the value at which it is returned for closing stock purposes.

Imputation provisions
(Clauses 24, 25, 26, 27, 29, 32, 33, 34 and 35)

This Bill will make amendments to the imputation system to remove some unintended consequences that arose from the introduction of a new system for collecting tax paid by companies, superannuation funds and similar entities on income derived during the 1989-90 and subsequent income years. These proposed amendments relate to the imputation system and consequently affect only companies and trusts that are treated as companies.

Under the new company tax collection system most companies are required to make an initial payment of tax of 85% of their notional income (generally the taxable income of the previous year of income), or an estimate of the actual tax liability for the year of income, no later than 28 July following the end of the year. Companies that do not have to make an initial payment of tax are those whose tax liability is less than $1000 or that are eligible to elect to make a single payment of tax because their tax liability falls within certain limits. Modified rules apply for companies that have adopted substituted accounting periods which have the effect of aligning the dates on which tax payments, etc. are due to those applying companies that balance on 30 June.

Under the existing law where the company has a franking deficit tax liability and makes its initial payment of tax on the basis of its estimated tax liability, the liability to pay franking deficit tax to the extent of that initial payment is waived. Although a franking credit arises when the initial payment of tax is made, no franking debit arises for the amount of that initial payment that is used to waive the franking deficit tax liability. Similarly, there is no provision for a franking debit to arise when an initial or subsequent payment of tax is refunded.

The existing law treats a subsequent payment of tax that is not a final payment as an initial payment for franking debit purposes. For franking credit purposes subsequent payments are treated as being quite separate from initial payments.

The amendments proposed by this Bill will result in franking debits arising when an initial payment of tax is applied to waive a liability for franking deficit tax and when an initial or subsequent payment of tax is refunded. These measures will apply from the day the Bill receives Royal Assent and any franking debits that would have arisen if the legislation had been in place earlier will arise on that day. Any companies that incurred a franking debit for underfranking as a consequence of anticipating these amendments taking effect will be compensated by way of a franking credit. Any such companies will suffer no disadvantage.

Other amendments proposed by this Bill will modify the way in which a franking debit arises when a subsequent payment of tax is applied, and will prevent an initial payment of tax made during the year to which the payment relates from giving rise to franking credits in that year. These franking credits will arise in the following franking year.

Quarrying
(Clauses 8 and 31)

The Bill will effect a minor technical amendment to Subdivision B of Division 10 of the Income Tax Assessment Act 1936, which deals with quarrying operations, that was inserted in the Income Tax Assessment Act 1936 by section 22 of Taxation Laws Amendment Act (No.2) 1990. It will clarify the treatment of unrecouped exploration and prospecting expenditure for quarrying where the mining right to which the expenditure relates is sold or is disposed of, etc.

The amendment will ensure that the excess unrecouped exploration and prospecting expenditure when the mining right is disposed of is only reduced by the amount of income, if any, which was exempt from tax by paragraph 23(pa). Any remaining unrecouped exploration and prospecting expenditure in respect of that right may be carried forward for deduction in subsequent years against income from any source.

The amendment will apply to exploration and prospecting expenditure incurred on or after 16 August 1989 which is the date of effect of the original amendment extending the general mining provisions to include quarrying operations.

Rebates for residents of isolated areas
(Clauses 7, 30 and 31)

The Bill will give effect to the proposal announced in the 1990-91 Budget to amend the income tax zone rebate arrangements, in response to a Review of Income Tax and Social Security Arrangements in Remote Areas.

Under the existing law, residents of the special area in Zone B are eligible for a rebate in respect of a year of income of $938 plus 20% of the relevant rebate amount. (The relevant rebate amount is calculated by reference to a taxpayer's dependants). This Bill proposes to increase the part of the zone rebate that is based on the rebates in respect of a taxpayer's dependants from 20% to 50% of the relevant rebate amount. This means that the level of rebate for residents of the special area in Zone B will be the same as that for residents of the special area in Zone A.

The Bill also proposes to include Lord Howe Island in Zone A. This means that due to its distance from the nearest population centre of 2,500 or more, it will be treated as being in the special area in Zone A. Further, Nhulunbuy in the Northern Territory is to be included in the special area in Zone A (currently it is in Zone A) and King Island, Tasmania and the Furneaux Group of islands, Tasmania are to be included in Zone B (currently these islands are not in a zone). These amendments mean that the residents of the relevant areas either become eligible for a zone rebate or for an increase in the amount of the zone rebate.

These changes will apply to assessments in respect of income of the 1990-91 and subsequent years of income.

Taxation treatment of profits and proceeds from the disposal of live stock due to contamination
(Clauses 5 and 31)

The Bill will make a minor technical amendment to subsection 36AAA(24) to allow an election for a year of income to be made when live stock is disposed of rather than when destroyed.

Gifts
(Clauses 6 and 31)

At present gifts to the Australian College of General Practitioners are allowable deductions for income tax purposes under the gift provisions of the Income Tax Assessment Act 1936 where the gifts are for the purpose of education or research in medical knowledge or science. Gifts to the Australian Sports Aid Foundation are also allowable deductions under the gift provisions of the Income Tax Assessment Act 1936.

The College changed its name on 23 June 1970 to the Royal Australian College of General Practitioners and the Foundation changed its name on 2 August 1989 to the Australian Sports Foundation. This Bill will amend the gift provisions so that gifts to the renamed organisations are deductible from the date on which they changed their names.

Simplified form of reference to "year of income"
(Clause 4)

This Bill will introduce a new form of reference to a particular "year of income" in the Income Tax Assessment Act 1936 intended to simplify the drafting process.

Initial payment of tax
(Clause 28)

The Bill will amend collection provisions relating to companies and certain funds in the Income Tax Assessment Act 1936 to make it more clear that an initial payment of tax, due 28 days after the end of a year of income, is due and payable on the relevant day.

Amendment of the Taxation Laws Amendment Act (No.2) 1990
(Clauses 37 & 38)

The Bill will also make an amendment to correct a drafting error that occurred when amending a definition in Taxation Laws Amendment Act (No.2) 1990.

A more detailed explanation of the provisions of the Bill is contained in the following notes.

PART 1 - PRELIMINARY

Clause 1 : Short title

This clause provides for the amending Act to be cited as the Taxation Laws Amendment Act (No.4) 1990.

Clause 2 : Commencement

Subject to subclause 2(2), the amending Act is, by subclause 2(1), to commence on the day on which it receives the Royal Assent. But for this subclause, the Act would, by reason of subsection 5(1A) of the Acts Interpretation Act 1901, commence on the twenty-eighth day after the date of Assent.

Clause 2 : Commencement

By subclause (2), Part 3 of the Bill dealing with an amendment of the Taxation Laws Amendment Act (No. 2) 1990 is to be taken to have commenced when section 4 of that Act commenced (i.e., 16 June 1990).

PART 2 - AMENDMENT OF THE INCOME TAX ASSESSMENT ACT 1936

Clause 3 : Principal Act

This clause facilitates reference to the Income Tax Assessment Act 1936 which, in this Part, is referred to as "the Principal Act".

Clause 4 : Interpretation

This clause amends section 6 of the Principal Act by inserting a new subsection (2A). The new subsection proposes to define a form of reference using words and numbers to be used in the Principal Act to define the reference to a particular year of income. The new form of reference will simplify the drafting process. Instead of referring to a year of income as, for example, "the year of income commencing on 1 July 1990", it will be referred to as "the 1990-91 year of income".

Clause 5 : Alternative election in case of disposal, death or compulsory destruction of live stock

This clause rectifies a technical defect which occurred in drafting subsection 36AAA(24) of the Principal Act. The subsection defines, for the purposes of the section, the year of income to which an election under subsection 36AAA(1AA) relates.

As a result of the amendment proposed by this clause, the year of income is defined as the year of income in which the live stock affected by the election were disposed of rather than destroyed.

Clause 6 : Gifts, Pensions etc.

This clause will amend section 78 of the Principal Act which authorises income tax deductions for gifts of the value of $2 and upwards of money - or certain property other than money - made to the funds, authorities and institutions that are listed in that section.

Subparagraph 78(1)(a)(xxxvi) authorises a deduction for gifts to the Australian College of General Practitioners where the gifts are for the purpose of education or research in medical knowledge or science. Paragraph (a) of clause 6 will change the reference to the Australian College of General Practitioners to the Royal Australian College of General Practitioners which is now the registered name for that body. By the operation of subclause 6(a), a deduction will be available for gifts made to the renamed organisation on or after 23 June 1970, which is the date on which the College changed its name.

Subparagraph 78(1)(a)(lxxxiv) authorises a deduction for gifts to the Australian Sports Aid Foundation. The amendment made by paragraph (b) of clause 6 will change the reference to the Australian Sports Aid Foundation to the Australian Sports Foundation which is now the registered name for that body. By the operation of subclause 6(b), a deduction will be available for gifts made to the renamed organisation on or after 2 August 1989, which is the date on which the Foundation changed its name.

Clause 7 : Rebates for residents of isolated areas

This clause proposes to amend section 79A of the Principal Act. First, to increase the dependant component of the zone rebate available to residents of the special area in Zone B from 20% of the relevant rebate amount to 50% of that amount. Secondly, to include Nhulunbuy, Northern Territory, in the special area in Zone A instead of Zone A as at present.

Existing paragraph 79A(2)(a) sets out the rebate to be allowed to a taxpayer who qualifies as a resident of the special area in Zone A. Paragraph (a) of clause 7 proposes to include a reference to the special area in Zone B in paragraph 79A(2)(a). This means that the rebate available to a resident of the special area in Zone B will be $938 plus 50% of the "relevant rebate amount". Relevant rebate amount is defined in subsection 79A(4) and broadly means the sum of the rebates for a taxpayer's dependants, including any sole parent rebate and any rebate in respect of a housekeeper.

Paragraph (b) of clause 7 proposes to omit paragraphs 79A(2)(b) and (c). This amendment is consequential upon the insertion of the special area in Zone B in paragraph 79A(2)(a). Paragraph 79A(2)(b) applied

to allow a rebate where a taxpayer was a resident of the special area in Zone B in a year of income and had not resided or actually been in Zone A during that year. This paragraph is no longer needed as these taxpayers will now be within the operation of paragraph 79A(2)(a). Paragraph 79A(2)(c) applied where, during a year of income, a taxpayer was a resident of Zone A and also resident of the special area in Zone B. This paragraph was needed because it would have been possible, depending on the taxpayer's dependants, for the Zone A rebate of $270 plus 50% of the relevant rebate amount, to be greater than the rebate of $938 plus 20% of the relevant rebate amount available for residents of the special area in Zone B.
Paragraph 79A(2)(c) is no longer needed as the percentage of the relevant rebate amount taken into account, is to be the same.

Existing subsection 79A(3D) defines the special areas within Zone A and Zone B, residents of which are entitled to a higher rebate. The special area is constituted by points within Zone A or Zone B that, as at 1 November 1981, were in excess of 250 kilometres by the shortest practicable surface route from the centre point of the nearest urban centre (whether or not within a zone) with a population of 2,500 or more. 1981 census data (or 1976 data in certain circumstances) is used to identify such centres.

Nhulunbuy, located on the north eastern edge of Arnhem land in the Northern Territory, is considered to be a particularly isolated area. However, as it has a census population in excess of 2,500, it and locations within its surrounding area, fall under the existing law in Zone A and not the special area in Zone A. Paragraph (c) of clause 7 proposes to insert new subsection 79A(3F) which deems Nhulunbuy to have a census population of less than 2,500 so that it will qualify as a special area in Zone A. Accordingly, residents of Nhulunbuy (and other areas taken to be in Zone A but not the special area in Zone A because Nhulunbuy has a population in excess of 2,500) will be eligible for the higher rebate of $938 plus 50% of the relevant rebate amount.

By subclause 5 of clause 31, the amendments to section 79A apply to assessments in respect of income of the 1990-91 year of income and subsequent years of income.

Clause 8 : Exploration and prospecting expenditure

Introductory Note

This clause proposes a minor amendment to rectify a technical deficiency in section 122JF of the Principal Act. Section 122JF allows exploration and prospecting expenditure, incurred to obtain materials by quarrying operations, to qualify for a deduction. This deduction can be carried forward to subsequent years even following the disposal of the mining right to which the expenditure relates. It is identical in application to section 122J, exploration and prospecting expenditure for mining operations, with one minor variation.

Where the mining right is disposed of, subsection 122JF(8) will reduce the exploration and prospecting expenditure available to be carried forward by the entire amount of any unrecouped exploration and prospecting expenditure in respect of that mining right, rather than by the amount of any exempt income derived in accordance with paragraph 23(pa).

Paragraph 23(pa) provides an exemption from tax for income derived by a bona fide prospector from the sale, transfer, assignment etc. of a right to mine. The paragraph also extends to taxpayers who derive income from the sale etc. of a right to mine for quarry materials which are also prescribed metals or minerals. Subparagraph 23(pa)(iii) limits the amount of income which qualifies for exemption to the excess of any deductions which are available or were allowed to the taxpayer in respect of exploration and prospecting expenditure incurred in relation to that mining right.

Section 122JF

Subsection 122JF(8) will be amended to include the phrase "that does not exceed the exempt income". This amendment will ensure that the amount of exploration and prospecting expenditure which a taxpayer is able to carry forward for deduction to a subsequent income year is reduced only by the amount of any exempt income derived in relation to the disposal of that right.

In other words, the amendment will ensure that any reduction in exploration and prospecting expenditure available to be carried forward, is equal to the applicable amount of exempt income determined in accordance with paragraph 23(pa), rather than the entire amount of excess unrecouped exploration and prospecting expenditure in respect of that right.

This will ensure consistency in the treatment of taxpayers engaged in mining and quarrying operations.

Clause 9 : Interpretation

Section 159GZA of the Principal Act sets out definitions of terms used in that Act. This clause will amend section 159GZA by inserting a number of new definitions. Each defined term is to have the given meaning unless the contrary intention appears.

"foreign bank" is defined to mean a non-resident company that is engaged in a banking business (within the ordinary meaning of that expression).

"nostro account" applies in relation to a financial institution and means an account held by the financial institution with a related foreign bank where both of the following conditions are satisfied:

- the account must be operated for the sole purpose of settling international transactions (paragraph (a)); and
- the account is maintained on the following basis:
  - deposits are cleared within 10 days (subparagraph (b)(i)); and
  - overdraft advances on the account are repaid within 10 days (subparagraph (b)(ii)).

"nostro amount" is defined in relation to a financial institution to mean an amount to satisfy a debt owed by the financial institution which is either:

- held in a nostro account in relation to the financial institution (paragraph (a)); or
- is an overdraft advance on a nostro account in relation to the financial institution (paragraph (b)).

"section 128F debenture amount" has the meaning given by proposed section 159GZJA (see notes on clause 12).

"short-term trade credit amount" has the meaning given by proposed section 159GZJB (see notes on clause 12).

"vostro account" applies in relation to a financial institution and means an account held by a related foreign bank with the financial institution where both of the following conditions are satisfied:

- the account must be operated for the sole purpose of settling international transactions (paragraph (a)); and
- the account is maintained on the following basis:
  - deposits are cleared within 10 days (subparagraph (b)(i)); and

.. overdraft advances on the account are repaid within 10 days (<u>subparagraph (b)(ii)</u>).

"<u>vostro amount</u>" is defined in relation to a financial institution to mean an amount to satisfy a debt owed to the financial institution which is either:

. held in a vostro account in relation to the financial institution (<u>paragraph (a)</u>); or

. is an overdraft advance on a vostro account in relation to the financial institution. (<u>paragraph (b)</u>).

<u>Clause 10 : Foreign debt</u>

This clause will amend subsection 159GZF(1) to enable a "nostro amount" of a financial institution held with a related foreign bank to be excluded from the definition of "foreign debt".

Under the existing legislation, an amount owing by a financial institution to a foreign bank, being a foreign controller or non-resident associate, would be foreign debt in terms of section 159GZF of the Principal Act. This result would not be disturbed though there is an amount in a nostro account which is in effect owed by the foreign bank to the financial institution. An overdraft advance at interest by a foreign bank on a financial institution's nostro account to settle the financial institution's third party debt would also fall within the definition of foreign debt.

The amendment proposed by this clause will exempt "nostro amounts" from the definition of foreign debt in section 159GZF. A "nostro amount" is defined in clause 9 (see notes on that clause), as is the term "nostro account". For the purposes of Division 16F, a "nostro account" is a foreign currency denominated account held by a financial institution with a foreign bank for the <u>sole purpose</u> of settling international transactions. These accounts must be operated on the basis that deposits are not held in the account for more than 10 days, and that an overdraft is repaid within 10 days.

The effect of this amendment is to ensure that nostro amounts of a financial institution do not count as foreign debt for the purpose of the thin capitalisation rules.

<u>Example 1</u> :

Assume a resident financial institution is required to repay foreign debt to a foreign bank (foreign controller) on the first of the month and that a deposit was made on that day by the financial institution to its nostro account with that bank. Settlement of the debt does not occur, however, until 5 days later due to oversight by the foreign bank. Under the amendments the deposit would qualify as a nostro amount and the debt would be treated as settled on the day of deposit as clearance occurred within 10 days of deposit.

Example 2 :

Assume that a resident financial institution is a counterparty to a foreign exchange transaction to be settled through its nostro account with a foreign bank and that the funds are transmitted to the wrong bank. Where an error such as this occurs the foreign bank may provide funds at interest to cover the deficiency. If the overdraft advance on the nostro account is repaid within 10 days, the amount will qualify as a nostro amount and be exempted from the scope of foreign debt under section 159GZF of the Principal Act.

Clause 11 : Foreign equity

Clause 11 will amend section 159GZG of the Principal Act, to exclude from the measurement of foreign equity "vostro amounts" in relation to a financial institution, "an amount standing to the credit of a nostro account in relation to the financial institution", "section 128F debenture amounts" and "short-term trade credit amounts".

Existing section 159GZG defines foreign equity, broadly, along the lines of the shareholders' funds concept found in company accounts. Under subsection 159GZG(1) the foreign equity of a resident company comprises the sum of the interests of foreign controllers and their non-resident associates in the paid-up capital, share premium accounts, accumulated profits and asset revaluation reserves and is reduced by prescribed amounts. In particular, paragraph 159GZG(1)(d) reduces the amount of equity by the balance outstanding at the end of the year of income on all amounts owing to the company by its foreign controllers or non-resident associates (equity loan back).

Paragraph (a) of clause 11 will replace the existing paragraph 159GZG(1)(d) with a new paragraph 159GZG(1)(d) which will have the same general application except that it will effectively exclude from the amounts owing for that purpose the following amounts:

- in relation to a company that is a financial institution - vostro amounts (as defined in clause 9 - see notes below and notes on that clause) - (subsubparagraph (d)(i)(A));

- in relation to a company that is a financial institution - a credit amount in a nostro account (as defined in clause 9 - see notes below and notes on that clause)- (subsubparagraph (d)(i)(B));

- section 128F debenture amounts (see notes on clause 12 - (subparagraph (d)(ii)); and

- short-term trade credit amounts (see notes on clause 12) - (subparagraph (d)(iii)).

Vostro amounts (new subsubparagraph (d)(i)(A))

Under existing paragraph 159GZG(1)(d) amounts owing by a foreign controller or non-resident associate to a financial institution may be deducted from the amount of foreign equity as described above. This result would not be disturbed if the foreign controller or non-resident associate was a foreign bank which held a deposit in a vostro account with the financial institution for the purpose of settling the debt. An overdraft advance on a vostro account provided by a financial institution to settle a related foreign bank's third party transaction will be an equity loan back if it occurs at the end of the income year measurement point.

By this amendment the definition of foreign equity in section 159GZG will exclude a "vostro amount" from th measurement of foreign equity. A "vostro amount" is defined in clause 9 (see notes on that clause), as is a "vostro account". For the purposes of Division 16F, a "vostro account" is an Australian dollar denominated account, held by a foreign bank with a resident financial institution for the sole purpose of settling international transactions. These accounts must be operated on the basis that deposits are held in the account for no more than 10 days and an overdraft is repaid within 10 days.

The effect of this amendment will thus be that a "vostro amount" in relation to an amount owing by the foreign bank will be excluded from the measurement of foreign equity in relation to a financial institution.

Credit amount in a nostro account
(new subsubparagraph (d)(i)(B))

Under the existing paragraph 159GZG(1)(d) a credit balance in a financial institution's nostro account at the end of its income year, the foreign equity measurement point, would be an equity loan back. This can occur where a deposit is made by a financial institution into a nostro account to settle an international transaction and clearance is delayed for a day or more.

Under this amendment the credit will not be treated as an equity loan back. The deposit must comply with the essential elements of a nostro account: that the account is operated for the sole purpose of settling international transactions and deposits are cleared within 10 days.

Example:

Assume a financial institution deposits $US500,000 into its nostro account with a related foreign bank (foreign controller) in New York, a day before its income year ends, to settle a debt to a third party. Assume further that settlement of the debt does not occur until 4 days after deposit. Under this amendment the credit balance pending settlement would not be treated as an equity loan back.

Paragraphs (b), (c) and (d) of clause 11 complement the exclusion by new subparagraph 159GZG(1)(d)(iii) of "short-term trade credit amounts" from the measurement of foreign equity in relation to a company. They will amend existing subsections 159GZG(3) (relating to partnerships), (4) (relating to trust estates), and (5) (relating to foreign investors) respectively, to similarly exclude "short-term trade credit amounts" from the measurement of foreign equity.

Under subsection 159GZG(3) of the Principal Act, "foreign equity", in relation to a partnership, is calculated by reference to partner's equity shown in a notional balance sheet of partnership property used to produce Australian-sourced assessable income of foreign controllers' and their non-resident associates reduced by the balance of any amounts owing to the partnership by the foreign controllers and their non-resident associates.

Paragraph (b) amends subsection 159GZG(3) to exclude a "short-term trade credit amount" from the balance of amounts owing by foreign controllers and non-resident associates. That is, a "short-term trade credit amount", within the meaning of proposed section 159GZJB, owing to a partnership by foreign controllers and non-resident associates will not reduce the foreign equity of the partnership.

Subsection 159GZG(4) of the Principal Act sets out the method for determining "foreign equity" in relation to trust estates. Foreign equity is calculated by reference to beneficiaries' equity shown in a notional balance sheet of trust property used during the year of income to produce Australian-sourced assessable income of foreign controllers and their non-resident associates. The beneficiaries' equity is reduced by the outstanding balance owing to the trustee by foreign controllers and non-resident associates.

Paragraph (c) of clause 11 amends subsection 159GZG(4) to exclude short-term trade credit amounts from the balance outstanding on amounts owing to the trustee by foreign controllers and non-resident associates. That is, a "short-term trade credit amount" within the meaning of proposed section 159GZJB will not reduce the foreign equity of the trust estate.

Existing subsection 159GZG(5) applies to certain foreign investors who are non-resident individuals or companies. It sets out the method for determining "foreign equity" of foreign investors who are not partners in a partnership, or trustees or beneficiaries of a trust estate. The foreign investor's equity is the amount that would be shown as that investor's equity if a notional balance sheet were prepared in relation to the foreign investor's activities in producing assessable income in Australia. The foreign investor's equity, reduced by the balance outstanding on amounts owing to the foreign investor by non-resident associates, is the "foreign equity".

Paragraph (d) of clause 11 amends subsection 159GZG(5) to provide an exclusion for "short-term trade credit amounts" in similar terms to proposed paragraph (c).

Clause 12 : Section 128F debenture amount; Short-term trade credit amount

The amendments proposed by clause 12 will insert two new sections - section 159GZJA and section 159GZJB - in the Principal Act.

New section 159GZJA, together with the proposed amendments in clause 9 and clause 11 (see notes on those clauses), will exclude from the thin capitalisation foreign equity calculation certain securities that qualify for the section 128F withholding tax exemption. That exclusion will apply where the securities are held by a foreign controller or non-resident associate, of a resident company who acts in the capacity of manager, underwriter or dealer, for a period of not more than 30 days following issue.

New section 159GZJA prescribes, for the purposes of Division 16F, that an amount owing to a resident company at a particular time will qualify as a "section 128F debenture amount" if it satisfies all of the tests set out in the section. A debenture that satisfies all of these tests will be excluded from the measurement of "foreign equity" in section 159GZG of the Principal Act.

Clause 12 will also insert new section 159GZJB which, together with the amendments proposed by clause 9 and clause 11 (see notes on those clauses), will exempt from the measurement of foreign equity short-term (not more than 30 days) trade credit amounts.

New subsection 159GZJB(1) prescribes, for the purposes of Division 16F, the circumstances in which an amount owing at a particular time to a resident company, a partnership, or a trustee of a trust estate is "a short-term trade credit amount". To qualify under this section, an amount owing must satisfy certain tests set out in the subsection.

New subsection 159GZJB(2) similarly, prescribes the circumstances in which an amount owing to a foreign investor by a non-resident associate is "a short-term trade credit amount".

New subsection 159GZJB(3) is an interpretative provision directing that the terms "provide" and "services" as used in subsection 159GZJB(1) and (2) are defined by reference to section 21A of the Principal Act.

Clause 13 : Adjustment of foreign equity in certain cases involving resident holding companies of financial institutions

The amendment proposed by clause 13 will insert a new section - section 159GZLA - in the Principal Act. This amendment will provide a particular form of debt:equity ratio calculation for certain foreign controllers with Australian equity in their resident operating banks. Where a foreign controller and its associates own all the shares of a resident holding company, the equity of that holding company in the resident bank will be treated as "foreign equity".

New subsection 159GZLA(1) provides the conditions under which a resident company (bank) will qualify for this particular method of measuring foreign equity in relation to a year of income. The conditions are cumulative tests and must be satisfied at all times during a year of income in which the company was in existence. (See in that respect, the notes below on new subsections 159GZLA (2) and (3) regarding incorporated but dormant companies.) To qualify under this section, a resident company (referred to as the "resident financial company") must satisfy the following conditions:

- it is a bank within the meaning of the Banking Act 1959 (paragraph (a)). In that Act, the term "bank" means a body corporate authorised to carry on a banking business in Australia; and

- the foreign controller of the resident financial company is its only foreign controller (paragraph (b)).

In addition, the conditions with respect to the onshore holding company, referred to as the "resident holding company", are:

- it is not a financial institution as defined in section 159GZA of the Principal Act (subparagraph (c)(i));
- it does not have any interest bearing debts (subparagraph (c)(ii));
- it is wholly owned by its foreign controller, or by the foreign controller and associates (subparagraph (c)(iii));
- it beneficially owns some, but not all, of the shares in the resident financial company (subparagraph (c)(iv)).

Where all of the above conditions are satisfied the following provisions are brought into operation:

- the resident holding company will be treated, for the purpose of section 159GZE(1), as though it were a non-resident (paragraph (d)); and
- if at the end of a resident holding company's year of income (the measurement point of foreign equity under section 159GZG of the Principal Act) it owes interest free debt to a foreign controller or non-resident associate, this amount must be subtracted from the notional foreign equity in relation to the resident financial company (paragraph (e)).

New subsections 159GZLA(2) and (3) relate to the requirement in subsection (1) that the conditions it contains must be satisfied at all times during a year of income when the resident financial company was in existence. They provide that a company is to be treated as being in existence if it has been incorporated and has not been dissolved, but not for any period that the company is dormant within the meaning of Part VI of the Companies Act 1981.

Clauses 14, 15, 16, 17, and 18: Introductory Note

The amendments proposed by the abovementioned clauses provide an alternative measurement of excess foreign debt for calculating the amount of foreign debt interest not allowable as a deduction.

Clause 14 : Resident companies

Clause 14 will amend section 159GZS of the Principal Act. This section operates to reduce the amount of the deduction that would otherwise be allowable in the year of income for "foreign debt interest" of a resident company where the debt:equity ratio limit prescribed by Division 16F is exceeded.

Paragraph (a) of clause 14 inserts new paragraph 159GZS(1)(aa), which directs that the formula presently contained in subsection 159GZS for measuring the amount of foreign debt interest for a year of income that is not allowable as a deduction is to only apply where new subsection 159GZS(2) does not apply. By this amendment and those contained in paragraph (b) of clause 14, a taxpayer will be given an option to use an alternative method of measuring excess foreign debt.

Paragraph (b) inserts into section 159GZS new subsections (2), (3), (4), and (5).

New subsection (2) is relevant to the calculation of the foreign debt interest of a resident company for a year of income. It provides that where the company makes an election under new subsection (5), the amount of excess foreign debt interest for which an allowable deduction is to be denied, will be determined in accordance with the formula contained in new subsection (3).

New subsection (3) sets out the formula to be used for determining the portion of foreign debt interest that is not allowable as a deduction in accordance with subsection (2).

New subsection (4) directs that, for the purposes of section 159GZS, a day will be an "excess foreign debt day" of the taxpayer in relation to the year of income if the total foreign debt of the taxpayer in relation to the particular day exceeds the foreign equity product of the taxpayer of the year of income.

On the basis that the accounts give a true and fair view of the financial position of the company, the total foreign debt in respect of a day will be measured by what is shown in the accounts. For example, if interest is payable on a daily balance, the closing balance for the day would generally be an appropriate measure. On the other hand, if interest is payable for periods of less than a day, the measure must reflect that fact.

New subsection (5) sets out the time by which an election to use the alternative formula contained in subsection (3) for measuring the amount of excess foreign debt interest for a year of income must be lodged with the Commissioner of Taxation. This is no later than the lodgment date of the taxpayer's return of income for the later of the following years of income:

- the year of income to which the election relates (paragraph (a));
- the year of income in which new subsection (5) commenced (paragraph (b));

or within such further period as the Commissioner allows.

It should be noted that, in calculating the foreign debt or the foreign equity product for the purpose of Subdivision C of Division 16F, the foreign debt owing to, and foreign equity of, foreign controllers and their non-resident associates must be aggregated. For example, a taxpayer who has three foreign controllers would, throughout the year, aggregate the foreign debt from its foreign controllers to establish its foreign debt for that year. Similarly, the equity of all foreign controllers would be aggregated when establishing the foreign equity and the foreign equity product of the company for the year of income.

Example

Assume that a foreign controlled resident manufacturing company has $100,000 foreign equity. The company's foreign equity product is $300,000 (ie $100,000 x 3). The foreign equity product is exceeded on 36 days during the year, with a high point of daily foreign debt of $400,000 on 1 day and $350,000 for 35 days. The company's average daily foreign debt for the year is $250,000. The foreign debt interest for the year is $30,000. The company elects pursuant to new subsections 159GZS(2) and (5) to use the alternative method of calculating excess foreign debt provided in new subsection 159GZS(3).

The amount of foreign debt interest that is not allowable as a deduction is calculated as follows:

Step 1

Average daily foreign debt for excess foreign debt days is:

$$= \frac{(400{,}000 \times 1) + (350{,}000 \times 35)}{36} = 351{,}389$$

Step 2

The portion of foreign debt interest that is disallowed is:

$$\frac{351{,}389 - 300{,}000}{250{,}000} \times \frac{36}{365} = 0.0203$$

Step 3

The disallowed interest deduction is the total foreign debt interest by the disallowed portion:

$30,000 x 0.0203 = $609

Clause 15 : Resident company groups

Clause 15 will amend section 159GZT of the Principal Act, which contains the formula for calculating the amount of foreign debt interest not allowable as a deduction for companies that are members of a resident company group.

Whether companies qualify as members of a resident company group is determined under existing section 159GZI, broadly by reference to the tests in section 80G (the company group loss provision). Only resident companies are taken to be part of a group.

Section 159GZT operates to reduce the foreign debt interest deduction otherwise allowable to members of a resident company group where the greatest total foreign debt of all members of the group exceeds the foreign equity product of the group member having foreign equity. Foreign debt may be provided directly to any member of the resident company group even though only one company in the group will have foreign equity.

Clause 15 amends section 159GZT to provide an alternative method of determining the amount of foreign debt interest that is not allowable. This amendment is, in its operation, broadly equivalent to the amendments to section 159GZS, but as discussed above, it applies to a resident company group as a whole, rather than separately to each company.

Paragraph (a) of clause 15 inserts new paragraph 159GZT(1)(aa), which directs that the formula presently contained in subsection 159GZT for measuring the amount of foreign debt interest for a year of income that is not allowable as a deduction is to only apply where new subsection 159GZT(3) does not apply. By this amendment and those contained in paragraph (b) of clause 15, a taxpayer will be given an option to use an alternative method of measuring excess foreign debt.

Paragraph (b) of Clause 15 inserts into section 159GTZ new subsections (3), (4), (5), (6), and (7).

New subsection (3) directs that where an election under subsection (7) is made by, or on behalf of, a taxpayer which is a member of a resident company group in relation to a year of income, the proportion of the foreign debt interest of the taxpayer not allowable as a deduction for that year is to be determined in accordance with the formula contained in new subsection (4).

New subsection (4) sets out the formula to be used in determining the portion of foreign debt interest that will not be allowable as a deduction. The formula is similar to the formula in proposed subsection 159GZS(3) but it applies on a group basis. The proportion thus obtained is applied to the interest deduction of each member of the group.

New subsection (5) is an anti-avoidance measure and mirrors existing subsection 159GZT(2). The provision ensures that the value of any foreign equity arising from a transaction between members of the resident company group reflects the value that would have been attributable to foreign equity had the transaction been between companies dealing with each other at arm's length. The term "arm's length value" is defined in section 159GZA of the Principal Act.

New subsection (6) sets out the test for determining whether a day is an excess foreign debt day for the purposes of this section. The first step is to add together the total foreign debt of every member of a company group in respect of a particular day for a year of income. The next step is to determine if the aggregate foreign debt for the particular day exceeds the foreign equity product in that year of income of the group member that has foreign equity for the same year of income. Each excess day will be an "excess foreign debt day of each member of the group".

On the basis that the accounts give a true and fair view of the financial position of the company, the total foreign debt in respect of a day will be measured by what is shown in the accounts. For example, if interest is payable on a daily balance, the closing balance for the day would generally be an appropriate measure. On the other hand, if interest is payable for periods of less than a day, the measure must reflect that fact.

New subsection (7) directs that an election, by the member of a resident company group which has foreign equity, to use the alternative method of measuring excess foreign debt, as provided in new subsection (4), must be lodged with the Commissioner of Taxation no later than the time of lodgment of the member's return of income for the later of the following years of income:

- the year of income to which the election relates (paragraph (a));
- the year of income in which the subsection commenced (paragraph (b));

or within such further period as is allowed by the Commissioner.

Example:

Assume a foreign controlled resident company retailing group comprising only two companies with foreign debt (Holding company A and subsidiary company B). Holding company A's foreign equity is $33,333.33. Its foreign equity product is $100,000 (ie. $33,333.33 x 3). Subsidiary company B is wholly owned by company A and therefore does not have any foreign equity. However it does have loans from the foreign controller. Holding company A elects pursuant to new subsections 159GZT(3) and (7) to use the alternative method of calculating excess foreign debt provided in new subsection 159GZT(4).

The foreign equity product and foreign debt of the resident companies is as follows:

Holding Company A:

Foreign equity product	-	$100,000	
Foreign debt (1/7-31/5)	-	$ 20,000	(335 days)
(1/6-30/6)	-	$200,000	(30 days)

Subsidiary Company B:

Foreign equity product	-	$0	
Foreign debt (1/5-30/6)	-	$ 10,000	(61 days)

Step 1

To calculate the average daily foreign debt for foreign debt days, the daily foreign debt of each company in the group is first aggregated:

20,000 x 304 days for the period 1/7-30/4

20,000 + 10,000 x 31 days for the period 1/5-31/5

200,000 + 10,000 x 30 days for the period 1/6-30/6

The average daily foreign debt is thus:

$$\frac{(20{,}000 \times 304 + 30{,}000 \times 31 + 210{,}000 \times 30)}{365}$$

= $36,466

Step 2

For each day that the aggregate foreign debt of the members of the group exceeds the foreign equity product of Company A the day is an excess foreign debt day for the group. The average of the debt on those days (ie. 1/6 - 30/6) is calculated as follows:

$$= \frac{(200{,}000 + 10{,}000) \times 30}{30}$$

$$= 210{,}000$$

Step 3

Using the formula in new subsection 159GZT(4), the portion of foreign debt interest that is disallowed is:

$$\frac{(210{,}000 - 100{,}000)}{36{,}466} \times \frac{30}{365}$$

$$\approx 0.248$$

Therefore 24.8% of Company A's interest and 24.8% of Company B's interest will be disallowed.

Step 4

The actual interest deduction disallowed is foreign debt interest multiplied by the portion calculated above.

Total foreign debt interest for Company A is:

$$10\% \left[\frac{(20{,}000 \times 335 + 200{,}000 \times 30)}{365 \text{ days}} \right] = \$3479$$

Interest disallowed is;

$3479 x 0.248 = $863

Total foreign debt interest for Company B is:

$$10\% \left[\frac{(10{,}000 \times 61)}{365 \text{ days}} \right] = \$167$$

Interest disallowed is:

$167 x 0.248 = $41.

Clauses 16, 17, and 18: Partnerships, Trusts and Foreign Investors

The amendments proposed by these clauses to the sections listed below respectively, operate in a manner identical to the amendments to section 159GZS proposed by clause 14 (see notes on that clause). The sections are:

- partnerships (section 159GZU);

- trust estates (section 159GZV);

- foreign investors (section 159GZW).

Clause 19 : Eligible gold mining expenditure - election regarding estimate of mine life for pre-changeover years

This clause will insert a new section, section 159GZZKA, into the Principal Act. Broadly, section 159GZZKA will provide an option for the calculation of residual eligible gold mining expenditure.

Section 159GZZKA

Introductory Note

The transitional provisions in Division 16H of the Principal Act allow a deduction, after 31 December 1990, for eligible gold mining expenditure (essentially development expenditure of a capital nature) incurred prior to 1 January 1991 which is used after that date to produce assessable income. Section 159GZZK allows such a deduction, after 31 December 1990, which would have been available if income from gold mining operations had not been exempt from income tax. This deduction is based on the residual value of eligible gold mining expenditure which, with a few minor variations, is determined in accordance with the general mining provisions. This is achieved by an application of the notional writing-down assumptions in section 159GZZJ.

The notional writing-down assumptions basically assume that a taxpayer had sufficient income each year to utilise the entire deduction for that year and exclude the operation of certain provisions of Division 10 (Mining and Quarrying). The relevant provision of Division 10 which would have allowed the deduction is then assumed to have applied to the expenditure from the date the expenditure was incurred.

Generally section 122DG will be the relevant section which is notionally applied to the expenditure prior to 1 January 1991 and applied to determine the actual deductions allowable after that date. The sections allowing deductions for allowable capital expenditure incurred prior to 19 July 1982 are similar in application as section 122DG. However, under these sections the expenditure is written off on a diminishing value basis, i.e. greater deductions are available in the earlier years.

Section 122DG allows a deduction for allowable capital expenditure on a straight line basis. Subsection 122DG(3) provides for this by dividing the total unrecouped expenditure by the lesser of:

- 10 years, reduced by one for each year of income a deduction has been allowed, or was allowable; or
- the remaining whole years in the estimated life of the mine which has the longer life on that mining property at the end of that year of income.

For the purposes of determining actual deductions under section 159GZZK in the changeover year and subsequent years, it is assumed that deductions in respect of eligible gold mining expenditure were notionally allowed in accordance with the relevant provision in each earlier year of income. As a result, in accordance with the relevant provision, this expenditure is written off on the basis of the estimate of the life of the mine which was held in those relevant earlier years even though with the benefit of hindsight this may now have been an incorrect estimate.

The proposed amendments will enable taxpayers to use this historical information for the purposes of determining residual eligible gold mining expenditure upon which entitlements to actual deductions are based.

<u>Subsection 159GZZKA(1)</u> provides taxpayers with an option to elect an alternative method to notionally write down their eligible gold mining expenditure. Deductions notionally allowed in respect of eligible gold mining expenditure incurred prior to the commencement of the changeover year can be determined on the basis of the notional writing-down assumptions including the assumption in subsection (2) of this section.

Where a taxpayer makes such an election, the election must be made in accordance with subsection (3), which is discussed in the notes on that subsection. The election must be in respect of all eligible gold mining expenditure incurred in relation to that mining property before the commencement of the taxpayer's changeover year of income. The 'changeover year' is defined in existing section 159GZZJ as the year of income of the taxpayer in which 1 January 1991 occurs.

Where the taxpayer makes such an election, the notional writing-down assumptions will include the assumption in subsection (2).

<u>Subsection 159GZZKA(2)</u> ensures that the notional writing-down assumptions include the assumption, in the years of income prior to the taxpayer's changeover year, that the relevant provision, i.e. either paragraph 122D(2)(a), or 122DB(2)(a), or 122DD(2)(a), or 122DF(2)(a) or 122DG(3)(b) applied to the expenditure as though the unrecouped eligible gold mining expenditure was divided by the lesser of:

- the fixed statutory periods as provided in the relevant paragraphs; or
- the number of years of income after the year of income for which the deduction is notionally being determined up to and including the taxpayer's changeover year plus the estimated life of the relevant mine held at the end of the changeover year. The relevant mine at the end of the changeover year is the one to which the paragraph relates, i.e. the mine or proposed mine with the longer or longest life.

Where an election is made, this method of calculation is used for the purposes of the appropriate paragraphs (for expenditure incurred after 19 July 1982 paragraphs 122DG(3)(a) and (b)), for each year of income before the taxpayer's changeover year.

For example: A taxpayer incurred $900 eligible gold mining expenditure in May 1985 and the estimated life of the mine with the longest life on that mining property at 30 June 1991 is 3 years.

By an election under this section and in accordance with section 159GZZJ, the eligible gold mining expenditure will be notionally written off over 9 years, i.e. 6 years plus an estimate of 3 years.

1985 - $900 divided by 9 = $100 notional deduction
1986 - $800 divided by 8 = $100 notional deduction
1987 - $700 divided by 7 = $100 notional deduction
1988 - $600 divided by 6 = $100 notional deduction
1989 - $500 divided by 5 = $100 notional deduction
1990 - $400 divided by 4 = $100 notional deduction

Therefore, at the beginning of the taxpayer's changeover year, 1991, $300 of eligible gold mining expenditure remains. The amount of the actual deduction available to the taxpayer will be determined in accordance with section 159GZZL.

Subsection 159GZZKA(3) sets out the requirements that must be met for the election in subsection (1) to be a valid election. The election must:

- be made in writing by or on behalf of the taxpayer and must be signed by the taxpayer or a duly authorised representative (paragraph (3)(a)); and
- be delivered to the Commissioner on or before the last day for the furnishing of the return of income of the changeover year, or within such further time as the Commissioner allows (paragraph (3)(b)).

•

This proposed amendment overcomes some of the anomalies which arise by allowing deductions for this expenditure as it is incurred rather than when it is first used to produce assessable income. For example, where the expenditure is notionally written off before the mine is operational and generating income. It will also provide a better approximation of the residual value of any eligible gold mining expenditure by using the actual mine life to date and so provide greater accuracy in the matching of revenue and expenses.

Clause 20 : Repeal of section 159GZZP

This clause will repeal section 159GZZP of the Principal Act. Broadly, section 159GZZP provides a modified application of the capital gains tax provisions contained in Part IIIA for eligible gold mining expenditure. Basically, it ensures that certain capital gains are determined prospectively where the asset is disposed of after 31 December 1990. Clause 23 will insert a broader transitional arrangement to modify the application of the capital gains tax provisions, by inserting proposed Subdivision D which will extend the general application of existing section 159GZZP.

Clause 21 : Heading

By this clause, the heading to Subdivision C of Division 16H of Part III of the Principal Act, which currently reads "Subdivision C - Division 10AAA and related provisions", will be amended to exclude the words "and related provisions".

Clause 22 : Repeal of Section 159GZZZA

This clause repeals section 159GZZZA of the Principal Act. Section 159GZZZA has, in respect of eligible gold transport expenditure, the same application as section 159GZZP which itself is also to be repealed. Clause 23 proposes to insert a provision which replaces this section and extends its general application.

Clause 23 : Insertion of new Subdivisions

This clause inserts two proposed new Subdivisions into Division 16H of the Principal Act after section 159GZZZB. The first, 'Subdivision D - Part IIIA' modifies the application of the capital gains tax provisions in Part IIIA of the Principal Act. It will extend the concessional treatment, as previously provided by sections 159GZZP and 159GZZZA, to disposals of all assets subject to Part IIIA and ensure that the calculation of capital losses is consistent with the treatment of capital gains.

The clause will also insert, 'Subdivision E - Subdivision B of Division 2', which will modify the application of the trading stock provisions of the Principal Act namely sections 28, 29 and 31 to enable gold miners to bring trading stock on hand at the end of 31 December 1990 into account for the purpose of determining taxable income.

Subdivision D - Part IIIA

Introductory Note

With the removal of the income tax exemption for gold miners, all gold mining assets, excluding certain exempt mining rights, acquired after 19 September 1985, will be subject to the capital gains tax provisions of Part IIIA if disposed of on or after 1 January 1991. Prior to this date certain gains were exempt from tax by subsection 160Z(6) where the disposed assets were used solely for the purpose of producing exempt income. Similarly any loss on the disposal of those assets was not available as a deduction by virtue of paragraph 160Z(9)(c).

This new Subdivision has a similar application as sections 159GZZP and 159GZZZA which are being repealed by this Bill. However this Subdivision extends the application of those provisions.

Section 159GZZZBA - Interpretation

Section 159GZZZBA ensures that expressions used in new Subdivision D that are also used in Part IIIA, the capital gains tax provisions, have the same meanings as they do in Part IIIA.

Section 159GZZZBB - Disposals of assets to which Sections 159GZZZBC and 159GZZZBD apply

Sections 159GZZZBC and 159GZZZBD will only modify the application of the capital gains tax provisions in certain circumstances. Section 159GZZZBB outlines five conditions which must be satisfied before those provisions can apply.

Paragraph 159GZZZBB(a) requires that the relevant asset is at the end of 31 December 1990 owned by a taxpayer. In Subdivision D the end of 31 December 1990 is defined as the 'changeover time'.

Paragraph 159GZZZBB(b) requires that the asset was used by the taxpayer before 31 December 1990 solely for the purpose of producing exempt income. This exempt income must principally be income to which paragraph 23(o) (income from gold mining operations) or subsection 23C(1) (exemption of certain income from sale of gold) applied. This will ensure that only those assets, whose use prior to 1 January 1991 was principally in respect of gold mining operations, will qualify for the concessional treatment.

Paragraph 159GZZZBB(c) requires that the taxpayer actually disposes of the asset after the end of 31 December 1990. This disposal from 1 January 1991 is defined as the 'post-changeover disposal' in this Subdivision.

Paragraph 159GZZZBB(d) requires that the asset was owned by the taxpayer at all times after 31 December 1990.

Paragraph 159GZZZBB(e) requires that the capital gains tax provisions apply to the disposal of the asset.

This section enables taxpayers to qualify for the concessional treatment in accordance with sections 159GZZZBC and 159GZZZBD in respect of assets acquired after 19 September 1985 and where they were used principally in gold mining operations or by the Gold Producers' Association Ltd prior to 1 January 1991, and where there was any other use it was also solely for the purpose of producing exempt income.

Section 159GZZZBC - Capital gains adjustment

Subsection 159GZZZBC(1) modifies the application of Part IIIA in respect of the calculation of capital gains so that capital gains are calculated prospectively from 1 January 1991 where the conditions in section 159GZZZBB are satisfied. Basically, the asset must be acquired by the taxpayer after 19 September 1985 and disposed of after 31 December 1990 and used solely for the purpose of producing exempt gold mining income prior to that date.

Subsection 159GZZZBC(1) ensures that this provision only applies where the market value of the asset at 31 December 1990 is greater than what would be the asset's indexed cost base at that time if it were being disposed of.

Where that is the case, the following paragraphs apply in respect of the disposal of the asset by the taxpayer after 31 December 1990:-

Paragraph (a) deems there to be a disposal of the asset at the end of 31 December 1990 for an amount equivalent to the asset's indexed cost base.

Paragraph (b) then deems the taxpayer to reacquire the asset at an amount equal to its market value at the end of 31 December 1990.

The effect of these two paragraphs is to increase the cost base of the asset to its market value at the end of 31 December 1990 so that only gains which accrue after that date are subject to capital gains tax. This ensures that any capital gain in respect of these assets is calculated prospectively from 1 January 1991.

Paragraph (c) clarifies which date of acquisition is taken to have applied for the purposes of subsection 160Z(3). Subsection 160Z(3) applies where there is a disposal of an asset within 12 months of acquisition. Where such a disposal occurs this paragraph ensures that the date the asset is actually acquired by the taxpayer, and not 31 December 1990, is the acquisition date to be used for the purposes of subsection 160Z(3).

Subsection 159GZZZBC(2) applies where a taxpayer disposes of an asset after 31 December 1990 and the disposal of the asset occurs within 12 months of its actual acquisition. This subsection will ensure that any reference to the asset's indexed cost base in subsection (1) is taken to be a reference to the asset's cost base for CGT purposes. This reflects that there is no indexation of an asset's cost base where acquisition and disposal occur within a 12 month period.

Section 159GZZZBD - Capital loss adjustment

This section mirrors the application of section 159GZZZBC in respect of certain capital losses and so provides symmetrical capital gains and capital losses treatment. It also modifies the application of Part IIIA in respect of capital losses and ensures that certain capital losses are calculated prospectively from 1 January 1991 where the conditions in section 159GZZZBB are satisfied. This is broadly where gold mining assets were acquired after 19 September 1985 and disposed of on or after 1 January 1991 and were before that date used solely for the purpose of producing exempt income.

Section 159GZZZBD ensures that this section only applies in certain circumstances. This section will apply where the market value of the asset at the end of 31 December 1990 is less than the reduced cost base of the asset at that time. Where this occurs the following paragraphs will apply for the purposes of determining a capital loss in accordance with Part IIIA on the disposal of the asset after 31 December 1990.

Paragraph (a) deems the taxpayer to have disposed of the asset at the end of 31 December 1990 for an amount equal to the reduced cost base of the asset at that time.

Paragraph (b) then deems the taxpayer to immediately reacquire the asset for an amount equal to its market value at the end of 31 December 1990.

This section will ensure capital losses are determined on the basis of the market value of the asset at the end of 31 December 1990 where the market value is less than the reduced cost base of the asset at that time. As a result, the calculation of these capital losses will be entirely prospective from 1 January 1991. Where the conditions of this section are not satisfied, i.e. where the market value is not less than the reduced cost base, or the conditions in section 159GZZZBB are not satisfied, the reduced cost base is used to calculate any capital loss.

The treatment accorded to capital gains and capital losses in sections 159GZZZBC and 159GZZZBD ensures that the application of the capital gains tax provisions is entirely prospective from 1 January 1991 with symmetrical treatment accorded to the calculation of gains and losses.

Section 159GZZZBE - Notional deductions for section 160ZK purposes

Introductory Note

Section 159GZZZBE extends the application of section 160ZK of Part IIIA of the Principal Act for the purposes of determining the reduced cost base of assets in respect of which a taxpayer has been allowed notional deductions for eligible gold mining expenditure and eligible gold transport expenditure. This section is identical in application as subsections 159GZZP(4) and 159GZZZA(4) which are being repealed by this Bill.

Section 160ZK in conjunction with subsection 160ZH(3) effectively provides for the cost base of an asset for capital gains tax purposes to be reduced by any part of the consideration, costs or expenditure on the asset which has been allowed or is allowable or would but for section 61 (where an asset on which depreciation is allowable is used only partly for the purpose of producing assessable income) be allowable as a deduction in any year. This reduction is offset by any amount which by virtue of any other section of the Principal Act, for example section 59, is added back to the assessable income of the taxpayer in the year of disposal of the asset.

In the event of a sale of a gold mining asset section 160ZK could operate to reduce the cost base of the asset only by the amount of post 31 December 1990 actual deductions and not notional deductions for the pre 1 January 1991 period, notwithstanding the reference in that section to section 61. This would produce a greater CGT loss than for similar non-gold mining assets and allow taxpayers to convert non-allowable deductions to allowable CGT losses. The effect of the proposed amendment of section 160ZK will be to ensure that notional deductions are fully taken into account in determining the reduced cost base of such assets.

Section 159GZZZBE(1) will apply where a taxpayer disposes of an asset after 31 December 1990 and the taxpayer incurred eligible gold mining expenditure on the asset. In such cases, paragraphs (a) and (b) will apply.

Paragraph (a) ensures that, for the purposes of any application of subsection 160ZK(1), notional deductions are to be considered to have been allowed in respect of eligible gold mining expenditure.

Paragraph (b) ensures that, for the purposes of the application of subsection 160ZK(1), the balancing adjustments that are required to be made by section 122K of the Principal Act on the sale, etc. of property to which Division 10 applies should be determined as if section 122K had not been modified by section 159GZZO.

This will ensure that notional deductions are fully taken into account in the determination of the reduced cost base of relevant gold mining assets for capital gains tax purposes. The purpose of this paragraph is to reverse the balancing charge apportionments of section 159GZZO which only apply to eligible gold mining expenditure.

Subsection 159GZZZBE(2) has, the same application as subsection (1) where a taxpayer disposes of an asset after 31 December 1990 and the taxpayer incurred eligible gold transport expenditure on the asset, paragraphs (a) and (b) will apply.

Paragraph (a) ensures that, for the purposes of any application of subsection 160ZK(1), notional deductions are to be considered to have been allowed in respect of eligible gold transport expenditure.

Paragraph (b) ensures that, for the purposes of the application of subsection 160ZK(1), the balancing adjustments that are required to be made by section 123C of the Principal Act on the sale, etc. of property to which Division 10AAA (Transport of Certain Minerals) applies should be determined as if section 123C had not been modified by section 159GZZZ.

Similarly, this will ensure that notional deductions are fully taken into account in the determination of the reduced cost base of relevant gold mining assets for capital gains tax purposes. The purpose of this paragraph is to reverse the balancing charge apportionments of section 159GZZZ which only apply to eligible gold transport expenditure.

Subdivision E - Subdivision B of Division 2

Introductory Note

The provisions in Subdivision B of Division 2 deal with trading stock for the purposes of determining whether or not the taxpayer has a taxable income. Depending on the value of trading stock ascertained in accordance with the Subdivision, section 28 will either include an amount in the assessable income of the taxpayer or allow an amount as a deduction from the assessable income of the taxpayer. Subsection 28(1) requires the value of all trading stock on hand at the beginning and end of the year of income to be taken into account for the purposes of determining whether or not the taxpayer has a taxable income. Taxpayer's whose income was exempt by virtue of paragraph 23(o) or subsection 23C(1) have no such value for the beginning of the year of income, since for most taxpayers 1 January 1991 occurs in the middle of a year of income.

In conjunction with section 31, taxpayers whose income was exempt by virtue of paragraph 23(o) or subsection 23C(1) will have a value for trading stock at the end of the year of income for section 28 purposes where that year of income ends after 31 December 1990.

Section 29 also requires the value of trading stock at the beginning of the year of income to be the value which was used in section 28 for the purposes of determining taxable income in the immediate preceding year of income. Taxpayers whose income was exempt by paragraph 23(o) or subsection 23C(1) will not have such a value.

The proposed Subdivision E will overcome these deficiencies and enable taxpayers to apply the provisions of Subdivision B of Division 2 for the purpose of determining taxable income for the changeover year.

Section 159GZZZBF - Interpretation

Section 159GZZZBF defines two phrases for the purposes of Subdivision E. It defines:

'changeover year', to mean the year of income of the taxpayer in which 1 January 1991 occurs. For taxpayers with normal balancing dates this will be the year of income from 1 July 1990 to 30 June 1991;

'eligible trading stock' is defined as the trading stock of a taxpayer that is on hand at any given or nominated point in time which would have been taken into account for the purposes of determining taxable income under section 28 except that exempt income was derived by the taxpayer in respect of that trading stock. Basically this is a taxpayer's trading stock at any nominated point in time which is used to derive gold mining income in accordance with paragraph 23(o) or subsection 23C(1).

<u>Section 159GZZZBG - 31.12.90 eligible trading stock to be taken into account for beginning-of-changeover-year valuation purposes</u>

This section enables a taxpayer to come within the provisions contained in Subdivision B of Division 2 of Part III of the Principal Act (the trading stock provisions) for the purposes of ascertaining whether or not the taxpayer has a taxable income.

<u>Subsection 159GZZZBG(1)</u> deems the eligible trading stock of a taxpayer which is on hand at the end of 31 December 1990 to be the taxpayer's trading stock on hand at the beginning of the year of income for the purposes of determining whether or not the taxpayer has a taxable income under section 28 for the changeover year. However, only the value of gold mining trading stock to which paragraph 23(o) and subsection 23C(1) applies, which is on hand at the end of 31 December 1990 is taken into account for the purposes of determining taxable income under section 28. Trading stock on hand at 1 July 1990 is therefore specifically excluded.

<u>Subsection 159GZZZBG(2)</u> will ensure that for the purposes of determining a taxpayer's exempt income for the period of the changeover year prior to 1 January 1991, subsection (1) does not deem the trading stock of the taxpayer at the end of 31 December 1990 to be the beginning of the year of income trading stock for the purposes of a notional application of section 28.

<u>Section 159GZZZBH - Method of determining value of beginning-of-changeover-year trading stock</u>

This section enables taxpayers to utilise the methods of valuing trading stock in accordance with section 31. In the absence of the taxpayer exercising an option, the cost price of the trading stock is taken to be its opening value for the beginning of the changeover year.

<u>Subsection 159GZZZBH(1)</u> will only apply to the trading stock identified in section 159GZZZBG which is basically 'gold mining' trading stock on hand at the end of 31 December 1990. The following paragraphs will apply to determine the value of this beginning of the year trading stock for the purposes of ascertaining whether or not the taxpayer has a taxable income in accordance with section 28.

<u>Paragraph (a)</u> ensures that the requirements in section 31 are satisfied, which applies at the end of years of income, by deeming the end of 31 December 1990 to be the end of the year of income before the changeover year. The taxpayer may, in accordance with subsection (3), exercise the options in subsection 31(1) to value the beginning of the changeover year trading stock at either cost, market or replacement value. The taxpayer may also provide any

notice in accordance with subsection 31(2).

Paragraph (b) ensures that, where a taxpayer does not exercise a valid option in accordance with paragraph (a), the stock on hand identified in section 159GZZZBG is valued at its cost price for the purposes of section 28.

Subsection 159GZZZBH(2) is an anti-avoidance provision designed to defeat taxpayers who may seek to manipulate stock values to obtain a deduction for trading stock which is not disposed of in the taxpayer's changeover year of income.

Subsection 159GZZZBH(2) applies where both paragraphs (a) and (b) are satisfied.

Paragraph (a) requires the taxpayer to have elected cost price as the basis of valuation under section 31 in respect of any trading stock on hand at the end of the changeover year.

Paragraph (b) is satisfied where the trading stock in paragraph (a) was also on hand at the beginning of the changeover year as well as the end of the changeover year.

Where these two paragraphs are satisfied the cost price of the trading stock at the end of the year of income is deemed to be the value at which it is taken into account at the beginning of the year of income for the purposes of ascertaining whether or not the taxpayer has a taxable income in accordance with section 28.

Subsection 159GZZZBH(3) sets out the requirements that must be satisfied for the notice or option in paragraph (1)(a) to be effective. The taxpayer must notify the Commissioner of Taxation in writing before 1 March 1991 or within such further time as the Commissioner allows. The option or notice must be signed by the taxpayer or a duly authorised representative.

Section 159GZZZBI - 31.12.90 eligible trading stock to be taken into account for end-of-changeover-year valuation purposes in determining exempt income

This section will enable a taxpayer's 'gold mining' trading stock on hand at the end of 31 December 1990 to be taken into account for a notional application of section 28 for the purposes of determining a taxpayer's exempt income, or expenses incurred in deriving exempt income for the period of the changeover year prior to 1 January 1991.

Section 159GZZZBI ensures that for a notional application of section 28 for the purposes of determining the exempt income, or expenses incurred in deriving the exempt income, paragraphs (a) and (b) will apply.

Paragraph (a) deems the eligible trading stock of a taxpayer which is on hand at the end of 31 December 1990 to be the taxapayer's trading stock on hand at the end of the year of income of the changeover year for a notional application of section 28. Basically this is 'gold mining' trading stock on hand at the end of 31 December 1990. Any other trading stock of the taxpayer is excluded, for example, trading stock on hand at the end of 30 June 1991.

Paragraph (b) ensures that this value, in respect of the trading stock identified in paragraph (a), is the same as the value ascertained for the beginning of the year of income of the changeover year in accordance with paragraph 159GZZZBH(1)(a). In effect this ensures that the value of trading stock on hand at the end of 31 December 1990 is the same for the purposes of determining taxable income or net exempt income.

Clause 24: Initial payment of tax

This clause proposes the repeal of existing section 160APMA and the substitution of a revised section to provide that the day on which the franking credit arises from the making of an initial payment of tax by a company will depend on whether or not the payment was made during the year of income to which it relates.

Existing section 160APMA provides for a franking credit to arise on the day on which an initial payment of tax required to be made under section 221AP is made. Thus, an initial payment made during the year of income to which it relates gives rise to a franking credit in that earlier franking year.

New section 160APMA will be to the same effect as the existing section except where the initial payment is made during the year of income to which the payment relates. The new section will provide that where a company makes an initial payment of tax that it is required to make under section 221AP in respect of a year of income the franking credit will arise:

- if the day on which the payment is made is during the year of income to which the payment relates, on the first day of the following year, (paragraph (a))

- if the day on which the payment is made is not during the year of income to which the payment relates, on the day payment is made (paragraph (b))

Clause 25: Application of initial payment of tax by a company

Clause 25 proposes an extension to the operation of section 160APYA to include refunds of initial payments of company tax made under section 221AZF.

Existing section 160APYA provides for a franking debit to arise when an initial payment of company tax is credited by the Commissioner in accordance with section 221AZF. Section 221AZF sets out the manner in which an initial or subsequent payment of tax is to be credited by the Commissioner and requires that any amount not credited is to be refunded.

Amended section 160APYA will provide for a franking debit to arise:

- when an initial payment of tax is applied whether by way of credit or refund or both (paragraph (a)),
- on the day the initial payment is applied, whether by credit, refund or both (paragraph (b)); and
- of the amount applied whether by credit, refund or both (paragraph (c)).

Clause 26: Application of subsequent payments of tax before determination of taxable income

This clause proposes the insertion of section 160APYAA to provide for franking debits to arise on the application of subsequent payments of tax. Its effect in relation to subsequent payments of tax made under the company tax collection system will be similar to that of amended section 160APYA in relation to initial payments of tax.

Companies are permitted by Division 1B of Part VI of the Principal Act to make a further payment on account of tax that is not a final payment, after it has made an initial payment as required under section 221AP. These payments are mentioned in subsection 221AR(7). When the payment is made a franking credit arises on the day the payment is made under section 160APMB.

Under the existing law by virtue of the operation of existing section 221AZ (see later notes) a subsequent payment of tax is deemed to be an initial payment of tax. When such a payment is credited against the company's tax liability a franking debit arises under existing section 160APYA.

New section 160APYAA provides for a franking debit to arise on the day a subsequent payment is applied where:

- a company has made a subsequent payment of tax in relation to a year of income after it has made the initial payment of tax and before making the final payment for that year required by section 160AZD (paragraph (a)); and

- the subsequent payment is applied by the Commissioner of Taxation, either by way of credit against any of the liabilities specified in subsection 221AZF(1) or by making a refund under subsection 221AZF(2) (paragraph (b)).

Clause 27: Waiver of franking deficit tax

This clause proposes the insertion into the Principal Act of section 160APYC which provides for a franking debit to arise where a company is not liable to pay an amount of franking deficit tax because of the operation of subsection 160AQJ(2).

Subsection 160AQJ(1) of the Principal Act provides that where a company has a deficit balance in its franking account at the end of a franking year it is liable to pay franking deficit tax. The franking deficit tax payable is calculated according to a formula and is the additional amount of company tax that the company would have paid if it had generated sufficient franking credits to frank its dividends to the extent it did.

Subsection 160AQJ(2) was inserted into the Principal Act as part of the legislative amendments to implement the collection of tax paid by companies, superannuation funds and similar entities on income derived during the 1989-90 and subsequent years of income. By virtue of subsection 160AQJ(2), where a company makes an initial payment of tax on the basis of its own estimate of its income tax liability for a year of income, the company is not liable to pay franking deficit tax to the extent of the amount of the initial payment. When the company makes the initial payment a franking credit arises under section 160APMA for the adjusted amount of the whole of that payment.

A company is entitled under section 160AQK to offset the franking deficit tax it has become liable to pay against an assessment or amended assessment of company tax. By virtue of the operation of subsection 160AQJ(2), the amount of franking deficit tax a company is liable to pay is the amount calculated under subsection 160AQJ(1) less the amount waived by subsection 160AQJ(2). The net amount is therefore the amount of the offset entitlement under section 160AQK.

A franking debit arises under section 160AQ for the amount of the offset entitlement under section 160AQK that is allowed in an assessment or amended assessment of company tax. The franking debit is therefore based on the amount of franking deficit tax a company was actually liable to pay. No franking debit arises under the existing law for the amount of franking deficit tax waived by subsection 160AQJ(2).

New section 160APYC will provide for a franking debit to arise where a company liable to pay franking deficit tax has made an initial payment of tax under section 221AP on the basis of a written notice of the company's estimate of its tax payable for that year made under paragraph 221AQ(1)(a). The franking debit will arise on the day the company makes the initial payment. The amount of the franking debit will be:

- where the initial payment is greater than the amount of the franking deficit tax payable by the company, the adjusted amount (in accordance with that definition in section 160APA) of the franking deficit tax liability (paragraph (a));
- where the franking deficit tax payable under subsection 160AQJ(1) exceeds the amount of the initial payment, the adjusted amount of the franking deficit tax that is equal to the initial payment (paragraph (b)).

Clause 28 : When initial payment to be made

This clause amends section 221AP of the Principal Act by inserting a new subsection (2). Section 221AP is one of the operative provisions under the collection arrangements for companies and trustees of certain funds that requires the particular entities to make an initial payment of tax within 28 days of the end of the year of income to which the tax relates.

New subsection (2) is a drafting change intending to make clear that an initial payment of tax is due and payable on a particular day in the sense that other income tax is due and payable under the Principal Act.

Clause 29 : Additional payment to form part of initial payment

Clause 29 will amend section 221AZ to provide that for imputation purposes a subsequent payment of tax of the kind mentioned in subsection 221AR(7) will not be taken to be an initial payment of tax.

Under the existing law initial and subsequent payments of tax are treated as different types of payments for the purposes of giving rise to franking credits under sections 160APMA and 160APMB, whereas section 221AZ is invoked to treat both kinds of payments as an initial payment and to give rise to a franking debit under section 160APYA.

Section 221AZ provides that payments made under subsection 221AR(5), 221AW(4) or 221AX(8) or those mentioned in subsection 221AR(7) are to be treated as an initial payment of tax. Payments made under the first three subsections can be directly related to the initial payment in that they provide for an additional payment to be made where the original estimate is considered to be too low, either by the taxpayer or the Commissioner of Taxation, or has been underestimated for tax avoidance purposes. On the other hand, payments mentioned in subsection 221AR(7) are further payments made voluntarily before the day on which the final payment is made.

Amended subsection 221AZ(1) will continue to have its present effect in that payments under the specified sections will continue to be regarded as an initial payment of tax for the purposes of Division 1B of Part VI of the Principal Act (collection of tax on companies and trustees of certain funds).

Subsection (2), however, will prevail over subsection (1) so that subsequent payments of company tax made after the initial payment and before the final payment will not be treated as an initial payment for imputation purposes.

Clause 30 : Schedule 2

Clause 30 proposes to amend Schedule 2 to the Principal Act. Schedule 2 describes those parts of Australia which fall within either Zone A (Part I of the Schedule) or Zone B (Part II of the Schedule) for the purposes of the zone rebate available under section 79A of the Principal Act.

Paragraph (a) of clause 30 proposes to include Lord Howe Island in Part I (Zone A) of Schedule 2. Because of the distance of Lord Howe Island from a centre with a population of 2,500 or more, Lord Howe Island will then qualify as a special area in Zone A. The zone rebate available under section 79A for residents of the special area in Zone A is $938 plus 50% of the relevant rebate amount (defined in subsection 79A(4)).

Paragraph (b) of clause 30 proposes to include King Island, Tasmania and all the islands in the group of islands known as the Furneaux Group, Tasmania in Part II (Zone B) of Schedule 2. The zone rebate available under section 79A for residents of Zone B is $45 plus 20% of the relevant rebate amount.

Clause 31 : Application of Amendments

This clause, which will not amend the Principal Act, contains application provisions relating to the operation of certain measures contained in the Bill. For reference purposes the Principal Act, as proposed to be amended by this Bill, is (by subclause (1)) called the "amended Act".

By subclause (2) the amendment concerning the disposal of live stock because of contamination proposed by Clause 5 is to apply in relation to live stock disposed of on or after 1 July 1987.

By subclause (3), the proposed amendments to the gift provisions made by paragraph (a) of clause 6, to reflect the change in name of the Australian College of General Practitioners, will apply to gifts made on or after 23 June 1970.

By subclause (4), the proposed amendments to the gift provisions made by paragraph (b) of clause 6, to reflect the change in name of the Australian Sports Aid Foundation, will apply to gifts made on or after 2 August 1989.

By subclause (5), the amendments proposed by clauses 7 and 30 in relation to the zone rebate arrangements, are to apply to assessments in respect of income of the 1990-91 year of income and subsequent years of income.

Subclause (6) ensures that the amendment in respect of quarry exploration and prospecting expenditure applies on or after 16 August 1989, which is the date from which such expenditure qualified for deduction.

Under subclause (7) the amendments proposed by clause 10, clause 11(a)(i) and clause 11(a)(ii) and clause 13 will apply to assessments for the year of income commencing on 1 July 1987 and all subsequent years of income.

Subclause (8) provides that the amendments proposed by subparagraph 159GZG(1)(d)(iii) of the Principal Act as amended by this Bill, and by paragraphs 8 (b), (c), and (d), clauses 14, 15, 16, 17, and 18 will apply to assessments for the year of income commencing on 1 July 1988 and all subsequent years of income.

Subclause (9) ensures that the amendments made by the insertion of Subdivision D into Division 16H of the Principal Act applies to the relevant assets irrespective of when they were acquired by the taxpayer. This will ensure that the provisions of the new Subdivision D in Division 16H override the sections being repealed, namely 159GZZP and 159GZZZA.

Clause 32: Transitional - section 160APX of the amended Act

By subclause (1) a reference in this section to the "amended Act" is a reference to the Income Tax Assessment Act 1936 as proposed to be amended by this Bill.

Subclause (2) provides for a franking credit to arise where a company has incurred a franking debit under section 160APX that it would not have incurred if sections 160APYA (as amended), 160APYAA and 160APYC had been in force at the time the franking debit arose under section 160APX.

Section 160APX provides for a franking debit to arise when a frankable dividend is franked to an extent less than the required franking amount. No franking debit arises if the required franking amount is less than 10% of the dividend. Since franking debits will arise on the day on which sections 160APYA (as amended), 160APYAA and 160APYC are enacted, that is the day of Royal Assent, companies that underfranked a frankable dividend in anticipation of the enactment of those provisions could suffer a double franking debit.

The franking credit will arise on the day the amending Act receives Royal Assent where:

- before the enactment of this provision the company incurred a franking debit (actual franking debit) under section 160APX (paragraph (a));
- if sections 160APYA and 160APYC had been in operation earlier (paragraph (b)):
  - no franking debit would have arisen under section 160APX (subparagraph (i)); or
  - a franking debit (notional franking debit) would have arisen on the payment of the dividend (subparagraph (ii)); and
- if there is a notional franking debit - the actual franking debit is greater than the notional franking debit (paragraph (c)).

The franking credit that arises is equal to:

- the franking debit that arose under section 160APX that would not have arisen if sections 160APYA (as amended), 160APYAA and 160APYC had applied (paragraph (d)); or
- the amount by which the actual franking debit exceeds the notional franking debit if there would have been a franking debit under section 160APX even if sections 160APYA (as amended), 160APYAA and 160APYC had applied (paragraph (e)).

Subclause (3) is an interpretative provision to ensure that in determining the effect of section 160APYA (as amended) for the purposes of subsection (2), the day on which the franking debit arises is to be that on which the payment would have been applied under that section and not the day on which the franking debit will arise by virtue of clause 33.

Subclause (4) is an interpretative provision and ensures that in determining the effect of section 160APYAA for the purposes of subsection (2), the day on which the franking debit arises is to be that on which the subsequent payment is applied under that section and not the day on which the franking debit will arise by virtue of clause 34.

Subclause (5) is an interpretative provision and ensures that on determining the effect of section 160APYC for the purposes of subsection (2), the day on which the franking debit arises is to be that on which the initial payment that removed the liability to pay franking deficit tax was made, and not the day on which the franking debit will arise by virtue of clause 35.

Clause 33: Transitional - section 160APYA of the amended Act

By subclause (1) a reference in this section to the "amended Act" is a reference to the Income Tax Assessment Act 1936 as proposed to be amended by this Bill.

Subclause (2) extends the effect of section 160APYA to refunds of an initial payment of tax made before that section, as amended, came into operation. By virtue of this subclause:

- franking debits will arise under section 160APYA where a refund of an initial payment of tax was made before the section was amended (paragraph (a)); and
- the franking debit will arise on the day the amending Act comes into operation which, by subclause 2(1), is the day on which it receives Royal Assent (paragraph (b)).

Clause 34: Transitional - section 160APYAA of the amended Act

By Subclause (1) a reference in this section to the "amended Act" is a reference to the Income Tax Assessment Act 1936 as proposed to be amended by this Bill.

Subclause (2) extends the effect of section 160APYAA to subsequent payments of tax made before that section came into operation. By virtue of this subclause:

- franking debits will arise under section 160APYAA where a subsequent payment of company tax is applied in accordance with section 221AZD before the section commenced (paragraph (a)); and

- the franking debit will arise on the day the amending Act comes into operation which, by subclause 2(1), is the day on which it receives Royal Assent (paragraph (b).

Clause 35: Transitional - section 160APYC of the amended Act

By subclause (1) a reference in this section to the amended Act is a reference to the Income Tax Assessment Act 1936 as proposed to be amended by this Bill.

Subclause (2) extends the effect of section 160APYC to the amount of any liability for franking deficit tax waived under subsection 160AQJ(2) where the initial payment of tax was made and the franking deficit tax liability was waived before section 160APYC came into operation. By virtue of this subclause:

- franking debits will arise under section 160APYC where the initial payment of tax was made before the section commenced (paragraph (a)); and

- the franking debit will arise on the day the amending Act comes into operation which, by subclause 2(1), is the day on which it receives Royal Assent (paragraph (b)).

Clause 36 : Amendment of assessments

Clause 36 will give the Commissioner of Taxation authority to re-open an income tax assessment made before the Bill becomes law should this be necessary for the purposes of giving effect to the amendments proposed by the Bill.

PART 3 : AMENDMENT OF THE TAXATION LAWS AMENDMENT ACT (NO. 2) 1990

Clause 37 : Principal Act

This clause facilitates reference to the Taxation Laws Amendment Act (No.2) 1990 which, in this Part, is referred to as the "Principal Act".

Clause 38 : Interpretation

This clause proposes a minor technical amendment to section 4 of the Principal Act to correct a drafting error that occurred when amending the definition of the term "exempt debit" in subsection 3(1) of the Debits Tax Administration Act 1982. The amendment sought to amend the term "exempt income" instead of "exempt debit". This amendment does not alter the content or application of the Principal Act any further.

The amendment by clause 38 applies, by subclause 2(2) of this Bill, on and from 16 June 1990, the date of Royal Assent to the Principal Act.