

1990-91-92

**THE PARLIAMENT OF THE COMMONWEALTH  
OF AUSTRALIA**

**SENATE**

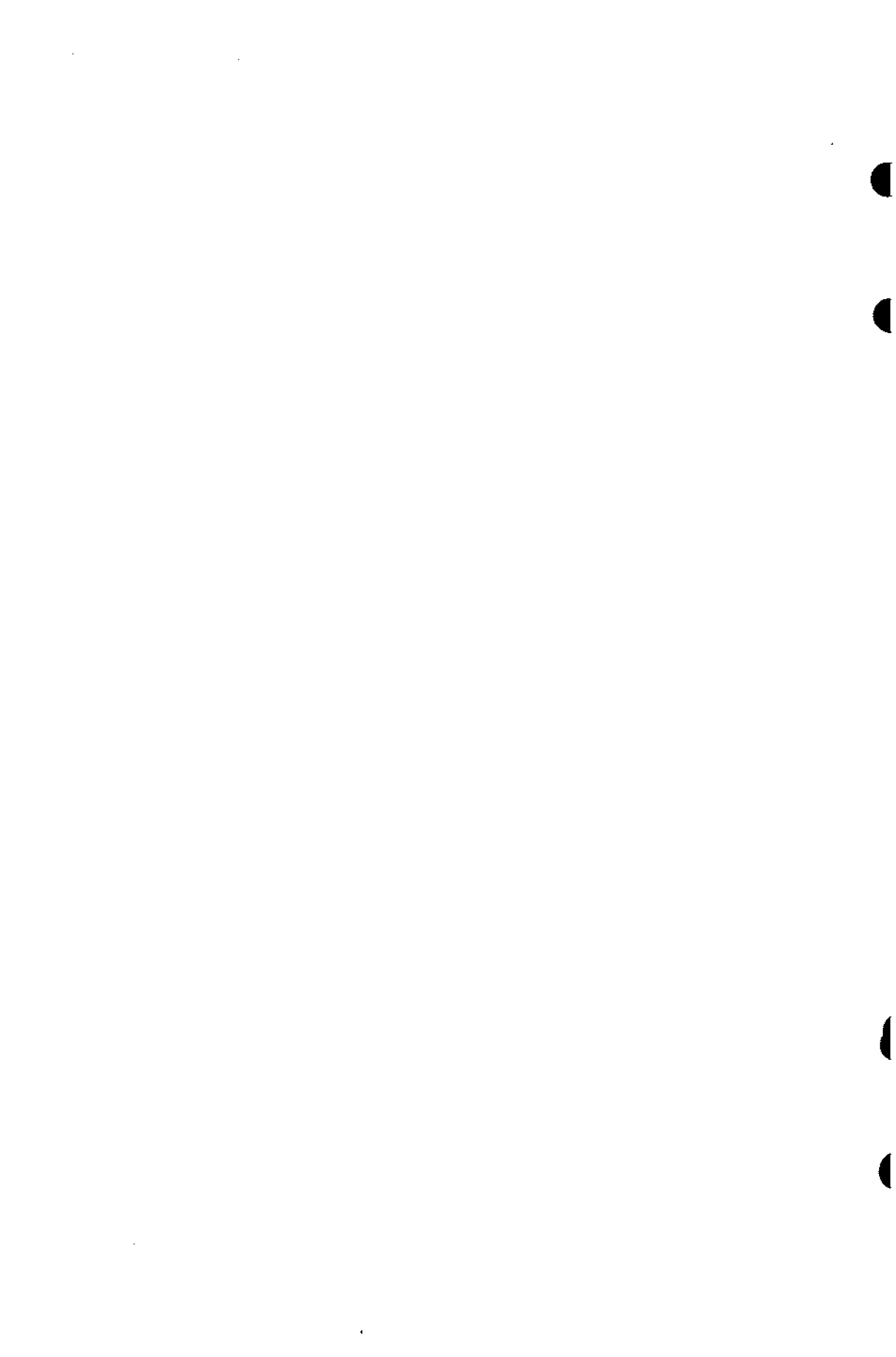
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**TAXATION LAWS AMENDMENT BILL (NO.5) 1992**

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**SUPPLEMENTARY EXPLANATORY  
MEMORANDUM**

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



## **General Outline and Financial Impact**

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### **Research and Development Expenditure**

The supplementary amendments will make deductions available for participants who incur research and development (R&D) expenditure to a government body or an associate, even if the participant has some guaranteed return, if the body is subject to Commonwealth income tax and operates on a fully commercial basis.

A set of guidelines detailing what criteria will be taken into account in ascertaining a government body's eligibility must be prepared by the Industry Research and Development Board (the Board).

A register ('Register of Commercial Government Bodies') must be prepared and administered by the Board and will list government bodies and their associates which satisfy these criteria.

*Financial impact:* no immediate cost

### **Royalty Withholding Tax**

The amendment will make it clear that royalties, derived by a non-resident of a country with which Australia has concluded a double tax agreement (DTA) in carrying on business in Australia at or through a permanent establishment of the non-resident in Australia, are not to be subject to royalty withholding tax and are to remain subject to normal tax by assessment.

*Revenue impact:* None.

## **Research and Development Expenditure**

### **Explanation of proposed amendments**

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#### *Changes to the Income Tax Assessment Act*

##### **Deductions for expenditure incurred to government bodies**

Proposed section 73CB will deny deductions for expenditure incurred by a company to a government body or an associate in connection with R&D activities if the company is guaranteed a return on or of any part of the expenditure.

The effect of the proposed supplementary amendment is that section 73CB will not apply if the government body or associate to which the expenditure is incurred is entered on the 'Register of Commercial Government Bodies'. Government bodies entered on the register cannot be exempt from Commonwealth income tax and must be operating on a fully commercial basis. The register is to be administered by the Board [*Amendments 1 & 2*].

The register will be established, together with guidelines for entry to the register, removal from the register, and other appropriate administration procedures, under the changes to the *Industry Research and Development Act 1986* as discussed below.

#### *Changes to Industry Research and Development Act 1986*

##### **Commercial Government Bodies Guidelines**

The Board will be required to develop Guidelines setting out criteria which will indicate whether a government body is a commercial government body which may be entered on the Register of Commercial Government Bodies. Expenditure to government bodies or their associates which are not included on the Register can only be deductible under section 73B if there is no guaranteed return on or of any part of the expenditure [*Amendment 4, new section 39HB*].

The Board is to prepare and publish guidelines within 90 days of the commencement of the section setting out the criteria by which it will determine whether or not a Government body is a commercial Government body. Only those government bodies that, in the opinion of the Board, satisfy the criteria contained in the guidelines will be able to be entered onto the 'Register of Commercial Government Bodies'. The guidelines will be published in the Gazette and will be made available free of charge [*Amendment 4, new subsections 39HB(1) and (2)*].

The guidelines will be contained in a disallowable instrument under the *Acts Interpretation Act 1901*. So, they will be subject to the scrutiny of Parliament, [*Amendment 4, new subsection 39HB(5)*].

In developing the guidelines the Board will have regard to a number of factors. These will include, but shall not be limited to:

- (a) the commercial environment in which the government body operates. This will include such factors as the degree of funding and other forms of backing that may be provided by the Commonwealth, State or Territory governments and the body's exposure to commercial risk and to competition;
- (b) whether and how the operations and performance of the body are subject to scrutiny;
- (c) to what extent the government body is bound by Commonwealth, State or Territory regulations, taxes and charges;
- (d) how much private investment there is in the body. The Board may take into account indirect investment, for instance through investment in companies, partnerships or trusts with interests in the body. So, for example, a body won't have to be treated as free of private investment, where interests are held by another government body in which there is private investment; and

- (e) if the eligible government body is established by or under a law of the Commonwealth, a State or Territory, the policies of the relevant government on treating the body as fully commercial [*Amendment 4, new subsection 39HB(3)*].

Any Government body or associate that is exempt from income tax will be excluded from inclusion on the Register of commercial Government bodies [*Amendment 4, new subsection 39HB(4)*].

Examples of Government bodies that may qualify as commercial government bodies under the proposed guidelines include:

- the Australian Overseas and Telecommunications Corporation;
- Aerospace Technologies of Australia Ltd;
- the Snowy Mountains Engineering Corporation; and
- the Commonwealth Serum Laboratory.

Eligibility for inclusion on the Register will be determined on an individual case by case basis.

### **Register of Commercial Government Bodies**

The Board will be required to maintain a Register of Commercial Government Bodies [*Amendment 4, new section 39HA*].

Only those government bodies that are listed on the Register will be excluded from the provisions of proposed section 73CB of the ITAA which would otherwise operate to disallow a deduction under section 73B. Only those government bodies or their associates which satisfy the Commercial Government Bodies Guidelines will be included on the Register.

The Register of Commercial Government Bodies will be administered by the Board and will be made available for inspection on request. Those looking to incur expenditure to government bodies or their associates will have an

interest in examining the register to indicate that deductions under section 73B of the ITAA may be available *[Amendment 4, new subsection 39HA(2)]*.

### **Applications for inclusion on the Register of Commercial Government Bodies**

In order to be included on the Register of Commercial Government Bodies, a government body must apply to the Board in writing, providing all necessary information as required by the Board in order to make a decision as to the body's eligibility for inclusion on the Register *[Amendment 4, new section 39HC]*.

After it considers a body's application for inclusion on the Register the Board must either grant or refuse the application *[Amendment 4, new subsection 39HC(1)]*.

The Board must advise the applicant of its decision in writing and, if it refuses, set out the reasons for its decision *[Amendment 4, new subsections 39HC(3) and (4)]*.

Only those applications under proposed section 39HD(1) which satisfy the Commercial Government Bodies Guidelines will be included on the Register.

If required, the Board may seek additional information from the applicant in order to make a determination as to the eligibility of the applicant for inclusion on the Register.

### **Deemed refusal of application after 90 days**

The Board has to make a decision within 90 days from the date of receipt of the original application or, if the Board seeks additional information from the applicant, within 90 days from the date of receipt of that additional information. If not, the Board shall be taken to have made a decision to refuse the application for inclusion on the Register. This deemed refusal does not require notice to the body, or a statement of reasons *[Amendment 4, new subsection 39HC(2)]*.

### **Date of effect of entry on the Register**

Inclusion on the Register of Commercial Government Bodies will take effect from no later than the date of the Board's decision. If asked by the applicant, the Board may specify an earlier effective date [*Amendment 4, new subsection 39HC(5)*].

The Board may determine an effective date for inclusion in the Register that is earlier than the commencement day for the section under which the effective date is determined. Should the Board do so the provisions of the proposed legislation will operate as though the Register had been in existence at that specified date [*Amendment 4, new subsections 39HC (6) and (7)*].

So companies incurring expenditure to unregistered government bodies in connection with R&D activities may still obtain deductions under section 73B, despite some guaranteed return, if the body obtains a back-dated entry on the Register because of particular circumstances making that appropriate.

### **Removal from the Register of Commercial Government Bodies**

If the Board is satisfied that a government body does not satisfy the criteria established under the commercial government bodies guidelines, the Board must remove the body from the Register [*Amendment 4, new subsection 39HF(1)*].

Before doing so, the Board must advise the Government body and provide a written statement of reasons. The Board must also invite the body to make a written submission about the removal from the Register to the Board within 60 days from the date of notification.



Should the Government body make such a submission within the time given, the Board must consider the matters raised in the submission in determining whether the body should be removed from the Register on the basis of a failure to comply or a failure to continue to comply with the guidelines [*Amendment 4, new subsection 39HF(2)*].

#### **Date of effect of removal from the Register**

If the Board removes a government body from the Register, the removal will take effect from the date the body was told the Board was considering its removal from the register and given reasons.

The date of effect will not be earlier, as this could disadvantage companies seeking to claim deductions under section 73B for expenditure to the body incurred when the body was listed on the register and had no reason to believe that registration might be withdrawn.

The Board must provide the government body with written advice of its decision [*Amendment 4, new subsection 39HF(3) and (4)*].

#### **Administrative Appeals Tribunal**

Where a government body is not satisfied with the decision of the Board to deny registration or revoke registration of the body then the matter can be referred to the Administrative Appeals Tribunal for review [*Amendment 4, amendment to section 39T*].

Appropriate notices must be given about such review rights [*Amendment 4, amendment to section 39U*].

## **Royalty Withholding Tax**

### **Explanation of the proposed amendment**

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Australia's Double Tax Agreements (DTAs) provide different treatment for royalties paid to non-residents who have a permanent establishment (for example, a branch) or fixed base in Australia and those non-residents who do not have a permanent presence in Australia.

Where the royalties are effectively connected with an Australian permanent establishment or fixed base, the royalties are taxed under the provisions of the "business profits" article or "independent personal services" article of the DTA and not the royalties article. They are subject to tax at the normal income tax rates and do not qualify for the withholding tax limitation (generally 10%) set out in the royalties article.

A possible interpretation of the proposed new withholding tax regime is that although the royalties are taxable as business profits or personal services they do not form part of assessable income and, therefore, cannot be taxable in the normal way by assessment. Concern has also been expressed that because the withholding tax limitation will not apply they would be taxable at the non-DTA rate of 30%.

An amendment to section 17A of the *Income Tax (International Agreements) Act 1953* will make it clear that royalties paid to a non-resident of a treaty country carrying on business through a permanent establishment in Australia are not subject to withholding tax. In order to assist in the precise drafting of the provision it was necessary to mention a particular agreement. The Chinese agreement was chosen at random and the reference to that agreement has no other consequences [*Amendment 3*].

**CORRECTION**

**TO THE**

**EXPLANATORY MEMORANDUM**

**FOR**

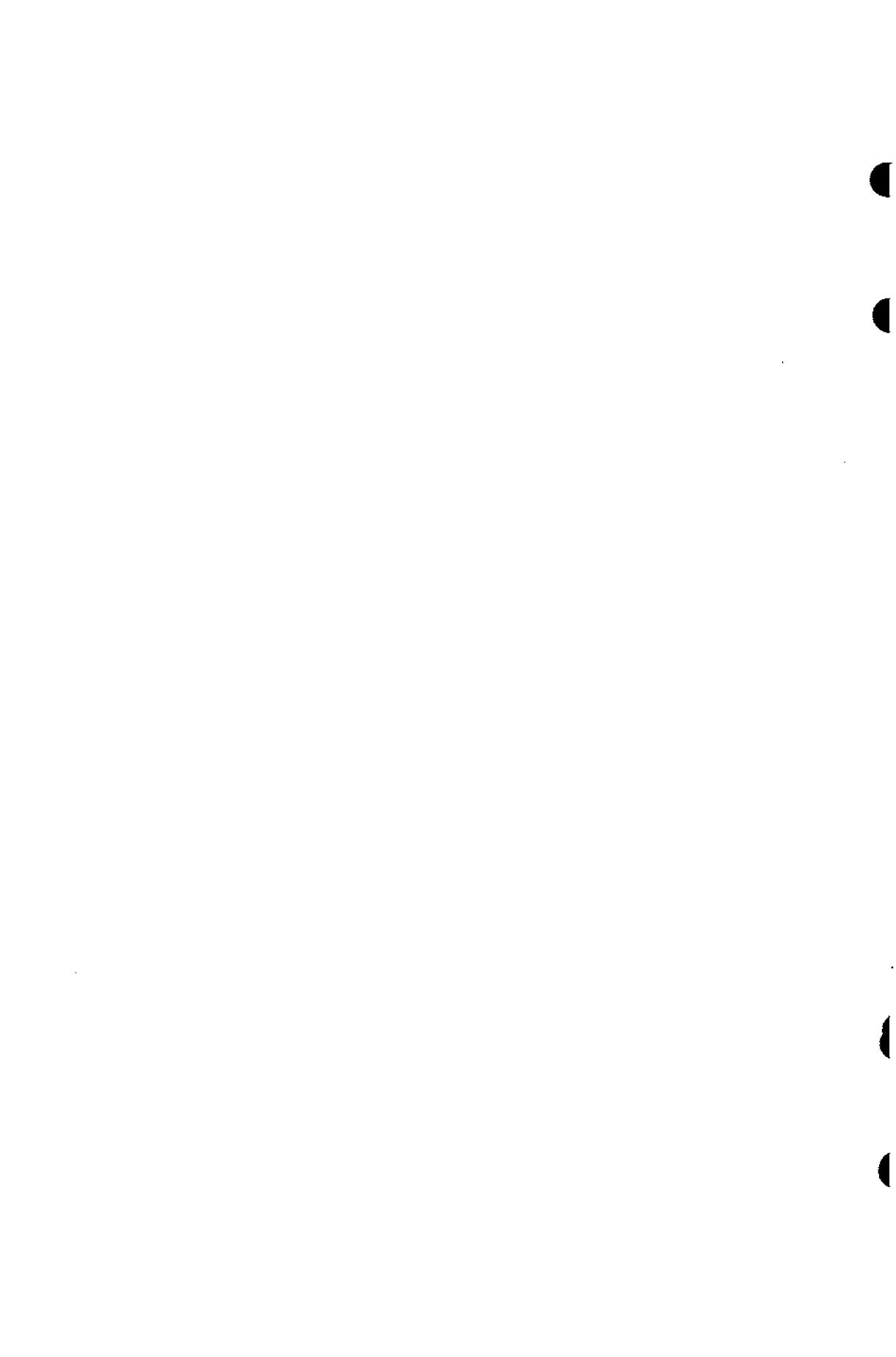
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The following corrections are made to the Explanatory Memorandum:

Page 16 - substitution of legislative citation to correct error which occurred at the printing stage; viz - reference in narration regarding Subclause 7(b) to new subparagraph 78(1)(a)(cviv) should be to new subparagraph 78(1)(a)(cix).

Page 44 - substitution of legislative citation to correct error which occurred at the printing stage; viz - legislative reference in narration regarding "Organisations admitted to the Register" to *[Subclause 7(b) new subparagraph 78(1)(a)(cviv)]* should be to *[Subclause 7(b) new subparagraph 78(1)(a)(cix)]*.

Page 132 - substitution of legislative citation to correct error which occurred at the printing stage; viz - legislative reference in index heading "Gifts, pensions, etc" to subparagraph 78(1)(a)(cviv) should be to subparagraph 78(1)(a)(cix).

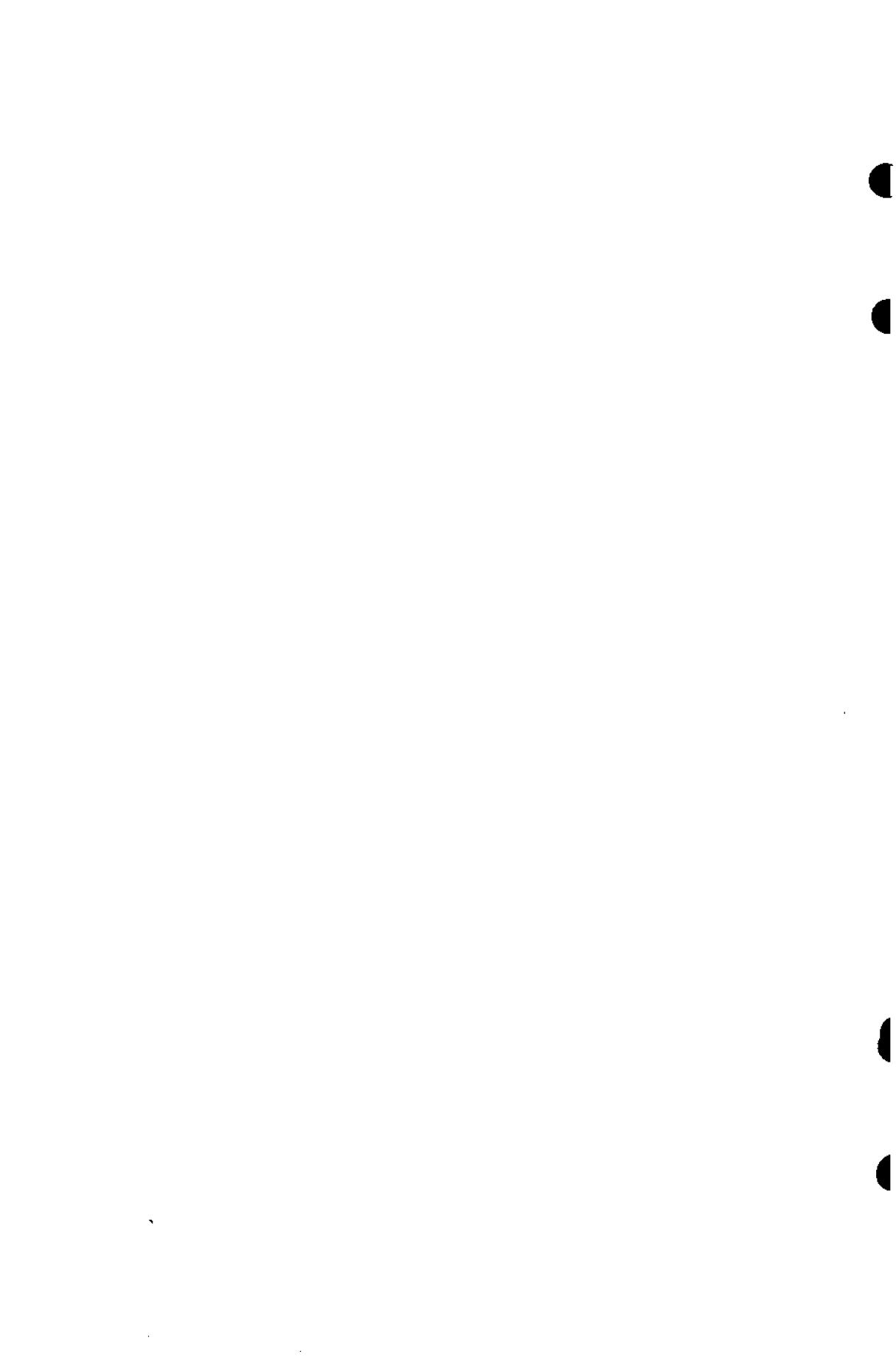


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