Chapter 2

Overview of the Bill

2.1 As noted in the previous chapter, the Bill has seven schedules, which relate to:

(a) the taxation of interest paid by the Government on unclaimed money (Schedule 1);

(b) the reform of airline transport fringe benefits (Schedule 2);

(c) the tax treatment of payments and related expenditure made under the Sustainable Rural Water Use and Infrastructure Program (Schedule 3);

(d) acquisitions and disposals of certain assets between related parties and SMSFs (Schedule 4);

(e) the introduction of a loss carry-back tax offset (Schedules 5 and 6); and

(f) miscellaneous amendments to various taxation laws to address minor technical issues and legislative uncertainties (Schedule 7).

2.2 This chapter provides an overview of the background and operation of these schedules.

Schedule 1: Taxation of interest on unclaimed money

2.3 Schedule 1 of the Bill amends the income tax and superannuation law to ensure that income tax is generally not payable on the interest paid by the Commonwealth on unclaimed money from 1 July 2013.

2.4 Part 1 of Schedule 1 amends the *Income Tax Assessment Act 1997* (ITAA), *Superannuation (Departing Australia Superannuation Payments Tax) Act 2007*, and *Superannuation (Unclaimed Money and Lost Members) Act 1999*, to make interest paid by the Commonwealth on unclaimed superannuation (other than interest paid on unclaimed superannuation belonging to former temporary residents)[1] a tax-free component of a superannuation benefit. Consistent with other tax-free superannuation benefits, these interest payments are non-assessable non-exempt income.

2.5 Part 2 of Schedule 1 amends the ITAA to make interest paid by the Commonwealth on forms of unclaimed money other than unclaimed superannuation – such as unclaimed bank accounts, corporate property, First Home Saver Accounts and life insurance moneys – exempt income.

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1 Payments of interest by the Commonwealth on the unclaimed money of former temporary residents reclaimed after 1 July 2013 are a taxable component of a superannuation benefit that has been untaxed in the fund and are subject to Departing Australia Superannuation Payments tax at a rate of 45 per cent. Explanatory Memorandum, p. 17.

Background and context of the amendments

2.6 In the 2012-13 Mid-Year Economic and Fiscal Outlook (MYEFO), the government announced new unclaimed moneys measures. These measures included the payment of interest from 1 July 2013 on unclaimed money for the period the money is held by the government. The government further announced that the interest rate would be calculated according to regulations, with the intention being that the rate would be calculated in accordance with the Consumer Price Index (CPI).

2.7 According to the Explanatory Memorandum, the payment of tax-exempt CPI interest is intended to preserve the real value of unclaimed money. Under the current law, any interest paid by the government would be subject to income tax. This taxation of this interest would be:

> …inconsistent with the Government's objective of ensuring the real value of unclaimed money is preserved, as individuals would receive the real value reduced by the relevant tax on the amounts of interest. To achieve its objective, the Government is legislating to ensure that interest paid by the Commonwealth on unclaimed money is generally not subject to income tax.[2]

2.8 The *Treasury Amendment (Unclaimed Money and Other Measures) Act 2012* gave effect to the new unclaimed moneys measures, but did not deal with the taxation of interest paid on unclaimed money.

Schedule 2: Fringe benefits tax – reform of airline transport fringe benefits

2.9 Schedule 2 of the Bill amends the *Fringe Benefits Tax Assessment Act 1986* (FBTAA) to align the special rules for calculating airline transport fringe benefits (as currently contained in Division 8 of Part III of the FBTAA) with the general provisions dealing with in-house property fringe benefits and in-house residual fringe benefits.

2.10 Schedule 2 also updates the method for determining the taxable value of airline transport fringe benefits to, according to the Explanatory Memorandum, 'simplify the practical operation of the law and to better reflect the economic value of the benefit.'[3]

Background and context of amendments

2.11 An airline fringe benefit may arise when an employee of an airline or travel agent is provided with free or discounted travel on a stand-by basis – that is, travel in which seating is subject to availability and is not guaranteed for the employee. The

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2 Explanatory Memorandum, p. 12.

3 Explanatory Memorandum, p. 21.

taxable value of airline transport fringe benefits is currently the stand-by value of the benefit less the employee contribution.[4]

2.12 According to the Treasurer's media release on the planned changes, the current method of calculating the fringe benefit value:

> …was developed when stand-by travel was a feature of commercial airline pricing and staff could be displaced from a flight up to the time of boarding. The concept of stand-by travel, however, is no longer commercially relevant as airlines now use discounted pricing to optimise passenger levels.[5]

2.13 According to the Explanatory Memorandum, stakeholders from the airline industry had also raised concerns about the time and resources required to calculate the taxable value of the benefit, particularly given stand-by travel is no longer offered by airlines commercially to members of the public.[6]

2.14 The Explanatory Memorandum further explains that the government announced the reforms in the 2012-13 Budget in response to these concerns.[7]

2.15 The amendments also progress recommendation 9(a) of the *Australia's Future Tax System Review*, which stated that 'market value should generally be used to value fringe benefits.'[8]

Schedule 3: Sustainable Rural Water Use and Infrastructure Program (SRWUIP)

2.16 Schedule 3 of the bill amends the ITAA 1997 to allow participants in SRWUIP to choose to make payments they derive under the program free of income tax (including capital gains tax). If the payment recipient chooses this approach, expenditure that is made because of the payments is non-deductible and does not form part of the cost of any asset it is spent on.

2.17 Alternatively, payment recipients can choose the existing income tax treatment of payments they derive under the SRWUIP. Under these arrangements, payments under the SRWUIP are generally taxable in the year they are received, either as a subsidy included in assessable income or, to the extent that the payment is

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4 Free or discounted travel provided to employees *without* stand-by restrictions is not an airline transport fringe benefit, but is instead taxable under the ordinary in-house property and residual fringe benefits rules. Explanatory Memorandum, p. 21.

5 The Hon Wayne Swan MP and the Hon David Bradbury MP, '2012-13 Budget builds on growing record of tax reform,' *Joint media release*, 8 May 2012.

6 Explanatory Memorandum, pp. 22–23.

7 Explanatory Memorandum, p.23.

8 Report on Australia's Future Tax System, December 2009, *Part One: Overview*, p. 82.

deemed consideration for the supply of surrendered water rights, as a capital gain. The expenditure on improvements is usually then deductible over time.

2.18 The amendments commence on Royal Assent but apply in relation to payments made by the Commonwealth on or after 1 April 2010.[9]

Background and context of the amendments

2.19 SRWUIP is a component of the Commonwealth's *Water for the Future* program. SRWUIP payments from the Commonwealth are used to upgrade irrigation and other rural infrastructure to improve water efficiency and sustainability. A set part of the water saved as a result of these improvements is then transferred to the Commonwealth, which in turn uses the water for environmental purposes.

2.20 Under the current income tax treatment of SRWUIP payments (see above), recipients of payments may need to fund the gap between incurring the tax liabilities and expenditure obligations associated with the payment and fully realising the tax effect of the expenditure that corresponds to the payments.

2.21 The Government announced on 18 February 2011 that it would amend the taxation law to remove the timing discrepancy between when SRWUIP payments are taxed and when deductions are available for grant applications for expenditure under the program.[10]

2.22 Under the arrangements in the bill, the taxpayer can either:

(a) chose the existing treatment of their SRWUIP payments and related expenditure; or

(b) make the subsidy part of their payment non-assessable non-exempt income, and disregard any capital gain or loss from transferring the water rights. If the taxpayer chooses this option, expenditure that is made because of the payments is not deductible and does not form part of the cost of any asset it is spent on.

2.23 The Explanatory Memorandum notes that some taxpayers would choose the existing tax treatment, given 'the amount included in their assessable income could be less than their deductions for expenditure on infrastructure improvements because they can access a CGT concession for the transfer of their water rights (for example, the rights might be a pre-CGT asset that is exempt from CGT or there might be a reduction in any capital gain on disposal of rights, such as the 50 per cent discount available to individuals and trusts).'[11]

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9 For more detail on the application and transitional provisions, see Explanatory Memorandum, pp. 51–52.

10 The Hon Tony Burke MP and the Hon Simon Crean MP, 'New approach to water recovery in the Murray Darling Basin,' *Joint media release*, 18 February 2011.

11 Explanatory Memorandum, p. 40.

2.24 However, as the Explanatory Memorandum further explains, other taxpayers would choose the new treatment, given that under current arrangements they 'could find themselves being taxed on the payments they receive in a year before they can deduct all the related expenditure. Because they are required to spend an amount equal to the Commonwealth payment on infrastructure improvements, having to pay the tax could create a financial gap that is only made good when the deductions are eventually available.'[12]

Schedule 4: Self-managed superannuation funds (SMSFs) – acquisitions and disposals of certain assets between related parties

2.25 Schedule 4 of the bill amends the *Superannuation Industry (Supervision) Act 1993* (SIS Act) to prescribe requirements for acquisitions and disposals of certain assets between SMSFs and related parties.

2.26 Specifically, Schedule 4:

(a) amends the existing prohibition on superannuation funds acquiring assets from related parties so that it applies to all regulated superannuation funds other than SMSFs;

(b) introduces a specific prohibition against trustees and investment managers of SMSFs acquiring assets from related parties, subject to certain exceptions;

(c) introduces new rules for SMSF trustees and investment managers when disposing of assets to related parties;

(d) introduces a prohibition on schemes which avoid the operation of the new rules regulating SMSF related party transactions; and

(e) introduces administrative and civil penalties for contravention of these new rules.

Background and context of amendments

2.27 As the Explanatory Memorandum notes, the *Super System Review* (the Review) expressed concerns that the off-market acquisition and disposal of assets between related parties and SMSFs, where the buyer and seller are effectively the same person, 'lacks transparency, is inherently risky and is open to greater abuse that non-related party transactions.'[13]

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12 Explanatory Memorandum, p. 40.

13 Explanatory Memorandum, p. 55. The Review was announced by the government on 29 May 2009, and provided its final report to the government on 30 June 2010.

2.28 In particular, the Review suggested that current provisions regulating SMSF related party acquisitions are insufficient to mitigate the risk of transaction date and asset value manipulation to illegally benefit the SMSF or a related party.[14]

2.29 The Review considered prohibiting all SMSF related party transactions, but concluded that SMSFs should have the ability to conduct certain limited party transactions.

2.30 As such, the Review recommended that acquisitions and disposals of assets between related parties and SMSFs should be conducted through an underlying market, or, where an underlying market does not exist, be supported by a valuation from a suitably qualified independent valuer.

2.31 The amendments in the Bill implement the government's response to these recommendations. According to the Explanatory Memorandum, the new requirements given effect in the Bill are intended to 'ensure that these transactions are conducted with transparency and are not used to circumvent the requirements of the superannuation law.'[15]

Schedules 5 and 6: Loss carry-back tax offset

2.32 Schedules 5 and 6 amend the income tax law to allow corporate tax entities to carry back tax losses to previous income years. This is achieved by allowing corporate tax entities that have paid tax in the past, but are now in a tax loss position, to obtain a refund of some of the tax they have previously paid, in the form of a refundable tax offset.

2.33 The amendments would allow a corporate tax entity the choice of carrying back all or part of an unutilised tax loss from the current income year, or from the preceding income year, against an unutilised income tax liability for either of the two years before the current year.

2.34 The available tax offset would be the lowest of the following:

(a) the tax value of the amount of the loss the entity chooses to carry back;

(b) the entity's franking account balance at the end of the current year;

(c) $1 million multiplied by the corporate tax rate ($300,000 based on the current corporate tax rate of 30 per cent); and

(d) the entity's tax liability for the income year(s) it carries the loss back to.

2.35 Only tax losses – which generally occur when deductions exceed income over the income year – may be carried back. Capital losses cannot be carried back, as the capital gains tax regime operates on a realisation basis. As the Explanatory

14 Explanatory Memorandum, pp. 55–56.

15 Explanatory Memorandum, p. 55.

Memorandum points out, allowing capital losses to be carried back 'to produce a tax offset would mean that entities could choose to realise their capital losses to get an offset but defer their capital gains.'[16]

2.36 The loss carry-back measure applies to assessments from the 2012-13 income year onward. A transitional one year carry-back period would apply for 2012-13.

Background and context of amendments

2.37 The 2010 *Australia's Future Tax System Review* recommended that 'companies should be allowed to carry back a revenue loss to offset it against the prior year's taxable income, with the amount of any refund limited to the company's franking account balance.'

2.38 Following the Tax Forum in October 2011, the Government established the Business Tax Working Group (BTWG) to consider Australia's business tax system.

2.39 Following consultations with interested parties on loss carry-back (see 'consultation,' below), BTWG issued its *Final Report on the Tax Treatment of Losses*, which recommended a model of loss carry-back that would:

(a) be limited to companies;

(b) provide a two-year loss carry-back period on an ongoing basis; and

(c) place a $1 million cap on the amount of losses that could be carried back.

2.40 On 6 May 2012, the government announced that it would introduce loss carry-back for corporate tax entities.[17] The discussion paper released by the government shortly thereafter (see 'consultation,' below) indicated that the government's loss carry-back model would be based on the model recommended by BTWG, including the design features listed above.[18]

2.41 As the Assistant Treasurer, the Hon David Bradbury MP, and the then Minister for Small Business, the Hon Brendan O'Connor MP, noted in their joint media release announcing the loss carry-back measure, businesses are already able to carry forward their tax losses to offset future profits and reduce future tax liabilities. According to Mr Bradbury and Mr O'Connor's media release, allowing businesses to also carry back their losses to offset past profits will mean 'businesses can access their tax losses now – when they need to – rather than in the future when their businesses are performing better.'

16 Explanatory Memorandum, p. 84.

17 The Hon David Bradbury MP and the Hon Brendan O'Connor MP, 'Tax relief for businesses in our patchwork economy,' *Joint media release*, 6 May 2012.

18 Australian Government, *Improving access to company losses*, discussion paper, July 2012, pp

2.42 The Explanatory Memorandum draws this point out, suggesting loss carry-back will:

> …encourage companies to adapt to changing economic conditions and take advantage of new opportunities through investment. Firms will be able to utilise their tax losses sooner and reduce the extent to which they risk never being able to use those losses.[19]

2.43 The Explanatory Memorandum further suggests that the loss carry-back measures will help remove the tax system's current bias against sensible risk taking, increasing the quantity and the quality of corporate investment, and thereby improving the allocation of resources across the economy. This, according to the Explanatory Memorandum, will have a positive flow-on effect on productivity, and in turn on real wages growth and employment.[20]

2.44 The Explanatory Memorandum also notes that the measures are targeted at small and medium sized businesses. Whereas large companies and consolidated groups are often able to offset losses in one activity against profits from other activities, improving their ability to utilise current losses, this approach is often not available to small and medium sized businesses:

> [C]ompanies that undertake only one business activity do not have other sources of income against which to offset their losses. Companies that make a current year loss are therefore required to carry that loss forward.[21]

Consultation

2.45 BTWG undertook broad consultations on loss carry-back. This process included an invitation for written submissions from businesses and the wider community on issues and ideas discussed in an interim report on the subject, which resulted in the receipt of 24 submissions; meetings with stakeholders in Melbourne, Sydney, Brisbane and Perth; and consultations with the Australian Taxation Office on matters concerning the implementation of the measure.[22]

2.46 Following the government's announcement of its intention to introduce loss carry-back, in July 2012 the Assistant Treasurer released a discussion paper, *Improving access to company losses*, and invited written submissions in response.[23] In August 2012, the Treasurer released an exposure draft package, including the draft

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19 Explanatory Memorandum, p. 76.

20 Explanatory Memorandum, pp. 76-79.

21 Explanatory Memorandum, p. 127.

22 For details on the BTWG's consultations, see the Regulation Impact Statement in the Explanatory Memorandum, pp. 147-49.

23 The discussion paper and submissions received in response are available at http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/company-losses-access.

legislation and explanatory memorandum for loss carry-back, for public consultation.[24]

Schedule 7: Miscellaneous Amendments

2.47 Schedule 7 makes a number of miscellaneous amendments to various taxation laws to correct minor technical and drafting defects, and remove anomalies and legislative uncertainties.

24 The exposure draft package is available at http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/company-losses-access-Exp-Draft.