The Senate

Standing Committee on Economics

Tax Laws Amendment (2007 Measures No. 5) Bill 2007 [Provisions]

September 2007

© Commonwealth of Australia 2007

ISBN 978-0-642-71871-6

Printed by the Senate Printing Unit, Parliament House, Canberra.

Senate Standing Committee on Economics

Members

Senator the Hon Michael Ronaldson, Chair	Victoria, LP
Senator Ursula Stephens, Deputy Chair	New South Wales, ALP
Senator Cory Bernardi	South Australia, LP
Senator Grant Chapman	South Australia, LP
Senator Annette Hurley	South Australia, ALP
Senator Barnaby Joyce	Queensland, NATS
Senator Andrew Murray	Western Australia, AD
Senator Ruth Webber	Western Australia, ALP

Secretariat

Mr Peter Hallahan, Secretary
Ms Sophie Power, Principal Research Officer
Mr Andrew Bomm, Senior Research Officer
Dr Richard Grant, Senior Research Officer
Ms Stephanie Holden, Senior Research Officer
Mr Glenn Ryall, Estimates/Research Officer
Ms Lauren McDougall, Executive Assistant

PO Box 6100
Parliament House
Canberra ACT 2600
Ph: 02 6277 3540
Fax: 02 6277 5719
E-mail: economics.sen@aph.gov.au
Internet: http://www.aph.gov.au/senate/committee/economics_ctte/index.htm

Table of contents

Membership of the Committee ... iii

Chapter 1 ... **1**

Introduction ... **1**

Background ... 1

Conduct of the inquiry ... 1

Chapter 2 ... **3**

Schedule 1—Tax preferred entities (Asset financing) ... **3**

Background and existing arrangements ... 4

Evidence received by the committee ... 6

Chapter 3 ... **11**

Schedule 2—Thin capitalisation—Excluded equity interests ... **11**

Chapter 4 ... **13**

Schedule 3—Thin capitalisation—Application to certain groups ... **13**

Background ... 13

Chapter 5 ... **15**

Schedule 4 – Capital gains tax marriage breakdown roll-over for small superannuation funds ... **15**

Chapter 6 ... **17**

Schedule 5—Prime Minister's Prizes ... **17**

Overview ... 17

Background and summary ... 17

Intended benefits of changes ... 17

Chapter 7 ... **19**

Schedule 6—Removal of the same business test cap ... **19**

Overview 19

Background and summary 19

Chapter 8 23

Schedule 7 – Partial capital gains tax roll-over for statutory licences 23

Overview 23

Background and summary 23

Chapter 9 27

Schedule 8 – Australian property trusts and stapled entities............................27

Provisions of the bill..27

Background..27

Recommendation 1.. 28

Chapter 10 31

Schedule 9—Deductible gift recipients..31

Overview 31

Background and summary 31

Intended benefits of changes 32

Chapter 11 33

Schedule 10 – Film production offsets 33

Overview 33

Background and summary 33

Intended benefits of changes 34

Issues with the bill 34

Effect on the independent production sector 34

Short animation series 39

Depreciation of capital assets 41

Production expenditure thresholds 42

Appropriate arrangements for transition 42

Committee view 43

Recommendation 2 44

Recommendation 3 45

Recommendation 4 45

Recommendation 5 46

Chapter 12 47

Schedule 11—Research and development tax concession 47

Background 47

Evidence on the Schedule 48

Committee view 51

Chapter 13 53

Schedule 12—Innovation Australia 53

Recommendation 6 54

APPENDIX 1 55

Submissions Received 55

APPENDIX 2 57

Public Hearing and Witnesses 57

APPENDIX 3 59

Response to Question on Notice taken by Treasury 59

Chapter 1

Introduction

Background

1.1 The Tax Laws Amendment (2007 Measures No. 5) Bill 2007 was introduced into the House of Representatives on 16 August 2007. On the same day, the Senate referred the provisions of the bill to the Senate Standing Committee on Economics for report by 5 September 2007.

Conduct of the inquiry

1.3 The committee advertised the inquiry in the *Australian* newspaper on 22 August 2007 and invited written submissions by 24 August 2007. Details of the inquiry were placed on the committee's website. The committee also wrote to a number of organisations and stakeholder groups inviting written submissions.

1.4 The committee received 18 submissions. These are listed in Appendix 1. A public hearing was held in Adelaide on 28 July 2007, at which Treasury and officers of the Department of Communications, Information Technology and the Arts and the Department of Industry, Tourism and Resources gave evidence by teleconference. Witnesses who presented evidence at this hearing are listed in Appendix 2.

1.5 The committee thanks those who participated in this inquiry.

Chapter 2

Schedule 1—Tax preferred entities (Asset financing)

2.1 Schedule 1 to the bill amends the income tax law to modify the taxation treatment of financing arrangements between public private partnerships (PPPs). The changes are intended to simplify the tax treatment of leasing and similar arrangements between taxpayers and the tax exempt sector for financing and providing infrastructure and other assets.[1] They 'will effectively remove a complex aspect of the current arrangements, and bring two different provisions of the 1936 Tax Act into one consolidated provision in the new law.'[2]

2.2 The policy objective of the provisions in the income tax law affecting tax-exempt asset financing arrangements is to restrict the transfer of tax preferences between taxable entities and tax-exempt entities (including non-residents).[3] The objective of the measure in Schedule 1 is to provide a more coherent and neutral tax treatment that reflects the economic substance of the arrangement.

2.3 Schedule 1 adds Division 250 to the *Income Tax Assessment Act 1997* (ITAA 1997). The aim of Division 250 is to encourage private sector investment in pubic–private partnerships (PPPs) by reducing compliance costs, providing tax benefits and giving greater certainty to private builders of major infrastructure. The legislation can therefore be viewed as a stimulus to PPP activity in Australia. The measure will apply if, broadly:

- the tax exempt entity (the public agency)[4] directly or indirectly uses, or effectively controls the use of the asset; and
- the taxpayer (the private investor) does not have the predominant economic interest in the asset.[5]

2.4 The Division will deny or reduce capital allowance deductions if the asset is put to a tax preferred use and the taxpayer has insufficient economic interest in the asset. (Schedule 1 of the bill defines and introduces into the ITAA 1997 various terms

---

1 The Hon. Mal Brough, MP, Minister for Revenue and the Assistant Treasurer, 'Tax Exempt Asset Financing Reforms', Press Release No. 081, 13 September 2005.

2 The Hon. Mal Brough, MP, Minister for Revenue and the Assistant Treasurer, 'Tax Exempt Asset Financing Reforms', Press Release No. 081, 13 September 2005.

3 EM, p. 105.

4 'Tax exempt entities' refers to federal, state and local governments, as well as charitable and other institutions such as hospitals and religious bodies. Tax preferred entities includes tax exempt entities as well as non-residents.

5 The Hon. Peter Dutton MP, Minister for Revenue, 'Continuing to Improve Australia's tax system', Media Release No. 100, 16 August 2007. See also, EM, pp 13 and 15.

relating to tax preferred use of an asset.[6]) Where deductions are denied or reduced, Division 250 treats the arrangement as a deemed loan that is taxed as a financial arrangement on a compounding accruals basis. The effect of such treatment is to allow deductions for interest payments which are spread over the period of the arrangement rather than over the period of the effective life of the asset.[7] Depending on the particular arrangement, this can spread deductions over a longer period.[8] This differs from existing treatment under the *Income Tax Assessment Act 1936* (ITAA 1936) where deductions are denied and all the proceeds from the arrangement are assessable (section 51AD) or capital allowance deductions are denied and the arrangement is treated as a deemed loan that is taxed on a cash receivables basis (Division 16D).[9]

2.5 Division 250 also contains various exclusions such as certain short-term and low value arrangements. Additionally, it does not apply to arrangements that operate for less than 12 months, where the taxpayer is a small business entity or where the financial benefits provided by the tax preferred sector do not exceed $5 million.[10]

2.6 The provisions of Schedule 1 offer more flexibility and incentives for public-private investment than current arrangements.

Background and existing arrangements[11]

2.7 A general principle of the income tax law is that, in order to claim deductions for expenditure relating to ownership of an asset (such as capital allowances), the owner must show that the asset is used for the purpose of producing assessable income or in carrying on a business for that purpose.

2.8 Stakeholders in public private partnerships developed arrangements to circumvent this principle[12] and so section 51AD and Division 16D of Part III of the ITAA 1936 were enacted in the 1984-85 income year to prevent the mischief. Section 51AD was designed to operate as an 'anti-avoidance' provision against this background because the large scale nature of the arrangements posed a significant threat to the revenue base.

2.9 Currently, section 51AD prevents a tax-exempt body—typically a government agency—from accessing tax benefits from an asset that is financed by highly leveraged non-recourse debt. Where this section applies, the taxpayer is assessed on

---

6 See items 2 to 24 of Schedule 1 of the bill.

7 Mr Anthony Regan, Manager, Company Tax Unit, Business Tax Division, Department of the Treasury, *Proof Committee Hansard*, 28 August 2007, p. 6.

8 Mr Regan, *Proof Committee Hansard*, 28 August 2007, p. 7.

9 EM, p. 17.

10 EM, pp 25–26 and pp. 43–50.

11 EM, pp 13–15.

12 See the EM at p. 14 for a description of these arrangements.

all the proceeds derived from the arrangement but is denied access to all deductions in respect of the asset (such as capital allowances and interest deductions).

2.10 Division 16D denies capital allowance deductions for the cost of, or capital expenditure on, property which a tax-exempt body uses under a finance lease or similar arrangement.[13] This division does not apply where section 51AD applies. If Division 16D applies, the arrangement is treated as a loan and payments made under that arrangement are treated as having an interest and principal component.

2.11 The amendments in Schedule 1 of the bill will replace section 51AD and Division 16D with Division 250 of the ITAA 1997. Division 250 will improve the taxation regime for asset financing arrangements between taxpayers and the tax-exempt sector as:

- the harsh impact of section 51AD will be removed;
- certain relatively short-term and lower value arrangements will be specifically excluded from the scope of the regime; and
- arrangements which come within the scope of the regime will be taxed as a financial arrangement on a compounding accruals basis.

2.12 Because of the specific exclusions in Division 250 and its more generous safe harbour tests, it will likely have a narrower scope than section 51AD and Division 16D.[14]

2.13 On 13 September 2005, the Minister for Revenue, the Hon. Mal Brough, announced the amendments to the law 'to give greater certainty for parties involved in major infrastructure projects'. He foreshadowed that the proposed amendments will insert a ‘lease, use or control of use of the asset’ test into the *Income Tax Assessment Act 1997*. He added:

> Stakeholders are familiar with the operation of the ‘lease, use or control of use of the asset’ test in the existing law. This is an important consideration in enhancing continued investment in Australia’s infrastructure. Stakeholder concerns about the scope of arrangements affected by the reforms being broadened by the use of new risk based tests will be alleviated by this change.[15]

2.14 On 16 August 2007, the Minister for Revenue, the Hon. Peter Dutton, announced the introduction of the legislation. He noted that the measure will apply to arrangements entered into on or after 1 July 2007, while the denial of all tax

---

13 EM, p. 15.

14 EM, p. 21.

15 The Hon. Mal Brough, MP, Minister for Revenue and the Assistant Treasurer, 'Tax Exempt Asset Financing Reforms', Press Release No. 081, 13 September 2005.

deductions in certain circumstances under section 51AD will cease to apply to arrangements entered into on or after 1 July 2003.[16]

Evidence received by the committee

2.15 The committee received seven submissions that commented on Schedule 1, one of which was confidential. Overall, submissions were supportive of the Schedule which is the outcome of an extensive consultation process between stakeholders and the Treasury.[17] Although there are some areas of concerns with the legislation,[18] submitters did not wish to see the passage of the bill delayed.

2.16 Broadly, submissions can be divided into three categories, as follows:

- those that welcome the amendments as a means of encouraging investment in infrastructure (Property Council of Australia, CPA Australia, Infrastructure Partnerships Australia, and Australian Chamber of Commerce and Industry);
- those that consider the amendments unfairly discriminate against Australian investors in foreign real estate – for example property trusts (Property Council of Australia); and
- the Minerals Council of Australia submission that points out that although the Australian minerals industry supplies commodity to tax exempt state owned corporations, Division 250 provisions will not apply in this context, a point of view it contends is supported by some of the examples in the Explanatory Memorandum (Examples 1.3 and 1.4).[19] Therefore the Council supports Schedule 1 of the bill on the proviso that these examples remain in their current form.

The 'limited recourse debt test'

2.17 One of the tests for applying Division 250 to a taxpayer in respect of an asset is that the taxpayer lacks a predominant economic interest in the asset. There are several tests in the division to determine whether this is the case and one of these is the 'limited recourse debt test'. Under this test the taxpayer lacks a predominant economic interest in an asset at a particular time if:

---

16 The Hon. Peter Dutton MP, 'Continuing to improve Australia's tax system', Media Release No. 100, 16 August 2007.

17 EM, pp 113 and 114.

18 See for example, *Submission 9*, Property Council of Australia; *Submission 15*, Infrastructure Partnerships Australia; *Submission 17*, Australian Chamber of Commerce and Industry.

19 *Submission 7*, Minerals Council of Australia, p. 1.

- where the asset is put to tax preferred use by a tax preferred end user, more than 80 per cent of the cost of acquiring or constructing the asset is financed (directly or indirectly) by limited recourse debt;[20] or
- where the asset is put to tax preferred use by an end user that is a non-resident, more than 55 per cent of the cost of acquiring or constructing the asset is financed (directly or indirectly) by limited recourse debt.

2.18 As well as applying in relation to public private partnership arrangements in Australia, the Division can also apply where Australian taxpayers invest overseas and the tax preferred end user in such an instance is a non-resident. The Property Council of Australia submitted that there is no sound public policy ground for the distinction between residents and non-residents in relation to their levels of limited recourse debt.[21] Mr Trevor Cooke, Executive Director, International and Capital Markets Division, Property Council of Australia told the committee that 'the 55 per cent test is too low and…it should be harmonised with that applying to domestic, which is 80 per cent.'[22] The Property Council submission argues that as it stands, the provision will:[23]

- generate additional foreign taxes payable by Australian investors in overseas real estate;
- put Australian investors at a disadvantage when bidding for foreign real estate assets;
- mean that Australian investors will take more risk and pay more to foreign banks for that risk; and
- penalise Australian investment.

2.19 Further, the submission suggests that foreign investors are not interested in tax benefit transfers and equalising the threshold will not give an advantage to foreigners.

2.20 Mr Tony Regan, Manager, Company Tax Unit, Business Tax Division, Department of the Treasury, told the committee that the fundamental policy question is that capital allowance deductions are intended to encourage investment in Australia rather than investment offshore.[24] Under the current law, an asset that is predominantly financed by non-recourse debt triggers section 51AD. When that occurs all capital allowance and interest deductions are denied.

2.21 However, Division 250 will relax the 50 per cent test for non-residents. Mr Regan stated that this will:

---

20 'Limited recourse debt' is defined in the section 243-20 of the ITAA 1997. Section 250-115 of Schedule 1 of the bill, further refines the definition as it applies to the test.

21 Property Council of Australia, *Submission 9*, p. 2.

22 *Proof Committee Hansard*, 28 August 2007, p. 2.

23 Property Council of Australia, *Submission 9*, pp 3 – 4.

24 *Proof Committee Hansard*, 28 August 2007, p. 6.

> …build some tolerance into [the test]. It will relax it to a greater extent where the asset is in Australia. But it also does not deny deductions as such. Strictly speaking, it denies capital allowance deductions but keeps the arrangement as a loan.[25]

2.22 Currently, the position is that a 50 per cent test exists for both residents and non-residents. As a result of representations received during the consultation process, the Government decided to increase those thresholds to 80 per cent for residents and 55 per cent for non-residents. Essentially, the increase to 55 per cent for non-residents was to build some tolerance into the test so that it would not be triggered it by a marginal breach of the 50 per cent test.[26]

Committee comment

2.23 The committee understands that the primary aim of the legislation is to encourage investment in Australia rather than investment offshore, so it is not persuaded about the need to equalise the proportion of non-recourse debt between residents and non-residents in this particular legislation.

2.24 The committee notes the evidence of Mr Regan that the Board of Taxation is currently reviewing the foreign income attribution rules (as part of the Board's Review of the Anti-Tax-Deferral Regimes) and depending on its findings, some future modification of the limited recourse debt test may be possible.[27]

Other issues

2.25 The Committee also received a submission from Deloitte Touche Tohmatsu Ltd which supported the bill for its removal of the 'draconian' impacts of section 51AD and the inclusion of 'many of the significant issues raised during the earlier consultation process'.[28] However, it raised some technical issues that it believed need to be corrected in three areas of the bill.

2.26 First, Deloitte expressed concern that the wording of Division 250-50 may define an 'end-user' in terms of the use or control of the property by the tax-exempt entity post transfer. This is inconsistent with the 'end user' test in section 51AD, which did not examine the use of control of the asset post the transfer. Accordingly, Deloitte recommends changing the definition of 'user end' in Division 250–50(1) to insert the words *during the arrangement period*.

---

25 *Proof Committee Hansard*, 28 August 2007, p. 6.

26 Mr Regan, *Proof Committee Hansard*, 28 August 2007, p. 7.

27 Mr Regan, *Proof Committee Hansard*, 28 August 2007, p. 8.

28 Deloitte Touche Tohmatsu Ltd, *Submission 6*.

2.27 Second, Deloitte argued that Division 250 may apply inappropriately to the controlled foreign companies (CFC) regime in cases where a CFC leases property located outside Australia to another non-resident entity. Section 383 of the ITAA 1997 does not assume that the other non-resident entity is to be treated as a resident for the purpose of Division 250. Deloitte therefore suggested that Division 250 be excluded:

> …until such time that proper consultation has occurred in respect of this interaction provision. We believe that a technical correction should be made to section 389 and 557A to achieve this result.[29]

2.28 Third, Deloitte noted that the transition rule in Schedule 1, Part 3, subitem 71(11) only has application from 1 July 2007, whereas the EM (paragraph 1.287) states that the legislation will be backdated to 1 July 2003. It argued that a technical amendment was required to change the reference from 1 July 2007 to 1 July 2003 to ensure that those affected by section 51AD since July 2003 are not adversely affected.

2.29 The committee did not canvass these issues during its public hearing and can therefore make no comment on them.

---

29 Deloitte Touche Tohmatsu Ltd, *Submission 6*, p. 3.

Chapter 3

Schedule 2—Thin capitalisation—Excluded equity interests

3.1 The ATO refers to this measure as a 'technical correction'.[1] The Explanatory Memorandum states that the amendment 'corrects an unintended consequence'.[2] To prevent manipulation of the thin capitalisation rules — through temporary, artificial inflation of equity and asset levels — certain short-term equity interests are excluded from thin capitalisation calculations for income years beginning on or after 1 July 2002.

3.2 The bill amends the definition of 'excluded equity interest' in the *Income Tax Assessment Act 1997* (ITAA 1997) to ensure that equity interests that remain on issue for a total period of 180 days or more do not become excluded equity interests, even if those interests have been on issue for less than 180 days at the valuation day.[3]

Background[4]

3.3 The thin capitalisation rules in Division 820 of the ITAA 1997 are designed to ensure that both Australian and foreign-owned multinational entities do not allocate an excessive amount of debt to their Australian operations. The rules operate to disallow a proportion of otherwise deductible finance expenses (eg interest payments) where the debt used to fund the Australian operations exceeds certain thresholds.

3.4 The thin capitalisation rules contain a number of integrity measures to prevent entities manipulating them. An ‘excluded equity interest’ is an example of an integrity measure. It is defined in subsection 820-946(2A) of the ITAA 1997. This provision is intended to prevent an entity (other than an authorised deposit-taking institution) from issuing a short-term equity interest just prior to the day on which its assets are valued for thin capitalisation purposes (the valuation day) — thereby increasing its assets and potentially allowing the entity to hold more debt under the safe harbour test — and then cancelling the interest shortly thereafter.

3.5 Manipulation of the value of an entity’s assets by the use of short-term equity interests is possible where the interest holder is not subject to the thin capitalisation

---

1 Australian Taxation Office (ATO) website, (accessed 22 August 2007): http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/00105190.htm

2 EM, p. 118.

3 Australian Taxation Office (ATO) website, (accessed 22 August 2007): http://www.ato.gov.au/taxprofessionals/content.asp?doc=/content/00105190.htm

4 EM, pp 117–118.

rules (eg, because it is an exempt entity), or where the issuer and holder of the interest are both subject to the rules but have different valuation days.

3.6 An equity interest that is an excluded equity interest is deducted from the total assets of the entity that issues the interest, which in turn reduces its maximum allowable debt. Thus, the issuer is prevented from gaining an advantage where such equity interests are issued prior to a valuation day and cancelled shortly thereafter.

3.7 The current definition of excluded equity interest excludes from thin capitalisation calculations equity interests that have been on issue for less than 180 days at the valuation day, regardless of how long those interests ultimately remain on issue. This is an unintended consequence of the definition, as it may capture equity interests that remain on issue for a total period of 180 days or more and are genuinely intended to be long-term.

3.8 Therefore, Schedule 2 of the bill amends the definition of 'excluded equity interest' in subsection 820-946(2A) of the ITAA 1997, the effect of which is to exclude from the definition certain long-term equity interests.

3.9 There were no submissions received in relation to this Schedule.

Chapter 4

Schedule 3—Thin capitalisation—Application to certain groups

4.1 Schedule 3 to the bill introduces a choice mechanism under which a particular type of authorised deposit-taking institution (ADI) — known as a specialist credit card institution — may, in certain circumstances, be treated for thin capitalisation purposes as if it was not an ADI but rather as if it was a financial entity.

Background

4.2 There are various tests that entities may use to determine their thin capitalisation position — the 'safe harbour' test, the 'arm's length' test and the 'worldwide gearing' test. The tests require the calculation of an entity's debt, assets and/or equity. The calculation method depends on various classifications of the entity, two of which are whether the entity is an authorised deposit-taking institution (ADI) or a financial entity that is not an ADI.

4.3 Specialist credit card institutions (SCCIs) were a new class of ADI established in 2003 as part of reforms to the credit card market. SCCIs are authorised under the *Banking Act 1959* to conduct banking business that is confined to credit card acquiring and/or credit card issuing. They are authorised and supervised by APRA which supervises them differently to other ADIs because of the limits placed on the banking business that they can conduct.

4.4 Unlike other ADIs, the capital adequacy of SCCIs is not determined on a consolidated group basis where an SCCI is part of a group that does not contain any other types of ADI. In this case, the capital adequacy requirements apply to an SCCI and its subsidiaries (if any) on a consolidated basis but not to the wider corporate group.

4.5 At the time the thin capitalisation rules were introduced, they did not foresee the advent of ADIs whose capital adequacy is not determined on a consolidated group basis for prudential purposes. Hence, the rules require all consolidated or multiple entry consolidated (MEC) groups containing ADIs to determine capital adequacy taking into account risk-weighted assets on a group-wide basis. In the case of groups containing only specialist credit card institutions, this unnecessarily increases compliance costs.

4.6 Therefore the amendments in the bill will allow the head company of a consolidated or MEC group containing one or more ADIs to apply the thin capitalisation rules as if the group did not contain an ADI, where all the ADIs in the group are specialist credit card institutions. Each specialist credit card institution will instead be treated as if it was a financial entity.

4.7 There were no submissions received in relation to this Schedule.

Chapter 5

Schedule 4 – Capital gains tax marriage breakdown roll-over for small superannuation funds

5.1 Schedule 4 of the bill implements a 2007 Budget measure announced by the Minister for Revenue and Assistant Treasurer on 8 May 2007. When announcing the measure, the Minister explained that:

> Currently the CGT roll-over for assets of small superannuation funds on marriage breakdown applies only to the spouse who benefits from a payment split made under the *Family Law Act 1975* and only to the assets subject to the payment split. These assets can only be rolled over to another small superannuation fund.[1]

5.2 Schedule 4 proposes to amend the *Income Tax Assessment Act 1997* to extend the capital gains tax (CGT) marriage breakdown roll-over to *in specie*[2] transfers of personal superannuation interests from a small superannuation fund[3] to another complying superannuation fund under specific conditions. According to the Explanatory Memorandum, these amendments would ensure that 'CGT need not be an impediment to separating spouses achieving a 'clean break' from each other in terms of their superannuation arrangements'.[4]

5.3 This measure has apparently been 'generally welcomed'. However, one commentator was disappointed that the proposed changes were not made effective from the time of the announcement in May, rather than to CGT events that happen on or after 1 July 2007.[5]

5.4 The committee received few comments on the Schedule during the inquiry. The Certified Practicing Accountants of Australia noted that:

> …a CGT roll-over on marriage breakdown to ensure that CGT is not an impediment to separating spouses achieving a 'clean break' from each other

---

1 The Hon Peter Dutton MP, Minister for Revenue and the Assistant Treasurer, 'Extending Small Superannuation Fund Capital Gains Tax (CGT) Roll-over on Marriage Breakdown', Press Release No. 046, 8 May 2007.

2 Where fund members contribute non-cash assets (such as shares) into a super fund, these are known as in-specie contributions: see further Australian Taxation Office *SMSF Newsletter*, Edition 1, at: http://www.ato.gov.au/super/content.asp?doc=/Content/85847.htm&page=2&H2 (accessed 21 August 2007).

3 A 'small superannuation fund' is defined as a complying superannuation fund with four or fewer members: see *Explanatory Memorandum*, p. 132.

4 EM, p. 130.

5 See further Tim Blue, 'Split the difference in assets', *The Weekend Australian*, 12 May 2007, p. 38.

> in terms of their superannuation arrangements, will also be of benefit to affected taxpayers and also the community generally.[6]

5.5 The committee considers that the schedule appears to be uncontroversial and should be supported without amendment.

---

6 CPA Australia, *Submission 12*, p. 2.

Chapter 6

Schedule 5—Prime Minister's Prizes

Overview

6.1 Schedule 5 of the bill seeks to amend the *Income Tax Assessment Act 1997* to exempt from income tax the Prime Minister's Prize for Australian History and the Prime Minister's Prize for Science, to the extent that the prizes would otherwise be assessable income.[1]

Background and summary

6.2 On 20 June 2007 the Prime Minister announced that the Prime Minister's Prize for Australian History would be made tax exempt.[2]

6.3 The amendments will apply to assessments for the 2006-07 income year and later income years.[3] As a result, from 1 July 2006, the Prime Minister's Prize for Australian History and the Prime Minister's Prize for Science will be exempt from income tax to the extent that the prizes would otherwise be assessable income.[4]

6.4 The amendments will have a negligible financial impact.[5]

Intended benefits of changes

6.5 These amendments will ensure that no tax is payable on the Prime Minister's Prize for Australian History or the Prime Minister's Prize for Science.[6]

6.6 No submissions were received in relation to this schedule.

---

1 EM, p. 139.

2 EM, p. 139, see also The Hon John Howard MP, Media Release: Australian History Prize, 20 June 2007, p. 1 of 1, http://www.pm.gov.au/media/Release/2007/Media_Release24372.cfm (accessed 24 August 2007).

3 EM, p. 6.

4 EM, p. 139.

5 EM, p. 6.

6 EM, p. 139.

Chapter 7

Schedule 6—Removal of the same business test cap

Overview

7.1 Schedule 6 of the bill seeks to amend the company loss recoupment rules in the *Income Tax Assessment Act 1997* to remove the $100 million total income cap on the same business test.

Background and summary

7.2 Under the company loss recoupment rules, a company is only able to claim deductions for prior year losses if it satisfies the continuity of ownership test or the same business test.

7.3 The continuity of ownership test broadly requires that the shares carrying more than 50 per cent of all voting, dividend and capital rights be beneficially owned by the same persons at all times during the ownership test period. The ownership test period is the period from the start of the loss year to the end of the income year in which the loss is to be deducted.

7.4 The same business test requires a company to carry on the same business in the income year a loss is claimed as a deduction at the 'test time'. The 'test time' is either the point in time that the continuity of ownership test is no longer satisfied, or the start of the income year when the loss is incurred where it is not practicable for the company to show that it has satisfied the continuity of ownership test. Currently, companies with total income for an income year in excess of $100 million are denied access to the same business test for losses incurred on or after 1 July 2005.

7.5 These amendments seek to remove this $100 million total income cap on the same business test. The amendments are to apply from 1 July 2005 so that:

- companies with total income in excess of $100 million that satisfy the same business test are not denied access to losses incurred since 1 July 2005; and
- companies do not incur additional compliance costs by having to separately keep track of losses incurred since 1 July 2005.

7.6 In summary, below is a comparison of key features of the current and proposed new laws :

Current law	***Proposed new law***
A company can deduct prior year losses that are incurred on or after 1 July 2005 in an income year if: • the company satisfies the continuity of ownership test; or • the company's total income for the income year is $100 million or less *and* it satisfies the same business test.	A company will be able to deduct prior year losses that are incurred on or after 1 July 2005 in an income year if: • the company satisfies the continuity of ownership test; or • the company satisfies the same business test.

7.7 This measure will have the following revenue implications[1]:

2007-08	***2008-09***	***2009-10***	***2010-11***
-$15m	-$40m	-$50m	-$70m

Intended benefits of changes

7.8 These amendments are in response to concerns raised by business and professional groups and would be beneficial to taxpayers as they would make it easier for companies to deduct prior year losses by removing the $100 million total income cap on the same business test.[2]

Issues in relation to the schedule

7.9 At the hearing Senator Murray expressed some concern about Treasury's estimate of the revenue implications of lifting the $100 million cap on the same business test.[3] In the Explanatory Memorandum, Treasury estimates that removing the cap will result in a revenue loss of $175 million over the four years from 2007–08 to 2010–11.[4] At the hearing, Treasury noted that they were 'reasonably confident of that costing', in part because:

> When the same business test cap was brought in there was a relaxation of the continuity of ownership test, so basically it was easier for some

1 EM, p. 7.

2 EM, pp 141 and 143.

3 Senator Murray, *Proof Committee Hansard*, 28 August 2007, p. 5.

4 EM, p. 7.

companies to be able to claim losses applying the continuity of ownership test, which meant that fewer companies needed to rely on the same business test.[5]

5 Mr Anthony Regan, Manager, Company Tax Unit, The Treasury, *Proof Committee Hansard*, 28 August 2007, p. 5.

Chapter 8

Schedule 7 – Partial capital gains tax roll-over for statutory licences

Overview

8.1 Schedule 7 of the bill proposes to amend the *Income Tax Assessment Act 1997* to extend the existing statutory licence capital gains tax (CGT) roll-over (under Subdivision 124-C) to provide for roll-over where one or more new licences are issued in consequence of the ending of one or more licences and to provide for a partial roll over. A partial roll-over would apply where one or more statutory licences end and are replaced by one or more new licences and the licensee also received non licence capital proceeds such as money.

Background and summary

8.2 The Minister for Revenue and Assistant Treasurer announced this measure on 8 June 2007. At that time, he explained that the amendments would have particular application to the Achieving Sustainable Groundwater Entitlements (ASGE) program. The ASGE program is a joint NSW and Australian Government initiative to ensure the six major groundwater systems in NSW are sustainable in the long term.[1] The program aims to address groundwater over-allocation and over-extraction through a number of measures, including replacing existing groundwater licences. The program also includes a financial assistance package for affected licence holders of up to $100 million. However, payments under the ASGE have apparently been delayed for some time pending a range of matters, including clarification of their taxation status.[2] Indeed, the committee was told that to date, no cash payments have been made under the ASGE, even though many old groundwater licences have been replaced with new licences, often with lower entitlements.[3]

---

1 EM, p. 156; see also NSW Government, *Achieving sustainable groundwater entitlements program,* http://www.waterwise.nsw.gov.au/water/groundwater_entitlements.shtml (accessed 22 August 2007).

2 Mr Michael Murray, Gwydir Valley Irrigators Association (GVIA)/NSW Irrigators' Council (NSWIC), *Proof Committee Hansard*, 28 August 2007, p. 11; see also Sophie Morris, 'Compo to flow for irrigators', *Australian Financial Review*, 13 June 2007, p. 14; NSWIC, 'Taxation of Groundwater Payments The Prime Minister Must Act', Press Release, 20 June 2007, available at: http://www.nswirrigators.org.au/pdf/press_release/25%20million%20tax%207%20June.pdf (accessed 21 August 2007).

3 Mr Murray, GVIA/NSWIC, *Proof Committee Hansard*, 28 August 2007, pp 10-11; also GVIA and NSWIC, *Submission 13*, p. [2].

Intended benefits of changes

8.3 The amendments proposed by Schedule 7 would ensure that licence holders who are also offered a cash payment under the ASGE program will obtain a partial CGT roll-over where the access licence (and any other new licences) replaces the original bore licence or licences.[4]

8.4 Although the amendments have particular application to the ASGE, they also have broader application. For example, media reports have suggested that they may also be relevant to the buy back of water licences under the $10 billion National Plan for Water Security.[5]

Issues

8.5 The committee received one submission on schedule 7 of the Bill. The NSW Irrigators' Council (NSWIC) and the Gwydir Valley Irrigators Association (GVIA) generally welcomed the amendments in Schedule 7, telling the committee that they would 'rectify an anomaly' in the CGT treatment of payments under the ASGE.[6]

8.6 The GVIA and NSWIC were satisfied that the amendments 'will result in an equitable taxation treatment of licences and ex-gratia payments made under the ASGE program'. They explained that, without these amendments, in some cases individual CGT liability would exceed any ex-gratia payment received under the ASGE.[7]

8.7 However, the GVIA and NSWIC raised a concern about the timing of the CGT event C2.[8] They told the committee that their advice — including informal discussions with Treasury and the ATO — suggested that the CGT event C2 occurred on the day the old licences were extinguished and the new licences were issued. They pointed out that, in the case of the ASGE, the extinguishment of licences has occurred on different dates in different groundwater systems:

> …five of the six valleys had their licences extinguished in the last financial year but the licences for the Lachlan Valley have not yet been extinguished

---

4 The Hon. Peter Dutton MP, Minister for Revenue and the Assistant Treasurer, 'Continuing to Improve Australia's Tax System', Press Release No. 100, 16 August 2007; 'Capital Gains Tax (CGT) roll-over on the ending of a statutory licence', Press Release No. 069, 8 June 2007.

5 Fleur Anderson and Sophie Morris, 'Tax deal aids water buy-back', *Australian Financial Review*, 9 June 2007, p. 4; Sophie Morris, 'Compo to flow for irrigators', *Australian Financial Review*, 13 June 2007, p. 14. See also EM, pp 148-154 for other examples.

6 Mr Murray, *Proof Committee Hansard*, 28 August 2007, p. 11; GVIA and NSWIC *Submission 13*, p. [2]; also NSWIC, '$25 Million Tax Top-Up, Press Release', 20 June 2007, available at: http://www.nswirrigators.org.au/pdf/press_release/$25%20Million%20Tax%20Top-Up%20_2_.pdf (accessed 21 August 2007).

7 GVIA and NSWIC, *Submission 13*, p. [2]; Mr Michael Murray, Proof *Committee Hansard*, 28 August 2007, p. 10.

8 See further section 104.25 of the ITAA for a description of CGT event C2.

> and, again, they are probably either weeks or months away from being extinguished and the new ones issued.[9]

8.8 The GVIA and NSWIC explained that this meant that licence holders in the Lachlan Valley would qualify for enhanced CGT Small Business Concessions, which commenced on 1 July 2007.[10]

8.9 The GVIA and NSWIC therefore suggested that Schedule 7 be amended to deem that the CGT event C2 occurs at the time the licence holder receives and accepts the letter of offer from the NSW Government (rather than the day the old licences were extinguished and the new licences issued).[11] They argued that:

> Without this you will see an inequity in the ASGE programme with entitlement holders in the Lower Lachlan being able to avail themselves of the enhanced CGT Small Business Concessions, while entitlement holders in the other groundwater sources will be denied this opportunity, yet both groups will become entitled to the payments in the same financial year.[12]

8.10 In response, Treasury explained that the taxing point for CGT is when there is a change of ownership of the particular CGT asset. In the case of the groundwater licences at issue, this meant the time that old groundwater licences were extinguished and new licences issued. Treasury acknowledged that this would mean that:

> Irrigators in the lower Lachlan may be able to access the enhanced CGT small business concessions, which apply from the 2007-08 income year... that difference in treatment arises from the timing of the ending of their bore licences…The fact that they were offered their cash payment in the same year as those whose licences ended in late 2006 does not change the timing of the CGT event that led to the cash payment.[13]

8.11 Treasury told the committee that:

> If the legislation were amended in accordance with the wishes of the irrigators council, it would create a precedent for taxpayers in similar circumstances to seek a change in the timing of the CGT event so that they too could benefit where more generous tax arrangements were not available at the time that the event occurred. More generally, amending the legislation would not only represent a change in the timing of the CGT event C2 but also bring into question the timing of CGT events more

9 Mr Murray, *Proof Committee Hansard*, 28 August 2007, p. 11; GVIA and NSWIC, *Submission 13*, p. [3].

10 Mr Murray, *Proof Committee Hansard*, 28 August 2007, p. 11.

11 GVIA and NSWIC, *Submission 13*, p. [3].

12 GVIA and NSWIC, *Submission 13*, p. [3].

13 Mr Paul McMahon, Manager, Capital Gains Tax Unit, Department of the Treasury, *Proof Committee Hansard*, 28 August 2007, p. 12.

> generally. A more general change in the timing of the CGT events would be complex to legislate and difficult to comply with and administer...[14]

Committee view

8.12 The committee welcomes the amendments proposed by Schedule 7 and hopes that their passage will mean payments under the ASGE program can be made without further delay. The committee notes the issue and suggested amendment raised by the GVIA and NSWIC in relation to the timing of the CGT event. However, the committee acknowledges Treasury's response that to amend Schedule 7 as suggested would create a problematic precedent.

14 Mr McMahon, *Proof Committee Hansard*, 28 August 2007, p. 12.

Chapter 9

Schedule 8 – Australian property trusts and stapled entities

Provisions of the bill

9.1 This bill amends the *Income Tax Assessment Act 1997* to provide a capital gains tax (CGT) roll-over for investors in a stapled group when a public unit trust is interposed between them and the stapled entities. The bill also makes a consequential amendment to the *Income Tax Assessment Act 1936* to ensure this interposed head trust is not taxed as if it were a company. Additionally, public unit trusts will be able to acquire controlling interests in, or control, foreign entities whose business consists primarily of investing in land outside Australia for the purpose, or primarily for the purpose, of deriving rent.[1]

Background

9.2 The EM explains that 'stapled entities' are a group of entities that may consist of two or more trusts, or one or more companies and one or more trusts, whose ownership interests are stapled together to form stapled securities.

9.3 A stapled security is created when two or more different things are contractually bound together so that they cannot be sold separately. For example property trusts may have their units stapled to the shares of companies with which they are closely associated, often because the property trust owns rental property and the associated company manages that property.[2]

9.4 The measure is designed to facilitate overseas investments by Australian Listed Property Trusts and improve their international competitiveness. Stapled entities purchasing equity in overseas property trusts are currently at a disadvantage compared with single entities. The present arrangements do not enable stapled entities to offer the same level of tax deferral as those single entities offering only their own equity, and current CGT provisions do not allow stapled entities to establish a head trust with a CGT roll-over.

9.5 These amendments will enable Australian Listed Property Trusts to interpose a head trust with CGT roll-over and be treated as a single entity for the purpose of overseas acquisitions.[3]

---

1 EM, p. 159.

2 EM, p. 163.

3 EM, p. 160.

9.6 Mr Cooke of the Property Council elaborated on why the measure is seen as important for international competitiveness:

> In the context of international competitiveness…our guys are now competing substantially offshore in an offshore market both for product and also for capital…International competitiveness is the benchmark by which our members are now being judged...The measure allows companies to destaple and to effectively allow…that part of a staple which is receiving active income to be a wholly owned subsidiary of the trust. Why is it important? It is important in the sense that, if a major Australian institution, for example, wanted to make a scrip bid for an offshore company…they cannot do it under a stapled arrangement because—I will use the US as an example—the staple is not recognised, there is no capital gains tax rollover relief and the whole thing becomes very uncommercial. This measure will overcome that and will allow, for example, scrip bids to occur.[4]

Issues with the bill

9.7 The Property Council of Australia told the committee that schedule 8 was a 'very welcome measure'.[5] However, by way of submission and in evidence, the council raised a technical drafting concern, which it considered to be a simple and easily corrected drafting error:

> The drafting, as we read it, currently contemplates CGT rollover relief for staples of any sort—for example, a staple which could be a trust in a company or a staple which could be a trust in a trust, stapled together. Division 6C relief, though, concomitantly, which must go with this measure, does not seem to apply to any staple, except a company and a trust.[6]

9.8 Mr Cooke emphasised that correcting this issue was 'very important', and that failure to correct it would 'cause substantial prejudice' within the property trust sector.[7]

9.9 Treasury evidence was sympathetic to the issue raised by the Property Council. Mr Ciccini of Treasury expressed agreement with the Property Council's summation of the issue:

> I acknowledge that that works where you have a public unit trust stapled to a company and that it does not work if you have a trust and another trust that is taxed as a company.[8]

---

4 Mr Trevor Cooke, Property Council of Australia, *Proof Committee Hansard, 28 August 2007*, p. 3.

5 Mr Cooke, *Proof Committee Hansard*, 28 August 2007, p. 2.

6 Mr Cooke, *Proof Committee Hansard*, 28 August 2007, p. 3.

7 Mr Cooke, *Proof Committee Hansard*, 28 August 2007, p. 3.

8 Mr Raphael Cicchini, Manager, Small Business and Trusts, Department of the Treasury, *Proof Committee Hansard*, 28 August 2007, p. 6.

9.10 Treasury told the committee that it intended having further discussions with the relevant minister's office in relation to the issue. Mr Cicchini also acknowledged that there did not appear to be any potential revenue implications arising from a possible amendment along the lines suggested by the Property Council, but was not in a position to commit the Government to any particular position.[9]

Committee view and recommendation

9.11 The committee considers that there was some merit in the argument put forward by the Property Council in relation to this schedule. The committee believes that a clear statement of reasons should be provided when the bill is considered, should the government decide against any further amendment.

Recommendation 1

9.12 **The committee recommends that Schedule 8 be passed and the Government give consideration to introducing an amendment to address the issue in relation to stapled entities identified in evidence by the Property Council.**

9 Mr Cicchini, *Proof Committee Hansard*, 28 August 2007, p. 6.

Chapter 10

Schedule 9—Deductible gift recipients

Overview

10.1 Schedule 9 of the bill seeks to amend the *Income Tax Assessment Act 1997* (ITAA 1997) to update the list of deductible gift recipients (DGRs).[1]

Background and summary

10.2 Deductible gift recipient (DGR) status assists relevant funds and organisations to attract public support for their activities. Income tax law allows taxpayers who make gifts of $2 or more to DGRs to claim tax deductions. To be a DGR, an organisation must fall within a category of organisations set out in the ITAA 1997,[2] or be listed by name under its provisions.

10.3 This schedule seeks to add nine organisations to the list of specifically listed DGRs. Gifts of $2 or more, made to these entities within each entity's eligible time period, will be tax deductible.[3]

10.4 The table below outlines the nine organisations that are to be added to the list of DGRs, and their respective dates of effect:[4]

Name of fund	*Date of effect*
The Bathurst War Memorial Carillon Public Fund Trust	the gift must be made after 2 August 2007 and before 3 August 2009
Kidsafe ACT (Inc.)	the gift must be made after 2 August 2007
Kidsafe New South Wales (Inc.)	the gift must be made after 2 August 2007
Kidsafe NT (Inc.)	the gift must be made after 2 August 2007
Kidsafe Qld (Inc.)	the gift must be made after 2 August 2007
Kidsafe SA Incorporated	the gift must be made after 2 August 2007
Kidsafe Tasmania (Inc)	the gift must be made after 2 August 2007
Kidsafe Vic (Inc.)	the gift must be made after 2 August 2007
Kidsafe Western Australia (Inc)	the gift must be made after 2 August 2007

10.5 The amendments also seek to extend the time period for which deductions are allowed for gifts to the Shrine of Remembrance Restoration and Development Trust.

1 EM, p. 8.

2 See Division 30.

3 EM, p. 179.

4 EM, p. 180.

Under the amendments, deductible gifts will be able to be made to the Trust until 30 June 2009.[5]

10.6 This measure will have the following revenue implications:[6]

2007-08	2008-09	2009-10
-	-$0.76m	-$0.76m

Intended benefits of changes

10.7 By granting DGR status to the Bathurst War Memorial Carillon Public Fund Trust and Kidsafe, and by extending the DGR status of the Shrine of Remembrance Restoration and Development Trust, the amendments would assist these entities in attracting public support for their activities. A brief overview outlining the work of these organisations is included below:

- The Bathurst War Memorial Carillon Public Fund Trust was established to raise funds to rebuild the Bathurst War Memorial Carillon to its original plans following damage caused by lightning in 2001.
- Kidsafe is a non-government, not-for-profit charitable organisation dedicated to preventing unintended injuries and reducing resulting deaths to children associated with childhood accidents. The national body, Child Accident Prevention Foundation of Australia, is listed as a DGR. As the result of a restructure of the foundation, the individual state and territory associations will now be listed.[7]
- The Shrine of Remembrance Restoration and Development Trust was established to raise funds for the restoration and development of the Shrine of Remembrance in Melbourne. The Shrine of Remembrance was built between 1928 and 1934 and is Victoria's largest war memorial. [8]

10.8 There were no submissions received in relation to this Schedule.

5 EM, p. 181.

6 EM, p. 9.

7 EM, p. 180.

8 EM, p. 181.

Chapter 11

Schedule 10 – Film production offsets

Overview

11.1 Schedule 10 amends the *Income Tax Assessment Act 1997* to alter the tax incentives provided to the Australian film industry.

Background and summary

11.2 The existing tax incentive scheme for Australian filmmakers will be replaced by refundable tax offsets. Currently, section 10BA of the *Income Tax Assessment Act 1936* allows investors in certified projects (Australian films) to claim a 100 per cent tax deduction against their taxable income for the year the investment is made. Section 10B is open to a wider range of formats and allows a 100 per cent tax deduction over two financial years, beginning when the film first derives an income.

11.3 The recent Government review into film funding support found the effectiveness of the scheme had been limited.

11.4 No new provisional certification applications under this regime will be accepted after the date of Royal Assent of this bill.

11.5 If the bill is passed, a refundable tax offset of 40 per cent for Australian feature films and 20 per cent for documentaries, television series, telemovies and animations will be introduced for producers. This will be available for expenditure incurred after 1 July 2007 and certification will be administered by the Film Finance Corporation (FFC) until the new Australian Screen Authority comes into existence on 1 July 2008. Minimum Australian production expenditure thresholds will apply and the 'Australianness' test will be based on existing section 10BA criteria.[1]

11.6 The current 12.5 per cent location offset will be increased to 15 per cent. Minimum expenditure thresholds will apply.

11.7 A refundable tax offset of 15 per cent will be introduced for post production, and digital and visual effects (PDV) production in Australia. Minimum expenditure thresholds will apply.[2]

---

1 The minimum Australian production expenditure thresholds for the various types of films are outlined at pages 196-197 of the EM.

2 EM, pp 184-186.

Intended benefits of changes

11.8 These new tax incentives are designed to strengthen the Australian film industry by encouraging greater private sector investment and improving the industry's market responsiveness.[3]

Issues with the bill

11.9 The committee heard concerns relating to the following matters:

- the potential effect of the bill on the allocation of resources between in-house and independent producers in the television production sector;
- the accessibility of the production offset to animators;
- the depreciation of low value capital assets used in film production;
- the level of qualifying Australian production expenditure thresholds for feature films; and
- assessing production expenditure that occurred around the transitional date to the new regime.

Effect on the independent production sector

11.10 The Screen Producers Association of Australia (SPAA) raised concerns over the possibility of Australian commercial television networks exploiting the 20 per cent producer rebate at the expense of the independent television production sector.

11.11 Commercial television broadcasters presently rely heavily on the independent production sector to meet their statutory Australian content requirements under the *Broadcasting Services Act 1992* and the Broadcasting Services (Australian Content) Standard. According to the SPAA: 'Currently, with the exception of the Seven Network, 80% of Australian documentary, children's programming and adult drama is outsourced to the independent sector'.[4]

11.12 The SPAA queried why the publicly funded producer offset should be available to broadcasters meeting their statutory obligations: 'This is effectively awarding them a discount for meeting a licence condition'.[5] It argued that a consequence of allowing the commercial television networks to access the producer offset would be to encourage a shift from the independent sector to in-house production, contrary to the bill's purpose of 'building sustainable and stable production companies'.[6]

---

3 EM, p. 183.

4 SPAA, *Submission 1*, p. 4.

5 SPAA, *Submission 1*, p. 6.

6 Mr Robert Campbell, Member, Screen Producers Association of Australia, *Proof Committee Hansard*, 28 August 2007, Adelaide, p. 25.

11.13 According to the SPAA, a shift away from independent production would lead to less competition and innovation in the production sector, as well as a reduced diversity of viewpoints on Australian television.[7] In evidence, it also claimed such a shift would increase the volume of long-running in-house drama series at the expense of 'high-end miniseries and telemovies', which have 'built our significant reputation overseas'.[8]

11.14 The SPAA recommended that broadcasters only be allowed to access the rebate for the production of Australian content in excess of their statutory obligations.[9] The Media, Entertainment and Arts Alliance also proposed such an amendment:

> The Alliance recommends the Bill be amended to ensure that the Producer Offset is used to drive greater levels of Australian television drama series than that mandated by the Content Standard by specifying that series made with the support of the Offset cannot be counted as eligible programs for the purpose of satisfying the Content Standard.[10]

11.15 The South Australian Film Corporation (SAFC) told the committee that:

> ...there is some merit in the idea of only allowing broadcasters to claim the rebate when the program does not count towards their content obligations, particularly their sub quota obligations in regard to drama, documentary and children's programming.[11]

It added:

> ...there is an in-principle argument that is about the extent to which a broadcaster that has a privileged access to a public resource is then able to use a government subsidy to fund the obligations that they have in order to use that public resource. From an in-principle point of view, that does seem to be an anomaly.[12]

11.16 FreeTV, representing the free-to-air commercial networks, rejected the notion that the legislation should discriminate against in-house producers by limiting their access to the rebate:

> There should be no distinction between different production houses such as those housed in entities such as Southern Star, Fremantle, Beyond, the Nine Network, Seven Network and Network Ten. Both independent and in-house productions make a significant contribution to the overall health of the production sector in this country.

---

7 SPAA, *Submission 1*, p. 7.

8 Mr Robert Campbell, *Proof Committee Hansard*, 28 August 2007, Adelaide, p. 22.

9 SPAA, *Submission 1*, p. 8.

10 Media, Entertainment and Arts Alliance, *Submission 3*, p. 3.

11 Mr Richard Harris, Chief Executive Officer, South Australian Film Corporation, *Proof Committee Hansard*, 28 August 2007, Adelaide, p. 40.

12 Mr Richard Harris, *Proof Committee Hansard*, 28 August 2007, Adelaide, p. 41.

> Production will be maximised if the market effectively allows and encourages production by all Australian producers.[13]

11.17 FreeTV also repudiated the claim that commercial networks' access to the rebate would shift production from the independent sector in-house. It argued that generating quality television content will always take precedence over maximising available tax rebates:

> ...broadcasters make production and programming decisions based on new and creative concepts which appeal to audiences – irrespective of whether they are generated in-house or externally. A minor difference in budget is simply not going to drive a broadcaster to reject a superior concept and risk the project being picked up by a competitor and potentially the loss of thousands of viewers.
>
> If the best idea for a program comes from an independent production company, it belongs to that producer. A broadcaster cannot produce the program without the participation of the owner of the concept. If the concept is the one that will deliver the maximum audience, that is the driver for the commissioning decision.[14]

11.18 FreeTV noted that it would not make sense, simply to maximise access to a tax rebate, for commercial networks to reinvent their existing infrastructure arrangements in order to source a greater proportion of their content through in-house production.[15] Mr Richard Harris of the SAFC commented that: 'I am not convinced that it would be enough to change their model'.[16]

11.19 While the SAFC supported the notion that commercial networks should not be offered a rebate for meeting their statutory obligations, it remained unconvinced that the effect of the bill would be to cause a shift to in-house production. The SAFC noted, though, that the Government ought to 'be concerned about if it was an outcome'.[17]

11.20 The SAFC's major concern related to the prospect of the rebate being transferred to the commercial networks through the project negotiation process, rather than being built into the producers' businesses. It commented that this concern is:

> ...the extent to which broadcasters dealing with independents in the future will be able to use their market power to coerce producers to hand over their rebate as part of their commercial dealings. In other words, the rebate, which was supposed to be about building equity and sustaining businesses, could be lost. If this is the result, the introduction of an offset for TV

13 Free TV, *Submission 4*, p. 2.

14 Free TV, *Submission 4*, p. 3.

15 *Proof Committee Hansard*, 28 August 2007, p. 31.

16 *Proof Committee Hansard*, 28 August 2007, p. 41.

17 Mr Richard Harris, *Proof Committee Hansard*, 28 August 2007, p. 41.

> production could well end up being a pyrrhic victory for the independent sector.[18]

11.21 It emphasised that utilising the benefits of the rebates was critical for independent producers to be able to build a business capable of continuing production, particularly in the context of needing to adapt to a future where content will be sold to, and broadcast on, platforms other than television.[19]

11.22 The SAFC suggested that the Government review the effect of the new regime in three years time.[20]

11.23 FreeTV denied that producers would be paid less because the rebate would lower costs of production. It explained that independent producers are paid a set licence fee for producing Australia drama so commercial networks can obtain the 'points' required to meet their statutory obligations:

> Under the Australian content standard point system for adult drama, a higher number of points are awarded to independent productions with a licence fee over a set amount.[21]

It added:

> ...budgets are tied to the points system. If we drop below a certain budget, we basically shoot ourselves in the foot because we do not get the amount of points. They are our compliance points, so we lose our licence if we do not meet that. So it is not logical for us.[22]

11.24 It is, however, logical for the commercial networks to demand extra content for the same price, given producers' lower costs of production. When queried as to the difference the rebate would make, FreeTV representative and Head of Drama at the Nine Network, Ms Jo Horsburgh, indicated:

> The hope is that it will mean that you can make more hours—so, for example, you can make a longer-running series because you know that you will have that rebate going back into production.[23]

---

18 Mr Richard Harris, *Proof Committee Hansard*, 28 August 2007, p. 41.

19 Mr Richard Harris, *Proof Committee Hansard*, 28 August 2007, pp. 42–43.

20 Mr Richard Harris, *Proof Committee Hansard*, 28 August 2007, p. 42.

21 Ms Julie Flynn, Chief Executive Officer, Free TV Australia, *Proof Committee Hansard*, 28 August 2007, p. 30.

22 Ms Jo Horsburgh, Head of Drama, Nine Network (Free TV), *Proof Committee Hansard*, 28 August 2007, p. 35.

23 *Proof Committee Hansard*, 28 August 2007, p. 34.

Departmental response

11.25 Departmental officers told the committee that the Government did not support commercial networks being excluded from accessing the producer offset. DCITA officers said that the independent production sector already receives additional, specific assistance from which commercial networks cannot benefit. This includes:

- commercial networks acquire greater 'points' toward meeting their statutory obligations by sourcing production from the independent sector;
- public broadcasters ABC and SBS receive Government funding to generate or acquire independently produced content;
- pay television drama channels are obliged to spend ten per cent on local content and have little in-house capability; and
- commercial networks are unable to receive funding from state and Commonwealth film agencies to co-produce in-house projects.[24]

11.26 DCITA suggested that these factors mitigate any potential eagerness by commercial television networks to shift production in-house:

> Those sorts of factors will impact and influence the willingness of broadcasters to bring production in house; to invest the associated money required—whether it be for capital or staffing and skill requirements—for that; and also to take on the inevitable risk involved in moving from acquiring a program for a broadcast licence fee which represents something less than 100 per cent of the cost of the program to making the bulk, if not the total, of the investment in that program and seeking to recover that from their commercial activities. There is a transfer of risk there that I presume would also be taken into account.[25]

11.27 It argued that the proposal to exclude commercial networks from the rebate would be difficult to implement, given that independently produced programs used to reach the quota would already have received the rebate:

> ...we already have a situation where programs that are produced in order to meet the Australian broadcast quotas are in receipt of a level of subsidy. Arguably, a compromise arrangement that broadcasters should not be able to receive the produced offset for in-house productions until they have met that quota would not actually change that situation because, to the extent that independently produced programs are made to meet that quota, they will still be in receipt of the rebate and potentially in receipt of direct financing from the screen agency. So there would still be a level of ongoing

---

24 Mr James Cameron, Chief General Manager, Arts and Sport, Department of Communications, Information Technology and the Arts, *Proof Committee Hansard*, 28 August 2007, p. 45.

25 Mr James Cameron, *Proof Committee Hansard*, 28 August 2007, p. 48.

> subsidy for programs produced which are used by broadcasters to meet their quota.[26]

11.28 DCITA also indicated that the practical difficulty of networks predicting whether a completed program will, at some point in the future, be counted towards a 'points' quota following its broadcast:

> The commercial free-to-air broadcaster quota arrangement counts points for programs when they are broadcast, and often that will be a significant period of time after they have been produced. In fact, those points systems are based on both annual and three-yearly calculations of the points.
>
> It seems to me that there is potential for quite a complex set of rules to be put in place to reconcile when a program, once it has been completed, has subsequently been used to meet the points system and—to the extent that that is a significant period after the program has been completed, and it would otherwise have been able to access the rebate—the cost of money, if I can use that term, of awaiting that points system. That would have a potentially substantial impact on the value of the offset, given that the broadcaster would have to wait for a period of time.[27]

11.29 Finally, departmental representatives outlined the Government's preparedness to monitor the effectiveness of the arrangements and any detrimental consequences. DCITA told the committee that the Minister had said that:

> ...the government would continue to keep an eye on the operation of the scheme and, in particular, on whether there was any evidence that broadcasters or other distributors were misusing the arrangements in a way that was inconsistent with the government's underlying policy intention. He flagged a preparedness to act if there was any evidence of that occurring. So I think it is fair to say that obviously the government will continue to review how the new scheme operates. If it were not operating in a way that is consistent with the original intention, clearly it would be open for the government to act.[28]

Short animation series

11.30 The committee was informed that certain definitions in the bill may unfairly exclude producers that deliver animations in episodes shorter than 30 minutes. The bill currently stipulates that to attract the rebate by producing what is classed as a series, the animation must comprise of two or more episodes with a minimum 30 commercial minutes per episode.[29] Without achieving this status, accessing the

---

26 Mr James Cameron, *Proof Committee Hansard*, 28 August 2007, p. 46.

27 Mr James Cameron, *Proof Committee Hansard*, 28 August 2007, p. 46.

28 Mr James Cameron, *Proof Committee Hansard*, 28 August 2007, p. 50.

29 Under proposed subsection 376-65(6). A program that is itself shorter than 30 minutes but runs over a 30 minute period on commercial television is considered a commercial half hour.

producer offset requires meeting the minimum expenditure threshold applicable to a short form animation.

11.31 Evidence to the committee suggested that the minimum length requirement for animation did not reflect industry practice as determined by consumer demand in this field. Specifically, instead of producing 30 minute episodes, Australian producers often adopted a quarter hour format to meet consumer preferences, especially for children's animation. The SPAA claimed that the $250,000 (or $1 million per hour) qualifying expenditure threshold applying to a short form animation would disqualify 85 per cent of Australian animation project expenditure from being eligible for the rebate, discouraging producers from participating in projects seeking to satisfy demand for quarter hour episodes.[30]

11.32 SPAA described the problem is a 'technical issue' that hinders the intent of the bill.[31] It requested that the bill be amended to enable 12 or more 15 minute episodes of animation to be defined as a series.[32] In evidence it indicated that it would also be content to see an amendment that allowed a series to be defined in terms of meeting a total, cumulative, commercial hours threshold.[33]

Departmental response

11.33 In response to a suggestion from the committee, Treasury indicated that providing greater definitional flexibility through the use of regulations, rather than relying on black-letter law, would conflict with the Government's intention to simplify the arrangements. However, Treasury did not rule out a legislative amendment in this area:

> There are two issues here. Firstly, are the thresholds and the criteria as spelt out in the bill appropriate? That is one issue that has been raised this morning. Secondly, there is the related question: to what extent will they remain appropriate through time? Again, because of the desire for certainty, we consider that it is better that, if there is a need to adjust those to reflect changes in policy—it is not so much the industry practice but the policy intent and the policy consistency—then nothing precludes a legislative amendment being made to reflect those.[34]

---

30 Mr Geoffrey Brown, Executive Director, Screen Producers Association of Australia; and Australian Screen Council, *Proof Committee Hansard*, 28 August 2007, p. 24; *Submission 1*, pp 11-12.

31 Mr Geoffrey Brown, Executive Director, Screen Producers Association of Australia, *Proof Committee Hansard*, 28 August 2007, p. 24.

32 Mr Ewan Burnett, Member, Screen Producers Association of Australia, *Proof Committee Hansard*, 28 August 2007, p. 23.

33 *Proof Committee Hansard*, 28 August 2007, p. 29.

34 Mr Matthew Flavel, Manager, Industry Tax Policy Unit, Department of the Treasury, *Proof Committee Hansard*, 28 August 2007, pp 48–49.

Depreciation of capital assets

11.34 Fox Studios and Warner Bros. raised their concern over production companies that are part of a tax consolidated group being unable to take into account the economic cost of using low value capital assets when calculating expenditure counted towards the producer offset. These organisations expressed their desire to be able to incorporate the balancing adjustment on assets valued at less than $1000 for the purposes of calculating such expenditure.[35] They claimed that while the low-value pool created administrative efficiencies for income tax purposes, production companies should be entitled to include all calculations pertaining to qualifying production expenditure, including the balancing adjustment on assets in the low-value pool. Warner Bros. explained this somewhat complex taxation issue to the committee as follows:

> The key issue we are concerned about is where a tax consolidated group has, at some stage in its history, elected to run a low-value pool for dealing with record-keeping requirements of assets that cost less than $1,000. Such an election would have been made for administrative convenience only, as it simplifies record keeping for low-value assets; it has no other tax advantages. Such an election is irrevocable and applies to all members of the tax consolidated group. We believe the intention is that subsection (7) will not allow us to include the balancing adjustment of assets included in the low-value pool and the qualifying production expenditure. If this is the case, then a decision made years ago for administrative convenience by one company in a consolidated group may impact on the qualifying expenditure for a production company that did not even exist at the time that the election was made.
>
> We believe the reason suggested for not including the balancing adjustment for items in the low-value pool is that it was thought that it was not possible to identify the decline in value, how much the asset was sold for and what the balancing adjustment might be. This is because when you are actually using the low-value pool for income tax purposes you do not need to do those things. However, we think that if we are both able and willing to perform the necessary calculations, separately to the calculations that we do for income tax return purposes and all the other conditions for claiming the balancing adjustment are met, we should be allowed to treat that balancing adjustment as qualifying production expenditure. We think that this is fair, given the nature of tax consolidated groups and the irrevocable nature of the election to go into the low-value pool. It was clear at the time of introducing the tax consolidation regime that the preference was that corporate groups enter the regime.[36]

---

35 Calculated depreciation or loss incurred on an asset.

36 Ms Louise Houston, Tax Manager, Warner Bros Entertainment Australia Pty Ltd, *Proof Committee Hansard*, 28 August 2007, p. 38.

Departmental response

11.35 Treasury rejected this proposal, informing the committee that it would establish a precedent that could generate additional administrative costs:

> We consider that it would have some precedent effects. In effect, when something goes into a low-value pool—that is, less than $1,000—it loses its character and the pool itself at an aggregate level is written off. The argument that is being put is that assets should be able to be pulled out of that pool so that any decline in value or balancing adjustment should be recognised for the purposes of the producer offset. It seems to go against the grain of the reductions in compliance costs that are associated with having low-value pools to in effect be putting something but then maintaining a separate record for it for the purposes of an offset.[37]

Production expenditure thresholds

11.36 The committee heard that small budget feature films may be excluded from accessing the rebate due to the $1 million qualifying Australian expenditure threshold. The South Australian Film Corporation (SAFC) told the committee that, although the threshold applying to the current incentive regime would not increase as a consequence of the bill being enacted, it is too high:

> ...the SAFC is still concerned that the threshold for feature films remains at $1 million. This threshold would have excluded films like, for example, The Castle and possibly films like Kenny and 2:37—a South Australian film which was selected for Cannes in 2006. These films might have just fallen short of the proposed threshold.[38]

Appropriate arrangements for transition

11.37 Fox Studios provided in camera evidence to the committee on the difficulty of assessing eligible expenditure during the transition period when using a cash accounting system, rather than on an accrual basis. The EM states that:

> 10.230 The amendments made to introduce the producer offset apply to qualifying Australian production expenditure incurred:
>
> • on or after 1 July 2007; and
>
> • before 1 July 2007, to the extent that such expenditure is attributable to goods or services provided on or after 1 July 2007.
>
> ***[Schedule 10, Part 4, subitem 91(3)]***
>
> 10.231 In respect of productions which are underway on 1 July 2007, it is intended that expenditure incurred will apply to services provided, or goods acquired, on or after 1 July 2007. This is regardless of when the contractual obligation to provide the services was undertaken. This means that in the

37 Mr Matthew Flavel, *Proof Committee Hansard*, 28 August 2007, p. 49.

38 Mr Richard Harris, *Proof Committee Hansard*, 28 August 2007, p. 40.

> case of any film in production on 1 July 2007, where contracts have been entered into prior to that date, applicants may make a reasonable apportionment of expenses (eg, crew expenses) for services provided and goods used on or after 1 July 2007.[39]

11.38 Although their evidence remains confidential, Fox Studios agreed to make their recommendation to Government public. It suggests that Part 4 of the bill be amended from reading 'before 1 July 2007, to the extent that such expenditure is attributable to goods and services provided on or after 1 July 2007' to the following: 'before 1 July, to the extent that such expenditure is paid on or after 1 July 2007'.[40]

Departmental response

11.39 Treasury agreed to respond to the issue on notice. However, during the hearing officers expressed the view that couching the transitional arrangements with regard to the timing of the economic activity struck a reasonable balance:

> The bill as it currently stands provides that the offset is paid on economic activity broadly defined, which occurs after 1 July 2007. Without wanting to go into great detail, you could think about arrangements where, for example, a film is already in production and the bulk of the costs were to be paid in a cash sense after 1 July 2007 or, alternatively, where commitments or liabilities had been entered into before that date—in other words, accrued or, on a tax law basis, incurred. I think the legislation strikes a reasonable middle ground between those two extremes and says that, as long as the economic activity has occurred after 1 July 2007, that amount should be eligible for the tax offset.[41]

11.40 In its response to the committee's question on notice, Treasury stated:

> The principal of attribution is used elsewhere in the tax law. In this context, it avoids the possibility of the film tax offset being available on activity which occurred prior to the start date of 1 July 2007, simply because the payment for that activity was delayed until after this date.[42]

Committee view

Effect on the independent production sector

11.41 The committee accepts FreeTV's comments that the priority for commercial networks is to obtain quality television content that will attract viewers and maximise advertising revenue. Given the competitive nature of commercial television in Australia and the increasing consumer appeal of other forms of entertainment media,

---

39 EM, p. 234.

40 *Proof Committee Hansard*, 28 August 2007, p. 49.

41 Mr Matthew Flavel, *Proof Committee Hansard*, 28 August 2007, p. 49.

42 Treasury, *Response to question on notice*, Appendix 3.

particularly via internet-based content, securing programs capable of attracting viewers and advertising revenue is of paramount importance to the commercial networks. Accordingly, they will continue to seek good programming ideas from the independent sector to achieve an advantage over competing networks and other sources of entertainment.

11.42 The restriction on commercial networks' access to funding from state and Commonwealth film agencies also negates any incentive to move production in-house. DCITA told the committee:

> Commonwealth film agencies have funding guidelines which indicate that they will not co-invest in projects which are in-house produced. The FFC is a particular example of that. We would expect that those arrangements would move into the new environment and sit alongside the producer offset.

11.43 The committee is of the view that this restriction should continue to apply when the FFC is subsumed into the new agency Australian Screen Authority on 1 July 2008.

Recommendation 2

11.44 **The committee recommends that the current restriction on the Film Finance Corporation from co-investing in projects produced in-house continue to apply to funding provided by the Australian Screen Authority after 1 July 2008.**

11.45 The committee is of the opinion that the availability of this rebate is unlikely to provide the catalyst for a dramatic shift away from sourcing content from the independent sector to in-house production. Limiting the producer offset to the independent production sector would also generate a degree of complexity that would not be justified by any discernable public policy benefit. Therefore, the committee does not consider that commercial television networks should be disqualified from accessing the rebate.

11.46 There are, though, reasonable concerns held about the extent to which the producer offset will be retained by independent producers in order to build a sustainable business capable of continuing film production. If the lower costs of production obtained through the rebate are entirely passed on to commercial networks in the form of more content for the same fee, then the intended benefits of the legislation may be jeopardised.

11.47 It would be the committee's expectation that were the availability of the scheme for in–house production to have a detrimental effect on the independent sector then the Government on the basis of that evidence should legislate to restrict the producer offset scheme to independent producers.

11.48 The committee did not have sufficient evidence before it during this inquiry to conclude that the likely impact of the scheme would be detrimental to independent producers. The committee therefore recommends that the Government review the situation in twelve months' time.

Recommendation 3

11.49 **The committee recommends that the Government review the implementation of the producer offset scheme in twelve months to ensure it is not being misused to mitigate the intention of facilitating a sustainable Australian film production sector, including a vibrant independent sector.**

Short animation series

11.50 The committee acknowledges SPAA's concerns about the potential exclusion of animators from accessing the producer offset due to the bill's definition of a 'series' failing to reflect widespread industry practice. The committee agrees that the bill's intent is hindered by the restrictions imposed by the definition and is of the opinion that it should be amended to enable producers delivering animation delivered in short episodes to access the rebate. The requirement to meet a threshold of total commercial hours ought to remain.

Recommendation 4

11.51 **The committee recommends that the bill be amended to allow ten or fifteen minute animation episodes to be categorised as a 'series' for the purposes of qualifying for the producer offset, provided that a total commercial hours threshold is met.**

Depreciation of capital assets

11.52 The committee notes the argument for allowing balancing adjustment calculations on low value assets to count toward production expenditure for the purposes of the producer offset. However, it shares the Government's view that amending the law in this area would generate an unwelcome precedent and add to compliance costs, conflicting with the intended purpose of having low-value pools. The committee is of the opinion that no change in this area is necessary.

Production expenditure thresholds

11.53 While the committee recognises the concerns of low-budget filmmakers that are excluded from accessing this scheme, it does not consider that the Government should actively encourage the production of low-budget feature films in Australia by expanding access to the producer offset. Unfortunately, the long term sustainability of Australian film production companies will not be ensured by making feature films with budgets of less than $1 million. Ensuring the long term sustainability of these enterprises is the purpose of the bill and its application should be targeted accordingly.

Appropriate arrangements for transition

11.54 The committee acknowledges that the arrangements for film producers undertaking projects during the transitional date may generate some administrative complexity. Instead of identifying for eligibility purposes the date an expense was contractually incurred or when cash was paid, film producers in this situation will be

required to assess which goods and services were used before, and after, 1 July 2007. Unfortunately, this is an unavoidable consequence of ensuring that fair and reasonable transitional arrangements apply. The committee does not therefore support any amendment to the transitional arrangements currently outlined in the bill.

Conclusion

11.55 The committee is of the opinion that this schedule of the bill contains necessary measures to improve the long term viability of the Australian film production industry. It believes that its recommendations add to the bill and strongly urges that they be accepted.

Recommendation 5

11.56 **The committee recommends that Schedule 10 of the Tax Laws Amendment (2007 Measures No. 5) Bill 2007 be passed.**

Chapter 12

Schedule 11—Research and development tax concession

12.1 Schedule 11 to the bill amends the *Income Tax Assessment Act 1936* (ITAA 1936) to extend the premium 175 per cent research and development (R&D) tax concession to companies belonging to a multinational enterprise group for additional R&D expenditure on behalf of a grouped foreign company above a rolling three-year average of expenditure. Companies will also receive a specific base deduction for all expenditure that contributes to a company's calculation of additional R&D expenditure in that income year.

12.2 The bill also amends the *Industry Research and Development Act 1986* to deliver the policy intent of the measure. These amendments will give the Industry Research and Development Board additional functions and powers relating to foreign-owned R&D activities.

Background

12.3 The ITAA 1936 allows a tax concession for companies that incur expenditure on R&D activities. For a claimant to receive the R&D tax concession, that R&D must be undertaken on behalf of the company, not have guaranteed financial returns to the company and be exploited for Australian benefit. These rules currently disqualify Australian companies who conduct R&D on behalf of a foreign company, from claiming the R&D tax concession.

12.4 The R&D tax concession comprises three main elements:

- a base R&D tax concession that provides a higher rate of deduction of 125 per cent for all eligible expenditure on R&D activities;
- a refundable R&D tax offset that provides a cash refund to the value of the deduction for small companies in a tax loss situation; and
- a premium R&D tax concession that provides an additional deduction of 50 per cent to a total deduction for that expenditure of 175 per cent for all additional expenditure above the average of the three previous years of expenditure.

12.5 On 1 May 2007, the Prime Minister and the Minister for Industry, Tourism and Resources jointly announced that the Government would extend the premium 175 per cent R&D tax concession to multinational subsidiaries that choose to hold resulting intellectual property offshore and are currently unable to claim the R&D tax concession.

12.6 The extension of the premium 175 per cent R&D tax concession is intended to encourage additional R&D expenditure in Australia by multinational enterprise subsidiaries. An immediate 100 per cent deduction for expenditure on eligible R&D

activities and an additional 75 per cent immediate tax deduction on expenditure above the average of the previous three years of expenditure on R&D, will be provided.

12.7 The amendments to the provisions for the premium 175 per cent R&D tax concession are intended to have minimal changes to the eligibility or entitlements of current claimants for the premium 175 per cent R&D tax concession under the existing rules if they do not conduct any R&D on behalf of a grouped foreign company.

12.8 Eligibility for the concession is determined by claims history provisions. According to the EM, companies will be eligible for the additional deduction for the increase in expenditure on foreign-owned R&D in the premium 175 per cent R&D tax concession if they could deduct, or an eligible group member could deduct, under the base 100 per cent specific deduction in the current claim year and each of the previous three R&D expenditure history years.[1]

12.9 Transitional arrangements apply. These arrangements will deem companies to have deducted under the base 100 per cent specific deduction in each of the three income years prior to the particular company's first full income year commencing after 1 July 2007. This does not preclude a company from qualifying with three previous nil expenditure years. Foreign companies that establish a new presence in Australia will have immediate access to the 175 per cent concession. However the nil expenditure year will only be available if neither the eligible company nor any grouped eligible companies existed in that year or the preceding 10 years.[2]

Evidence on the Schedule

12.10 The committee received evidence on this schedule from Deloitte Touche Tohmatsu Ltd (Deloitte), the Minerals Council, the Australian Chamber of Commerce and Industry (ACCI) and from Medicines Australia.

12.11 The Minerals Council welcomed the new R&D provisions in the legislation,[3] as did the ACCI, which said that 'we strongly support that'.[4] Deloitte, for its part, was critical of a number of aspects of the Schedule, arguing that it did not go far enough and would benefit only a small number of claimants. The Deloitte submission also pointed to what the organisation considered to be a number of shortcomings, which are described below.

---

1 EM, p. 247.

2 EM, pp 247–8.

3 Minerals Council of Australia, *Submission 7.*

4 Mr Michael Potter, Chief Economist, Australian Chamber of Commerce and Industry, *Proof Committee Hansard*, 28 August 2007, p. 5.

12.12 Medicines Australia was equivocal in its support, telling the committee that while it 'appreciated the policy initiative' and wanted to see the legislation pass, there were some outstanding concerns, specifically in relation to:

- how the legislation would be interpreted and implemented;
- the process of establishing a claim history (see paragraph 12.8); and
- written agreements.

12.13 Medicines Australia's major concerns revolved around how the legislation would be interpreted and implemented, once passed. Representatives told the committee that legislative interpretation had been a problem previously:

> We certainly do want to see the legislation passed, but that will necessarily flow on to some interpretative guidelines through the IR&D Board. In the past, as a result of interpretative guidelines, companies have been excluded from being able to access the tax concession, and we obviously would like to overcome those hurdles to maximise the ability of our member companies to access a tax concession. [5]
>
> …
>
> But it is the way the legislation is interpreted. … if the interpretation of other parts of 'eligibility' are not corrected then they still will not be able to access the tax concession and the incentive will not be there.[6]

12.14 Medicines Australia indicated that unless the legislation is interpreted in such a way as to allow companies to access it, it would not prove to be a significant incentive to greater R&D investment:

> …but my overall concern is that it will not be a very large incentive and that we will not see as big a rise in R&D as we would wish. So, the better it is interpreted to allow companies to access it, obviously the more incentive there is and you will get the greater investment.[7]

12.15 Medicines Australia representatives also questioned the process in the Schedule for establishing a claim history (the transitional claims history provisions).[8] They argued that the approach may disadvantage companies who are coming off a low R&D investment base, and sought an amendment that would allow an eligible entity to use its historical R&D spend as an alternative to the formula-based method.[9]

---

5 Ms Deborah Monk, Director, Innovation and Industry Policy, Medicines Australia, *Proof Committee Hansard*, 28 August 2007, p. 15.

6 Ms Monk, *Proof Committee Hansard*, 28 August 2007, p. 16.

7 Ms Monk, *Proof Committee Hansard*, 28 August 2007, p. 16.

8 See EM, paras 11.36-7, 28 August 2007, pp 247–8.

9 *Proof Committee Hansard*, 28 August 2007, p. 15.

12.16 Finally, Medicines Australia questioned the requirement for a written agreement[10] between the Australian entity and the foreign company:

> While it is appropriate that the company has an internal agreement to cover foreign owned R&D, we are concerned that this could be used to exclude R&D covered by another multiparty agreement. For example, an Australian subsidiary could be undertaking R&D as part of an agreement between itself, its parent company and other companies. The existence of this type of agreement should not cause the activity in Australia to become ineligible for the tax concession.[11]

12.17 Deloitte, while commending the Government's initiative to increase business expenditure on research and development, submitted that the amendments do not go far enough in encouraging a broader increase in such expenditure. The Deloitte submission was critical of the provisions in the Schedule, arguing that the concession will only benefit a small number of claimants and not the R&D claimant community generally. The submission stated that even for those entities that qualify, there are a number of operative concerns and administrative complexities that must be measured from a cost/benefit perspective.

12.18 Deloitte did identify one aspect of the Schedule as 'positive', namely the ability to sub-contract the foreign–owned R&D activities down one level from the eligible company and that eligible company retaining the eligibility to include this sub-contract expenditure as 'foreign–owned'.

Departmental response

12.19 Treasury and Department of Industry Tourism and Resources witnesses (departmental witnesses) did not agree with Medicines Australia's concerns about the transitional claims history provisions. Mr Davis, Principal Adviser, Business Tax Division, Department of the Treasury explained that in developing the provisions, the position that had been put by industry in the initial consultation process was that it would be very difficult for most companies to go back and build a three-year history, and even harder to have that as a verifiable history. He said that 'the administrative difficulties with doing that caused us to want to move to something that could work for everybody.'[12]

> The complexity in getting those histories out and verifying them would make that—I think the word 'nightmare' was mentioned by a few people—impossible for many. In order to find a way through that, we went with transitional histories.[13]

10 See EM, paragraph 11.8, p. 242.

11 Ms Monk, *Proof Committee Hansard*, 28 August 2007, p. 15.

12 *Proof Committee Hansard*, 28 August 2007, p. 18.

13 *Proof Committee Hansard*, 28 August 2007, p. 18.

12.20 Mr Davis also disputed the disincentive effects referred to by Medicines Australia:

> … I am somewhat confused by the argument I just heard that it would cause companies to not want to increase their R&D activities. Certainly, after the first year of implementation I cannot see how that works at all. In effect, they are given a transitional history that applies off the first year of spending then they have the same incentive to increase after that first year as they will at any time in the operation of this bill or act.[14]

12.21 In relation to the written agreement provisions, departmental witnesses confirmed that this is an integrity measure.[15]

12.22 Departmental witnesses did not address Deloitte's comments in their evidence. However, witnesses did advise the committee that the consultation process on the Schedule had been extensive. Industry forums had been held in Sydney, Brisbane and Melbourne, and about 60 industry representatives attended the forums. Questioned by committee members about industry groups who were expressing concern about the legislation, Mr Davis of Treasury responded that:

> You would expect that there would be a number of people who thought they might be able to do better. I have not been knocked down in the rush of complaints. That might be a nice way to put it.[16]

Committee view

12.23 The committee notes that this legislation extends the R&D provisions to groups that have not previously accessed them. While some concerns have been raised that the provisions are excessively restrictive or complex, it remains to be seen if these concerns will be borne out by experience. The committee suggests that the government review the effects of the Schedule in twelve months with a view to determining whether the amendments have been sufficiently stimulatory of R&D. The committee does not consider that any amendments to the Schedule are required before passage of the bill.

---

14 *Proof Committee Hansard*, 28 August 2007, p. 18.

15 *Proof Committee Hansard*, 28 August 2007, p. 18.

16 *Proof Committee Hansard*, 28 August 2007, p. 20.

Chapter 13

Schedule 12—Innovation Australia

13.1 Schedule 12 establishes a new board, Innovation Australia, which will combine the roles and responsibilities of the Industry, Research and Development Board and the Venture Capital Registration Board. This measure is intended to streamline existing administrative arrangements for the Industry portfolio's innovation and venture capital programs.[1]

13.2 The creation of Innovation Australia will be prescribed in the *Industry Research and Development Act 1986* (IR&D Act). The responsibilities of Innovation Australia that were previously carried out by the Industry Research and Development Board will remain prescribed in the IR&D Act; those that were previously carried out by the Venture Capital Board will remain prescribed in the *Pooled Development Funds Act 1992* (the PDF Act) and the *Venture Capital Act 2002*.[2]

13.3 The EM notes that there will be a consequential amendment to the IR&D Act to state that information is provided to Innovation Australia if it is provided to Innovation Australia itself, a member of Innovation Australia, committee, a committee member, a member of staff or a consultant.[3] A similar provision in the PDF Act will be repealed.

13.4 The bill also amends Section 19 of the IR&D Act to allow the Minister to give Innovation Australia directions for functions relating to the objects of the PDF and VC Act. Section 20 of the IR&D Act gives the Minister power to give directions to the IR&D Board in relation to the policies and practices to be followed in the performance of its functions. This power will be retained.[4]

13.5 Finally, Innovation Australia will be required to submit an annual report to the Minister for Industry, Tourism and Resources. These requirements will be the same as those currently stated in the IR&D and PDF Acts and adhered to by the IR&D and VCR Boards.[5]

13.6 There were no submissions received in relation to this Schedule.

---

1 EM, p. 269.

2 EM, p. 270.

3 EM, p. 271.

4 EM, p. 273.

5 EM, p. 275.

Recommendation 6

13.7 **The Committee recommends that the bill be passed.**

Senator the Hon. Michael Ronaldson

Chair

APPENDIX 1

Submissions Received

Submission Number	Submitter
1	Screen Producers Association of Australia
2	Deloitte Touche Tohmatsu Ltd
3	Media, Entertainment & Arts Alliance
4	Free TV
5	Confidential
6	Deloitte Touche Tohmatsu Ltd
7	Minerals Council of Australia
8	Australian Subscription Television & Radio Association (ASTRA)
9	Property Council of Australia
10	Australian Broadcasting Corporation (ABC)
11	Australian Writers' Guild
12	CPA Australia
13	Gwydir Valley Irrigators Association Inc. (GVIA)/NSW Irrigators' Council (NSWIC)
14	Australian Screen Council
15	Infrastructure Partnerships Australia
16	Confidential
17	Australian Chamber of Commerce and Industry
18	Confidential

Additional Information Received

- Additional Information received via email from Mr Geoff Brown, Screen Producers Australia Association (SPAA) on Monday 3 September 2007

TABLED DOUMENTS

- Documents tabled on Tuesday 28 August 2007 at Public Hearing in Adelaide;
    - Document from Medicines Australian from Ms Deborah Monk – Director, Innovation and Industry Policy
    - Document from Fairfax Media from Mr Ronald Walker – Chairman.

APPENDIX 2

Public Hearing and Witnesses

TUESDAY, 28 AUGUST 2007 – ADELAIDE

BERMAN, Ms Tricia, General Manager, Innovation Policy Branch
Department of Industry, Tourism and Resources

BROWN, Mr Geoffrey David, Executive Director
Screen Producers Association of Australia; and Australian Screen Council

BURNETT, Mr Ewan, Member
Screen Producers Association of Australia

CAMERON, Mr James David Alan, Chief General Manager, Arts and Sport
Department of Communications, Information Technology and the Arts

CAMPBELL, Mr Robert Bernard, Member
Screen Producers Association of Australia

CICCHINI, Mr Raphael, Manager, Small Business and Trusts
Department of the Treasury

COOKE, Mr Trevor, Executive Director, International and Capital Markets Division
Property Council of Australia

DAVIS, Mr Graeme, Principal Adviser, Business Tax Division
Department of the Treasury

FLAVEL, Mr Matthew James, Manager, Industry Tax Policy Unit
Department of the Treasury

FLYNN, Ms Julie, Chief Executive Officer
Free TV Australia

HARRIS, Mr Richard Miles, Chief Executive Officer
South Australian Film Corporation

HOLMES, Mr John Dickonson, Head of Drama
Seven Network (Free TV)

HORSBURGH, Ms Jo, Head of Drama
Nine Network (Free TV)

HOUSTON, Ms Louise Margaret, Tax Manager
Warner Bros Entertainment Australia Pty Ltd

McDONNELL, Ms Catherine Mary, Head of Business and Legal Affairs
Fox Studios Australia; Fox Filmed Entertainment Australia Pty Ltd; and Bazmark Film II Pty Ltd

McMAHON, Mr Paul Denis, Manager, Capital Gains Tax Unit
Department of the Treasury

MONK, Ms Deborah Jane, Director, Innovation and Industry Policy
Medicines Australia

MURRAY, Mr Michael, Chief Executive Officer
Gwydir Valley Irrigators Association/New South Wales Irrigators Council

POTTER, Mr Michael, Chief Economist
Australian Chamber of Commerce and Industry

PULLAR, Mr David, Policy Analyst
Sanofi-Aventis

REGAN, Mr Anthony Clive, Manager, Company Tax Unit, Business Tax Division
Department of the Treasury

ROONEY, Ms Jo, Drama Executive
Nine Network (Free TV)

SHEEHAN, Mr Vincent, Feature Film Councillor
Screen Producers Association of Australia

WELLS, Mr Philip John, Consultant
Warner Bros Australia

YOUNG, Mr Peter, General Manager, Film and Digital Content Branch
Department of Communications, Information Technology and the Arts

APPENDIX 3

Response to Question on Notice taken by Treasury

Senator MURRAY—I do not mind much if you decide that you just want to change the black-letter law. The problem is that black-letter law as it is expressed does not meet industry practice and it will negate your policy intention if the evidence of witnesses is accurate. That is why I ask you to have a look at it from that perspective.

I will now move to my second question. The witness who appeared before us in camera allowed for a specific element of their in-camera evidence to be put to you on the record. They said that the way in which the legislation is presently expressed makes it difficult for them to capitalise on the tax concession because they conduct a cash accounting method instead of an accrual accounting method, and their contractual constructions are difficult. So they asked that, with respect to the items in the explanatory memorandum, paragraph 10.231 should be drafted as follows: 'Before 1 July 2007 to the extent that such expenditure is paid after 1 July 2007'.

It is not my intention to try and recap their evidence, because I do not think that is proper. I will merely put it to you baldly as I have and ask whether you could take it on notice and let the committee know your view.

Answer

The provisions at Schedule 10, Part 4, subitem 91(3) of the draft bill present a fair and practical treatment of expenditure for a film that was already in production at 1 July 2007. Sub subitem (3)(b) allows for the recognition of qualifying Australian production expenditure incurred before 1 July 2007 to the extent that such expenditure is attributable to goods or services provided on or after 1 July 2007. This provision ensures that any economic activity on a production after 1 July 2007 will be recognised for the purposes of the tax offset, regardless of when any contractual arrangement was entered into or cash was paid for the goods or services.

The principle of attribution is used elsewhere in the tax law. In this context, it avoids the possibility of the film tax offset being available on activity which occurred prior to the start date of 1 July 2007, simply because the payment for that activity was delayed until after this date.