Taxation Laws Amendment Bill (No. 5) 1989

Date Introduced: 2 November 1989
House: House of Representatives
Portfolio: Treasury

Digest of Bill

Purpose
The main amendments will bring forward the time of tax payments for companies and certain other entities; and allow deductions in respect of certain actions taken to comply with tax law.

Background
The decision to bring forward the time for payment of tax by companies, complying superannuation funds, complying approved deposit funds (ADF) and pooled superannuation trusts was announced in the 1989 Budget. The changes will result in additional revenue of $885 million in 1989-90. Currently, companies pay tax in quarterly instalments in the year following that in which the income is earned. The final instalment adjusts the tax payable on the previous years income and the actual income for that year. As a result, there is a considerable deferral of tax when compared to PAYE taxpayers. As part of the Budget, it was announced that this deferral would be largely removed, with 85% of the tax payable, still based on the previous years income, by the 15 day of the month preceding the year of income (i.e. 15 July for those companies that balance on 30 June) with the remainder, based on the actual tax payable, payable by the 15 day of the ninth month following the end of the year of income. While there will be no increase in the amount of tax payable, the removal of the deferral will increase the costs to companies which no longer will be able to use the deferred tax payments and may have to borrow to replace these funds. The revenue gain of $885 million will occur only in this financial year, with lesser gains, estimated at approximately $330 million per year, applying in future years through reductions in Commonwealth public debt interest.

The proposal has been critised by a number of groups, including the CAI. One complaint is based on the time of payment for the 85% component, which is 15 days after the end of the companies balancing period. Many claim that it will be very difficult and expensive to calculate the tax owed in this period and that while estimated income may be used, the operation of the self assessment scheme combined with the desire not to overpay tax will mean that the estimate will

WARNING:
This Digest was prepared for debate and should not be taken as a complete guide to the legislation which may reflect amendments.
have to be based on figures that include revenue until the end of the financial year. If this approach is followed, the entity will have 15 days to collect the final information, calculate the tax payable and notify the Tax Office.

Another criticism concerns the likely need for companies to borrow to meet the 85% payment and the possible effect on the individual company and the capital market. Regarding the individual company, the concern is that companies, and small companies in particular, will need to borrow (with consequent interest costs) to meet this payment as their cash reserves are not sufficient to meet a payment of this size compared to the regular payments under the previous system. If companies do not borrow, the earlier payment will result in a reduction in their liquidity and may affect investment decisions. The claimed effect on the capital market arises from the likelihood of a substantial number of companies borrowing to meet the payment. If this occurs, there will be an increase in demand for funds towards the end of the financial year when most companies balance. It is argued that this will lead to an increase in the interest rate in the short term. The CAI has estimated that the changes will result in business entities having to find, within a three month period, over $2 billion more than under the old system.¹ There is no estimate of how much of this will need to be borrowed.

Following representations from business groups, two changes were made to the proposals. First, the time for payment by entities that balance after 30 June will be altered to place them on the same footing as other entities. Secondly, entities with a relatively small tax liability will have the option of making a single payment, generally six months after the end of their balancing period.

However, dissatisfaction with the Bill remains. On 17 November 15 business groups released a press statement criticising many aspects of the Bill, particularly the potential need to borrow to meet the earlier payments.

The cost of preparing an income tax return by a registered tax agent is deductible under a special provision (section 69) of the Income tax Assessment Act 1936 (the Principal Act), and the main question concerns whether the cost of appeals against decisions of the Tax Office are deductible under the general provision (section 51). The general view is that such costs are not incurred as part of the earning of assessable income and therefore not deductible. However, this position was challenged by a recent decision of the Administrative Appeals Tribunal. The decision allowed a deduction for legal costs incurred in disputing an assessment. The decision was appealed against in the Federal Court which decided, in 1989, that the essential nature of the dispute was to reduce the amount of tax payable, rather than being incurred in earning assessable income.² As a result, the expenditure was not deductible under the general deduction provision. Similarly, a taxpayer disputed the results of an audit and the expense incurred in employing an accountant to investigate the audit was non-deductible as it did not relate to the furnishing of a return as required by section 69 of the Principal Act and was not related to incurring assessable income.
Main Provisions

Clause 8 will amend section 10 of the Principal Act to increase the range of matters that will be deductible under section 69. Expenditure incurred after 1 July 1989 in respect of a 'tax related matter' will be deductible. 'Tax related matter' is defined as a matter relating to the management or administration of the taxpayers tax affairs or compliance with an obligation imposed by Commonwealth tax law. It will not include an offence related matter. As well, the expenditure will only be deductible if it is used to pay a fee or commission for advice from a professional tax advisor (registered tax agents and barristers and solicitors).

Section 78 deals with the deductibility of certain gifts etc. To the range of deductible gifts will be added those for the acquisition, construction or maintenance of a building used to accommodate rural students where the Commonwealth, a State or Territory funds all or part of the capital or recurrent costs of the school the students are attending (clause 9). The measure is complimentary to the new system of grants in respect of accommodation for rural students being introduced by the States Grants (Schools Assistance) Amendment Bill (No. 2) 1989.

Premiums are not assessable income for life insurance companies and expenses incurred in gaining the premiums are not deductible. Clause 10 will introduce risk components (that part of the premium calculated according to the regulations) and investment components (the remainder). For life assurance premiums, – other than superannuation premiums, premiums in respect of exempt policies and specified roll-over amounts, – the investment component is to be taken as assessable income in determining deductions (clause 11 which will insert a new section 111AA into the principal Act). Clause 12 will provide a deduction in respect of the investment component of premiums covered by proposed section 111AA.

The self-assessment provisions will be extended by clauses 13 and 14 to provide for self-calculation of credits. Similarly, self-assessment will apply to companies claiming an offset of tax (clause 25). Clause 30 will provide for self-assessment for relevant entities in proposed Division 1B of Part VI.

Clause 34 will amend the lending to the current provisions regarding the collection of tax from relevant bodies to provide that the current provisions will only apply to years of income ending on 30 June 1989.

A new Division 1B will be inserted into Part VI of the Principal Act by clause 36. Relevant entity is defined to be a company, an eligible ADF, an eligible superannuation fund or a pooled superannuation trust (proposed section 221AK). The basic rule is that relevant entities must pay an initial installment by 15 July in the year following the year of income (proposed section 221AP). The initial installment will be 85% of the amount of tax due as estimated by the entity or, if no estimate had been made, the notional tax in respect of that
year. If the use of the notional tax means that the amount paid has been greater than 85% of the assessed amount when the assessment is furnished, a refund will be made to the taxpayer (proposed section 221AQ). (Also see final paragraph).

Proposed section 221AN will modify the basic rule as it applies to entities that balance on a date other than 30 June, except those who balance between 1 June and 30 June. Entities balancing before 31 December in a year will have until 15 January to make their initial payment and will have until 15 September to make their final payment (unless an election is made under proposed section 221AU – see below). Where the balancing date is between 1 January and 1 June, the initial payment must be made by the 15 day of the month after the balancing date and the final payment by the 15 day of the ninth month following the balancing date (unless an election is made). Rules similar to the latter category will apply to entities that balance after 30 June, but the final payment must be made by the next 15 June following the above mentioned 30 June.

The treatment of capital gains in calculating the initial payment is dealt with in proposed section 221AL. For companies, other than life assurance companies, (and other entities covered by the Bill) gains are to be disregarded. The treatment of gains for life assurance companies etc; are detailed in the proposed section and depend on a number of complex components already contained in the Principal Act.

An entity making an estimate of its tax will be able to revise that estimate once before the final installment is payable (proposed section 221AR). The proposed section also provides for the payment or refund of amounts to ensure that the initial payment amount is equal to 85% of the revised amount.

Where the amount calculated in accordance with the formula: 100 times the initial payment and then divided by 85 is less than $1000, or such other amount as determined by the Commissioner, the entity will not be required to make an initial payment (proposed section 221AT).

Where the amount calculated in accordance with the above formula is between $1000 and $20 000, the entity may elect to make only one payment per year. If the entity opts to use this option, the payment generally is to be made six months after balancing. Such an election is irrevocable (proposed section 221AU).

Proposed section 221AV will give the Commissioner power to waive or reduce the initial payment in certain circumstances (proposed section 221AV). Similarly, when it appears to the Commissioner that an entities estimate of tax payable is wrong, the Commissioner may vary the estimate (proposed section 221AW).

Proposed sections 221AX and 221AY contain anti-avoidance provisions. They
will allow the Commissioner to overrule artificial schemes designed to overcome the new provisions and provide for penalty tax at the rate of 20% per annum of any amount which should have been included in the initial payment but was excluded by the arrangement.

The calculation of notional tax is dealt with in proposed section 221AZB. This will generally be the amount assessed in the previous year. The treatment of capital gains in the assessment of notional income will be the same as mentioned above in regard to proposed section 221AL. Proposed section 221AZC provides for the modification of the assessment of notional income for the year ending 30 June 1990 where an ADF, complying superannuation fund, pooled superannuation fund or life assurance company that balance before 1 June 1990. The modification will adjust the formula for the period between balancing and the end of the financial year.

The self-assessment penalty provision is contained in proposed section 221AZE. Basically, where an entity makes self-assessment of the tax due and this estimate is more than 10% too low (this may be based on a statement of final tax liability but special provisions are included for capital gains), additional tax at the rate of 20% per annum will be payable on so much of the initial payment that was not paid due to the underestimation.

References

2. F. C. of Tax v Ryder, 89 ATC 4250

For further information, if required, contact the Economics and Commerce Group.

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This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

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