Taxation Laws Amendment Bill (No. 4) 1988

Date Introduced: 31 August 1988
House: House of Representatives
Presented by: Hon. Peter Morris, M.P., Minister Assisting the Treasurer

Digest of Bill

Purpose

To give effect to proposals:

- to abolish the general accelerated depreciation provisions
- to abolish the special 5 year write-off provisions for storage facilities for hay, grain and fodder and for new primary production plant
- to increase the depreciation rate loading to 20 per cent
- to require the adoption of a uniform depreciation method for all plant in the first year depreciated
- to provide for a maximum write-off period of ten years for certain pre-paid expenses
- to restrict the application of the intercorporate dividend rebate where unfranked dividends are received by a private company
- to terminate the application of section 26AAA to profits from property sold within 12 months of acquisition
- to modify the deduction available for the cost of connecting mains electricity to business premises
- to increase the prescribed minimum values for natural increases of livestock
- to increase the Pensioner and Beneficiary rebates
• to exempt from income tax the Temporary allowance to pensioners
• to implement the rules for calculating provisional tax in respect of the 1989 income year
• to tax business benefits received in non-cash form
• to introduce measures to restrict deductions for interest arising from the restructuring of groups of companies with a high level of foreign ownership
• to broaden the definition of 'eligible investment business' in respect of public unit trusts
• to amend the substantiation rules regarding retention of car records
• to amend the gift provisions to acknowledge the new organisation administering the Duke of Edinburgh Study Conference Account
• to amend the Fringe Benefits Tax Assessment Act 1986 to spread over a five to seven year period, the payment of fringe benefits tax for certain remote area housing benefits
• to repeal section 14ZKA of the Taxation Administration Act 1953 deemed redundant following the recent High Court of Australia decision, in favour of the Commissioner of Taxation, regarding the application of the State Limitations Act to Commonwealth taxation debts.

Background

The following notes are not intended to cover all of the changes proposed and should be read in conjunction with the Explanatory Memorandum to the Bill.

ACCELERATED DEPRECIATION

The changes proposed by this bill will revert the rules for depreciation to much the same as those which applied during the period 19 August 1980 to 30 April 1981.

At the moment the Income Tax Assessment Act 1936 (ITAA) provides two rate scales for most depreciation claims. The two scales are –

• effective life plus an 18 per cent loading, or
• the optional accelerated (20/30) rate scale.

Certain assets, such as motor cars, have been ineligible for any concessional rate and have continued to be subject to the effective life rates.
Briefly, the Commissioner of Taxation introduced a schedule of effective life rates of depreciation (income tax order 1217) in the 1950's and those rates, with revisions, applied until 19 August 1980. For the period from 19 August 1980 to 30 April 1981 a loading of 20 per cent was added to the effective life rates. From 1 May 1981 until 25 May 1988 the loading was 18 per cent. The optional accelerated rates were introduced from 19 July 1982.

At the time the accelerated rates were introduced it was considered there was a need to stimulate Australian investment in productive assets to help increase Australian competitiveness. Accelerated depreciation was a means of doing this. It is now considered the concessions have caused a distortion in investment decisions as the tax benefits are greater for investment in long-lived assets relative to short-lived assets.

**DEPRECIATION – OPTION TO USE PRIME COST OR DIMINISHING VALUE CALCULATION METHOD**

Existing law allows flexibility in the choice of calculation method used. It is possible to select either method at the time of first depreciating an asset and to make a once only election to change from diminishing value method to prime cost method during the life of the asset. The proposed change will be to require all assets purchased, or first depreciated, during a tax year to be depreciated by the same method. No change may be made to the calculation method for any individual asset during its write-off period.

An asset is written off in a much shorter time when the prime cost method is used. This factor can be used as a tax planning tool, for instance, in periods of high taxable income the prime cost method may be more efficient. In low income or loss years the diminishing value method may be used to slow down the rate of annual deduction.

**PREPAYMENTS**

Provided certain conditions are satisfied, section 51 of the ITAA allows prepayments to be claimed as an income tax deduction in the year the prepayment is made. This has led to the creation of arrangements where, for instance, an investor pays a manager a lump sum, up front, to be used by the manager over the next twenty years to purchase goods and services. The investor is able to claim an income tax deduction in the year the lump sum is paid rather than the year in which the goods or services are purchased. The changes proposed by this Bill will spread the deduction available to the investor over a ten year period or, if the prepayment is intended to cover a shorter period, over that shorter period.

The proposed changes will not apply in all circumstances.

This is a measure designed to 'save the revenue'. In most instances a deduction to one taxpayer creates assessable income to another taxpayer in the same year. The prepayment tax shelters allowed an immediate deduction but delayed the inclusion of the corresponding income until a later year.
INTERCORPORATE DIVIDEND REBATE

This rebate, otherwise known as the section 46 rebate, effectively provides for dividend income received by a company to be free of tax. Without the rebate it is possible a dividend could be taxed several times as it passed from one company to another. The two changes contained in this Bill are as follows:

Dividends paid by:

- municipal or other local government bodies and public authorities
- religious, scientific, charitable or public educational institutions
- public and other non-profit hospitals
- trade unions and other registered industrial associations

will not be eligible for the section 46 rebate. This change is intended to treat as interest, dividend payments under what are essentially financing arrangements rather than equity investments.

The second change is to dividends received by private companies. The section 46 rebate will only apply to the franked portion of such dividends.

SHORT-TERM PROPERTY SALES (SECTION 26AAA)

S. 26AAA was enacted in 1973 and applied to property acquired after 21 August 1973. Under S. 26AAA profit from the sale of property sold within 12 months of its purchase was (with exceptions) automatically assessable.

When capital gains tax (CGT) was introduced various problems arose from the continued existence of S. 26AAA. Two problems are described below.

The major problem arose from the inability to offset short-term capital losses against short-term profits. This happened because the provisions of the ITAA applied the CGT rules to all capital losses but applied S. 26AAA to short-term profits. This meant many taxpayers who made short-term losses from the October 1987 stock-market crash needed to have capital gains to be able to claim the losses in the same year. Being able to carry the losses forward for offset against future capital gains was not seen as a reasonable solution.

The second problem arose when a taxpayer was taxed on the sale of their residence because it was sold within twelve months of purchase.

Application of S. 26AAA was only excluded if the sale took place as a result of a change in the taxpayer's employment (or place of business) or certain other limited circumstances. Once capital gains tax (CGT) was introduced an anomaly arose. CGT applied to sales after twelve months from the date of purchase and CGT did not apply to the family home. This meant that it was possible for the family home to be sold within 12 months of purchase and for the profit to be subject to tax at the taxpayer's top marginal rate, whereas a sale after 12 months was exempt.
Section 26AAA will not be abolished by this Bill, rather a terminating date, 25 May 1988, will be inserted.

ELECTRICITY CONNECTION COSTS

Since 1 October 1980 the cost of connecting mains electricity to business premises has been allowed as a deduction in full in the year incurred. The Bill implements the proposal to spread the deduction over a ten year period.

VALUATION OF NATURAL INCREASE

Section 34 of the ITAA sets out rules for the valuation of natural increase of livestock. A commonly used method is to adopt the prescribed minimum cost price. (These prices were increased by the May Economic Statement.) Existing provisions of the ITAA prohibit the adoption of a cost price which is less than the prescribed minimum cost price. Changes contained in the Bill allow actual cost to be adopted where actual cost of production is less than the prescribed minimum cost.

PENSIONER AND BENEFICIARY REBATES

As a concessionary measure persons receiving certain social security and other pensions are allowed a special rebate of income tax. The rebate has remained at the same level as it was when originally introduced in the budget of 17 August 1982. The Bill implements the changes proposed in the May Economic Statement to increase the pensioner rebate to $430 per annum and the rebate available to persons receiving certain social security benefits, a Formal Training Allowance or an allowance paid under certain Commonwealth educational schemes, to $600.

TEMPORARY ALLOWANCE TO PENSIONERS

The 12 week special social security or veteran's pension payment paid to the surviving pensioner following the death of his or her pensioner spouse, is to be made exempt from the 1988/89 income year.

PROVISIONAL Tax FOR 1988/89 YEAR

The Bill specifies the factors which will apply in calculating provisional tax for the 1988/89 income year. Some of those factors are:

- the uplift factor is to be 12 per cent (the uplift factor was first introduced for the 1980/81 income year at the rate of 7.5 per cent),
- the imputation credit is to be increased by 12 per cent, and
- where the 1987/88 income included a capital gain, the amount of the gain will be excluded from the net income increased by 12 per cent.
NON-CASH BUSINESS BENEFITS

Incentives or benefits paid to business to promote sales of the benefactor's product are to be taxed. Changes contained in the Bill give effect, with some modifications, to a proposal announced on 4 February 1985. The move followed the decision of the Full Federal Court in FC of T v. Cooke & Sherden 80 ATC 4140; (1980) 10 ATR 696. The matter considered in that case was whether or not the benefit from free holidays provided as an incentive was assessable as income. The Court found against the Commissioner. The decision was that, as the benefits in that case were not convertible to money, they were not in the nature of income according to ordinary concepts and were therefore not assessable.

The decision effectively rendered non-assessable any non-cash business benefits which were given, subject to conditions making them non-transferable or non-convertible.

The new section to be inserted by this Bill states 'a non-cash business benefit that is not convertible to cash shall be treated as if it were convertible to cash'.

Business benefits have been provided in two ways. The difference in the two arrangements is sufficient to require two changes to the legislation.

The first arrangement as described above, rewards sellers of a product, while the second arrangement is aimed at the buyer of an item. The latter arrangement effectively discounts the cost of an item by providing a 'gift' at no cost. Under present tax law, the buyer is able to claim an income tax deduction for the full amount paid, even though the cost of the item included the cost of the 'gift' provided. To nullify the effect of this second arrangement the amendment in the Bill will decrease the amount of the deduction by the value of the benefit ('gift') received.

CORPORATE RESTRUCTURES – DEBT CREATION INVOLVING NON-RESIDENTS

Measures in the Bill implement a modified version of the proposal announced on 30 April 1987 and are a substitute for the foreign investment approvals previously required.

The measures restrict the amount of interest which can be claimed as an income tax deduction in the event of a corporate restructure involving the acquisition of assets from related parties.

A draft of the legislation was released for consideration by interested parties and, as a result, some of the modifications suggested were adopted. For example, in the original proposal the new rules were to apply in instances of 15 per cent foreign ownership. The changes in the Bill however, apply in circumstances where foreign ownership is at least 50 per cent.
PUBLIC TRADING TRUSTS

The Bill implements proposals first made on 24 February 1988 to broaden the definition of 'eligible investment business' in relation to public unit trusts. The broadened definition will extend the business activities which can be conducted by the trustee of a public unit trust without the trust being treated as a public trading trust.

If a public unit trust is regarded by the provisions of the ITAA to be a public trading trust, it is taxed in the same manner as a company.

This amendment will first apply to business conducted during the 1987/88 income year.

Main Provisions

DEPRECIATION

Clauses 34 and 37 will repeal the accelerated depreciation provisions. Clauses 25, 26 and 27 will change the rules regarding the calculation method option.

PREPAYMENTS

Clause 45 will insert a new subdivision into Part III, of the ITAA.

INTERCORPORATE DIVIDEND REBATE

Clauses 17, 18 and 19 will effect the changes to sections 46 and 46A of the ITAA.

SECTION 26AAA

Clause 15 will insert a new section (1A) into the ITAA, which will state that the section will not apply to profits from the sale of property after 25 May 1988.

LIVESTOCK NATURAL INCREASE

Clause 16 will amend section 34 of the ITAA to allow the value to be the actual cost of production when cost is less than the prescribed minimum cost price.

PENSIONER AND BENEFICIARY REBATES

Clause 51 will amend section 160AAA of the ITAA as to the amounts of the rebate and the income level at which the rebate abates.

PROVISIONAL TAX

Clause 56 specifies the basis for calculating provisional tax for the 1988/89 income year. The clause does not amend the ITAA.
NON-CASH BUSINESS BENEFITS

Clause 13 will insert a new section 21A into the ITAA to make non-cash benefits assessable and clause 24 will insert a new section 51AK into the ITAA to reduce the amount of a deduction which would otherwise be available, by the amount of non-cash benefit received.

CORPORATE RESTRUCTURES – DEBT CREATION

Clause 50 will insert a new Division 16G into Part III of the ITAA – LIABILITY TO TAXATION of the ITAA.

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

18 October 1988

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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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