Income Tax Regulations (Amendment) 1993 No. 216

EXPLANATORY STATEMENT

STATUTORY RULES 1993 No. 216

Issued by Authority of the Treasurer

Income Tax Assessment Act 1936

Income Tax Regulations (Amendment)

GENERAL OUTLINE

Purposes of regulations

The purposes of these regulations, which amend the Income Tax Regulations, are to:

(a) enable notional deductions to be allowed, on an amortisation basis, for the cost of certain buildings under the calculation method of taxing foreign investment funds (FIFs); and

(b) insert a list of foreign trusts in the regulations to replace the list of foreign trusts in Schedule 6 to the *Income Tax Assessment Act 1936* (the Act).

The legislation giving effect to the FIF measures, the *Income Tax Assessment Amendment (Foreign Income) Act 1992,* received Royal Assent on 18 December 1992.

Background to the FIF measures

The FIF measures apply to Australian resident taxpayers who, at the end of an income year, have an interest in a foreign company or trust and broadly attribute to those taxpayers undistributed income of the company or trust. These measures aim to remove the tax advantage of deferring Australian tax by accumulating income in offshore companies and trusts that are not controlled by Australian residents.

Other measures, commonly referred to as controlled foreign company and transferor trust measures, apply to interests in foreign companies and trusts which are controlled by Australian residents.

The FIF measures provide a number of exemptions from FIF taxation, including an exemption for interests of Australian residents in certain foreign trusts. These exemptions are designed to exclude from the FIF measures interests in FIFs which are not the target of the measures. Where an exemption does not apply, the amount of FIF income to be included in a taxpayer's assessable income is determined using one of the following three taxing methods:

(a) the market value method;

(b) the deemed rate of return method; or

(c) the calculation method.

Matters covered by regulations

The amending regulations will insert two new regulations, namely, 152L and 152M, into the Income Tax Regulations and will also insert a new schedule into the regulations.

New regulation 152L prescribes certain buildings as a class of property and also specifies an amortisation rate of 2.5 per cent. This will have the result that 2.5 per cent of the acquisition cost of the prescribed buildings will be a notional deduction under the calculation method of determining the amount of FIF income that is to be attributed to an Australian taxpayer. This will benefit affected taxpayers because the notional deduction will have the effect of reducing their assessable FIF income.

New regulation 152M replaces the list of exempt foreign trusts for the purposes of the FIF measures. This list was originally contained in Schedule 6 of the Act and this regulation will add six new funds to that list.

DETAILED NOTES ON THE REGULATIONS

Regulation 1 - Commencement

Amending regulation 1 specifies the date on which the amending regulations are to take effect, i.e., 1 January 1993. As mentioned above, this commencement date will benefit affected taxpayers. Thus, they *will* not contravene subsection 48(2) of the *Acts Interpretation Act 1901,* which prohibits the retrospective operation of regulations which affect the rights of, or impose liabilities on, taxpayers.

Regulation 2 - Amendment

Amending regulation 2 formally provides for the Income Tax Regulations to be amended.

Regulation 3 - New regulations 152L and 152M

Amending regulation 3 is the provision which inserts the new regulations 152L and 152M into the Income Tax Regulations.

Regulation 152L

Regulation 152L provides for the inclusion of the relevant buildings as a prescribed class of property and for an annual amortisation percentage of 2.5 per cent.

The inclusion of these buildings in the Regulations as a prescribed class of property will, in effect, allow an Australian taxpayer, who uses the calculation method of FIF taxation, to claim a notional deduction for those purposes from the income of the FIF for expenditure incurred by the FIF in acquiring a prescribed building. The amount of the deduction is calculated by multiplying 2.5 per cent, the annual amortisation rate, by the amount of the expenditure incurred by the FIF in acquiring the building.

The definition of buildings contained in this regulation is taken from Division 10D of the Act. This is the normal domestic provision which allows for the amortisation of capital expenditure incurred on income producing buildings. Also, the 2.5 per cent annual amortisation rate is the same rate as that used in Division 10D.

Regulation 152M

Regulation 152M provides for the inclusion of certain foreign trusts in Schedule 11 of the Income Tax Regulations.

A specific exemption has been included in the FIF measures for certain foreign trusts in recognition of the fact that for some countries it is not possible for Australian residents to invest directly and thus derive FIF income. Rather, in those countries there exists a legal requirement that investment be made via an investment trust.

Schedule 6 of the Act currently stipulates the particular foreign trusts that fall within this exemption but the Act provides for the exempt foreign trusts to be named in the regulations, including the original list contained in Schedule 6.

Following representations to the Government, it has been decided to add six new foreign trusts to the existing list. Accordingly, these new foreign trusts and the existing foreign trusts contained in Schedule 6 of the Act will be named in the Income Tax Regulations by amending Regulation 3.

Regulation 4 - New Schedule 11

Amending regulation 4 is the provision which inserts Schedule 11 into the Income Tax Regulations. As mentioned above, Schedule 11 will contain the list of exempt foreign trusts.