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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAX AND SUPERANNUATION LAWS AMENDMENT (2014 MEASURES No. 6) BILL 2014

EXPLANATORY MEMORANDUM

(Circulated by the authority of the
Treasurer, the Hon. J. B. Hockey MP)

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

Abbreviation	*Definition*
ACCC	Australian Competition and Consumer Commission
ATO	Australian Taxation Office
AWOTE	Average Weekly Ordinary Time Earnings
BAS	Business Activity Statement
CGT	capital gains tax
Cleaner Fuels Regulations	*Energy Grants (Cleaner Fuels) Scheme Regulations 2004*
Commissioner	Commissioner of Taxation
CPI	Consumer Price Index
ITAA 1936	*Income Tax Assessment Act 1936*
ITAA 1997	*Income Tax Assessment Act 1997*
JSCOT	Joint Standing Committee on Treaties
MIT	managed investment trust
RBCO	Regulatory Burden and Cost Offset
The Agreement	*The Force Posture Agreement between the Government of Australia and the Government of the United States of America* done at Sydney on 12 August 2014
US	United States of America

General outline and financial impact

Removing tax impediments to certain business restructures

Schedule 1 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to extend the existing business restructure roll-overs available where a member of a company or unitholder in a unit trust can defer the income tax consequences of transactions that occur in the course of a business restructure.

In particular, the amendments permit taxpayers to apply the roll-overs in circumstances where they held the relevant shares or units as revenue assets or trading stock. The amendments also consolidate the separate but effectively identical business restructure roll-overs for shares and units in a unit trust into a single set of provisions.

The amendments also make a number of technical changes to provisions of the ITAA 1997 to:

- allow roll-overs for trusts transferring all their assets to a trust or company to apply where the new trust or company holds rights needed to facilitate the transfer;
- address a technical defect in the operation of the business restructure roll-overs in relation to revenue assets; and
- clarify that the business restructure roll-overs only apply where the new asset has the same character (as a revenue asset or trading stock) as the original asset.

Date of effect: The amendments extending the business restructure roll-overs in relation to revenue assets and trading stock have effect from:

- 7.30 pm on 8 May 2012 (by legal time in the Australian Capital Territory) for shares; and
- 7.30 pm on 10 May 2011 for unitholders in a unit trust who exchange their units for shares in a company.

The amendments relating to roll-overs where trusts transfer assets apply to transfers:

- after 1 November 2008 for transfers between trusts; and
- from 7.30 pm on 10 May 2011 for transfers from trusts to companies.

The technical amendment to the provisions in the business restructure roll-over for revenue assets applies from 7.30 pm on 8 May 2012.

Finally, the amendments introducing the same character rules for assets acquired in a business restructure apply from 7.30 pm on 8 May 2012.

Proposal announced: The technical amendments to the revenue asset roll-overs and to certain capital gains tax trust restructure roll-overs were announced on 10 May 2011 as part of the 2011-12 Budget.

The amendments providing revenue asset and trading stock roll-overs where interest holders exchange their units in a unit trust for shares in a company were announced in the 2011-12 Mid-Year Economic and Fiscal Outlook on 29 November 2011.

The amendments broadening the existing revenue asset and trading stock roll-overs that apply where interest holders exchange their shares in a company for shares in another company and introducing the same character rule were announced on 8 May 2012 as part of the 2012-13 Budget.

On 14 December 2013, in a media release titled Integrity restored to Australia's tax system, the Assistant Treasurer announced the Government intended to proceed with all of the components of this measure.

Financial impact: These amendments have a small unquantifiable cost to revenue over the forward estimates.

Human rights implications: This Schedule does not raise any human rights issue. See *Statement of Compatibility with Human Rights* — Chapter 1, paragraphs 1.96 to 1.99.

Compliance cost impact: Low overall, with a low implementation impact and no change in ongoing compliance costs for affected entities.

Managed investment trust withholding regime for foreign pension funds

Schedule 2 to this Bill ensures that foreign pension funds can access the managed investment trust (MIT) withholding tax regime and the associated lower rate of withholding tax on income from certain Australian investments.

Date of effect: This measure applies to income years commencing on or after 1 July 2008 ratifying current industry practice.

Proposal announced: This measure was announced in the joint Press Release of the Treasurer and the Assistant Treasurer No. 017 of 6 November 2013.

Financial impact: The amendments in Schedule 2 to this Bill are not expected to have a revenue impact against the forward estimates.

Human rights implications: Schedule 2 to this Bill does not raise any human rights issues. See *Statement of Compatibility with Human Rights* — Chapter 2, paragraphs 2.18 to 2.21.

Compliance cost impact: Low.

US Force Posture Initiatives

Schedule 3 to this Bill provides an exemption from Australian tax on income derived by certain entities engaged by the Government of the United States of America (US) in connection with Force Posture Initiatives in Australia.

Date of effect: The exemption will apply in relation to the 2014-15 income year and later income years.

Proposal announced: On 16 November 2011, the Australian and US governments announced two new Force Posture Initiatives to significantly enhance defence cooperation between Australia and the US.

Financial impact: The amendments in Schedule 3 to this Bill are not expected to have a revenue impact against the forward estimates.

Human rights implications: This Schedule does not raise any human rights issue. See *Statement of Compatibility with Human Rights* — Chapter 3, paragraphs 3.30 to 3.33.

Compliance cost impact: Low.

Fuel tax credits and grants

Schedules 4 and 5 to this Bill amend the *Fuel Tax Act 2006* and the *Energy Grants (Cleaner Fuels) Scheme Regulations 2004*. Schedules 4 and 5 ensure that changes to the amount of excise and excise-equivalent customs duty payable by taxpayers as a result of any tariff proposals

tabled in the House of Representatives are taken into account in calculating fuel tax credits and the cleaner fuels grant for biodiesel and renewable diesel. Therefore upon Royal Assent to this Bill, fuel tax credit and grant claimants are able to claim the higher rate of fuel tax credits and grant amounts as a result of the Excise Tariff Proposal (No. 1) 2014 and the Customs Tariff Proposal (No. 1) 2014 tabled in the House of Representatives.

These amendments also make consequential changes to the fuel tax credit attribution rules consistent with the introduction of fuel indexation under the Excise Tariff Proposal (No. 1) 2014 and the Customs Tariff Proposal (No. 1) 2014.

Date of effect: This measure applies generally from 10 November 2014. However the consequential change to the fuel tax credit attribution rules applies from 1 July 2014.

Proposal announced: The amendments to take into account the effect of tariff proposals in determining fuel tax credits and grants have not previously been announced. The changes to the fuel tax credit attribution rules were included in the Fuel Indexation (Road Funding) Bill 2014 that was introduced to Parliament on 19 June 2014.

Financial impact: This measure is estimated to have no cost to revenue over the forward estimates period.

Human rights implications: This measure does not raise any human rights issues. See *Statement of Compatibility with Human Rights*, paragraphs 4.28 to 4.37.

Compliance cost impact: This measure imposes minor ongoing compliance costs as affected claimants of fuel tax credits and cleaner fuel grants will need to become familiar with the changes and claim the revised rate of credits and grants as changes to the rate of duty occur.

The regulation impact statement (paragraphs 4.38 to 4.91) is included in this explanatory memorandum in the form in which it was approved and consulted on. Therefore, it does not reflect the impact of subsequent policy or technical changes that are contained in this measure. These changes result from the delay in the expected enactment of the fuel indexation measure from when the regulation impact statement was prepared in the context of the Excise Tariff Amendment (Fuel Indexation) Bill 2014, Customs Tariff Amendment (Fuel Indexation) Bill 2014, Fuel Indexation (Road Funding) Special Account Bill 2014 and Fuel Indexation (Road Funding) Bill 2014, that were introduced to the House of Representatives on 19 June 2014. In addition, the changes reflect that fuel duty rates are adjusted from 10 November 2014 under Excise Tariff Proposal (No. 1) 2014 and Customs Tariff Proposal (No. 1) 2014.

Summary of regulation impact statement

Regulation impact on business

Impact: Moderate.

Main point:

- The majority of the change in the compliance costs for businesses with entitlements to fuel tax credits is borne by entities who submit their Business Activity Statements on a monthly, quarterly or annual basis. These entities will be required to organise purchases of fuels between purchases before and after the indexation date, in order to properly account for their fuel tax credit entitlement.

Chapter 1
Removing tax impediments to certain business restructures

Outline of chapter

1.1 Schedule 1 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) (all legislative references are to the ITAA 1997 unless otherwise specified) to extend the existing business restructure roll-overs available where a member of a company or unit trust can defer the income tax consequences of transactions that occur in the course of a business restructure.

1.2 In particular, the amendments permit taxpayers to apply the roll-overs in circumstances where they held the relevant shares or units as revenue assets or trading stock. The amendments also consolidate the separate but effectively identical business restructure roll-overs for shares and units in a unit trust into a single set of provisions.

1.3 The amendments also make a number of technical changes to provisions of the ITAA 1997 to:

- allow the roll-overs for trusts transferring all their assets to a trust or company to apply where the new trust or company holds rights needed to facilitate the transfer;
- address a technical defect in the operation of the business restructure roll-overs in relation to revenue assets; and
- clarify that the business restructure roll-overs only apply where the new asset has the same character (as a revenue asset or trading stock) as the original asset.

Context of amendments

Business restructure roll-overs, trading stock and revenue assets

1.4 Subdivisions 124-G and 124-H both provide roll-overs (the business restructure roll-overs) to allow eligible taxpayers to defer tax consequences that might otherwise arise from certain business restructures.

1.5 Subdivision 124-G allows taxpayers to defer the capital gains tax (CGT) consequences that would arise from a company restructure by providing a CGT roll-over where interest holders exchange all of their shares in a company for shares in an interposed company.

1.6 For the roll-over to apply, the taxpayer must elect for it to apply and satisfy the requirements in Subdivision 124-G. Broadly, these requirements will be satisfied where:

- the interest holder is a member of the company;
- the company has more than one member;
- all of the members of the company dispose, cancel or redeem (subsequently in this Chapter, a reference to a disposal of shares or units includes a reference to the cancellation or redemption of the shares or units unless the contrary is indicated) all of their shares in the company and receive shares in the new company (the interposed company) as part of a scheme of re-organisation;
- immediately following the re-organisation, the interposed company owns all of the shares of the original company;
- the interests of members in the new company are equivalent to their interests in the old company; and
- the shares in the interposed company are not redeemable shares; and
- either:
  - the interest holder was an Australian resident; or
  - the interest holder was a foreign resident and the original shares, immediately before the time of disposal, and the new shares, immediately after disposal, were taxable Australian property.

1.7 Subdivision 124-G also includes provisions (see section 124-390) to provide an equivalent roll-over in the same circumstances in respect of the income tax consequences where the relevant shares are held as trading stock or revenue assets immediately before the company restructure. These roll-overs only apply where the original company and the company that is interposed are head companies of the same consolidated group.

1.8 The trading stock roll-over under Subdivision 124-G works by providing that the amount included in the taxpayer's income is its cost or value under the trading stock provisions and by providing that the replacement shares have been acquired for the same amount. As a result of the interaction of the trading stock provisions (Division 70) and the general law, this means that the assessable income from the disposal is offset by the deduction for the cost of acquiring the replacement shares, and the trading stock that the taxpayer acquires is taken to initially be the same as the value of the shares they replaced. This deferral does not alter the normal operation of the trading stock provisions under section 70-35 for changes in the value of the trading stock over the course of the income year.

1.9 The revenue asset income tax deferral uses the same approach as the concession for trading stock, requiring that the taxpayer include an amount in their assessable income. However, unlike the trading stock rules, the general income tax provisions do not necessarily provide a corresponding deduction for the acquisition of revenue assets. As a result, the provision does not always result in a tax deferral — interest holders may have to include amounts in their assessable income as a result of the realisation of their assets. This outcome is contrary to the intention of these provisions to permit the deferral of tax consequences.

1.10 Similar to Subdivision 124-G, Subdivision 124-H allows taxpayers to defer the CGT consequences that would arise from the restructure of a unit trust into a company where interest holders either transfer their units in a unit trust to a company or redeem or cancel their units in exchange for shares in the company.

1.11 For the roll-over to apply, the taxpayer must elect for it to apply and meet the requirements set out in the subdivision (which are effectively identical to those set out in Subdivision 124-G).

1.12 Unlike Subdivision 124-G, Subdivision 124-H does not allow taxpayers to defer the income tax consequences of a restructure where the affected units are held as a revenue asset or trading stock in any circumstances. As a result, taxpayers may incur an immediate income tax liability in respect of these restructures.

CGT roll-overs for a trust transferring an asset to a company or another trust

1.13 A CGT roll-over is available where a trust transfers a CGT asset to a company (Subdivision 124-N) or to another trust (Subdivision 126-G).

1.14 These roll-overs are not intended to allow for substantive changes in the underlying ownership arrangements or to provide tax advantages beyond the deferral of CGT consequences for the restructure. To prevent this, both of these roll-overs require that the company or trust receiving the asset must have no CGT assets other than a small amount of cash or debt.

1.15 Industry has identified that this condition may restrict the availability of the roll-over more widely than is intended. In particular, for certain transfers, the recipient entity must hold rights, which are themselves CGT assets, to facilitate the transfer of assets from the original entity to the receiving entity. Entities that hold such rights may be denied access to these roll-overs.

Trading stock and revenue assets

Trading stock

1.16 Trading stock is defined in section 70-10 as including anything that is held for the purpose of manufacture, sale or exchange in the ordinary course of business. As there will generally be high turnover of trading stock in an income year, applying the normal tax rules would involve considerable compliance costs and some potential inaccuracy.

1.17 To address this, Division 70 provides for a special tax regime for trading stock that is intended to reduce compliance costs while still producing an overall result that reflects the activities of the taxpayer in relation to the trading stock over the income year.

1.18 These rules provide that all of the taxpayer's earnings and outgoings in relation to trading stock are on revenue account. They also provide that, generally, a taxpayer must include the earnings from any disposal of trading stock and deduct the outgoings they incur in acquiring new trading stock from their assessable income for an income year. A taxpayer must also account for any net change in the value of the trading stock they hold at the end of any income year.

Revenue assets

1.19 A revenue asset is defined in section 977-50 as a CGT asset where:

- the profit or loss on the disposal of the asset would not be taxed under the CGT provisions, but under other provisions of the tax law; and

- the asset is neither trading stock under Division 70 nor a depreciating asset within the meaning of section 40-30.

1.20 In most cases, shares or units in a unit trust will be revenue assets if they are disposed of in the ordinary course of the taxpayer's business or the disposal forms part of an arrangement undertaken with the intention of realising a profit (see for example *Coles Myer Finance Ltd v Federal Commissioner of Taxation* (1993) 176 CLR 640). In this situation, the net profits from the sale of the shares will be subject to tax as ordinary income under section 6-5.

Announced changes

2011-12 Budget

1.21 The then Government announced, as part of the 2011-12 Budget, that it would provide certainty for interest holders by ensuring that the roll-over for revenue assets under Subdivision 124-G provided the intended deferral of tax.

1.22 It was also announced that the law would be amended to ensure that trusts transferring assets to another trust or company were not denied access to relevant roll-overs due to the recipient entity holding rights used to facilitate the transfer.

2011-12 Mid-Year Economic and Fiscal Outlook

1.23 During consultation on the 2011-12 Budget measures, concerns were raised that the lack of an equivalent deferral for revenue assets and trading stock in Subdivision 124-H presented a significant barrier to restructures of unit trusts.

1.24 To address these concerns, it was announced on 17 November 2011 that Subdivision 124-H would be extended to allow the deferral of the income tax consequences of unit trust restructures for taxpayers who hold units as either revenue assets or trading stock.

2012-13 Budget measures

1.25 During further consultation following the 2011-12 Mid-year Economic Financial Outlook announcement, further concerns were identified that the revenue asset and trading stock roll-overs in Subdivision 124-G only applied in limited circumstances — broadly only to restructures in the ownership arrangements of consolidated groups.

1.26 This meant that other restructures could result in significant tax consequences for interest holders, potentially deterring otherwise economically efficient restructures.

1.27 An issue was also identified that the existing provisions for the tax deferral for revenue assets and trading stock in Subdivision 124-G did not require that the replacement shares have the same tax character as the original shares. Changing the character of the replacement asset could result in the asset not being properly subject to tax under either the original revenue asset or trading stock provisions or the CGT provisions.

1.28 To address these two issues, the previous Government announced that it would:

- broaden the revenue asset and trading stock roll-overs to apply to all situations in which Subdivision 124-G can apply; and

- introduce a requirement in Subdivision 124-G and also in the proposed equivalent provisions in Subdivision 124-H to require that replacement assets must share the same tax character as the original asset for the concession to apply.

Summary of new law

1.29 These amendments improve the ability of businesses to restructure by extending the circumstances where an interest holder can defer the income tax consequences that may arise as a result of a business restructure.

1.30 In particular, these amendments extend the deferral in relation to revenue assets and trading stock by:

- removing the restriction that limits the option to defer tax consequences for interest holders that exchange shares in one company for shares in another company as part of a restructure to cases where both companies are part of the same consolidated group; and

- making the concession available to interest holders that exchange their units in a unit trust for shares in a company as part of a restructure.

1.31 Further, to simplify the law and remove duplication, the amendments consolidate the two separate Subdivisions which provide effectively identical roll-overs for restructures of trusts and companies into a single Division.

1.32 The amendments also make a number of technical changes to improve the operation of these and certain other roll-overs, including:

- allowing trusts that transfer assets to another company or trust to access relevant CGT roll-overs despite the recipient entity holding rights that are used to facilitate the transfer;
- correcting issues with the operation of the revenue asset deferral so that it properly defers tax liability in relation to the asset; and
- restricting the use of the business restructure roll-overs in relation to revenue assets and trading stock to cases where the replacement asset acquired in a restructure is of the same character as the replaced asset.

Comparison of key features of new law and current law

New law	*Current law*
Revenue asset and trading stock roll-overs are available where interest holders exchange their units in a unit trust for shares in a company.	Revenue asset and trading stock roll-overs are not available where interest holders exchange their units in a unit trust for shares in a company.
The revenue asset and trading stock roll-overs that are available where interest holders exchange their shares in a company for shares in another company are not limited to ownership arrangements involving consolidated groups.	The revenue asset and trading stock roll-overs that are available where interest holders exchange their shares in a company for shares in another company are only available for ownership arrangements involving consolidated groups.

New law	*Current law*
The revenue asset and trading stock roll-overs that are available where interest holders exchange their shares in a company for shares in another company and where interest holders exchange their units in a unit trust for shares in a company are only available where the replacement interests are of the same tax character as the interests that were exchanged under the restructure.	The revenue asset and trading stock roll-overs that are available where interest holders exchange their shares in a company for shares in another company do not require the replacement shares in the interposed company to be of the same tax character as the shares that were exchanged under the restructure.
The revenue asset roll-over that is available where interest holders exchange their shares in a company for shares in another company allows interest holders to defer a profit or loss on the exchange of shares under a corporate restructure.	The revenue asset roll-over that is available where interest holders exchange their shares in a company for shares in another company does not operate effectively to defer a profit or loss on the exchange of shares under a corporate restructure.
A trust transferring an asset to a company or another trust may access a CGT roll-over if the receiving entity holds rights that are used to facilitate the transfer of assets to that entity.	A trust transferring an asset to a company or another trust cannot access a CGT roll-over if the receiving entity holds any assets other than small amounts of cash or debt, including rights that are used to facilitate the transfer of assets to that entity.

Detailed explanation of new law

1.33 These amendments improve the ability of entities to restructure by extending the circumstances where an interest holder can defer their income tax consequences as a result of an entity restructure.

1.34 Broadly, these amendments do this in two ways: extending the availability of the concessions allowing taxpayers to defer the income tax consequences of exchanging shares or units they hold as revenue assets and trading stock for shares in a company as part of a restructure; and making technical amendments to improve the operation of the provisions.

1.35 These amendments also rewrite and consolidate Subdivisions 124-G and 124-H into the new Division 615 so as to reduce the number of provisions and simplify the law.

Extending the availability of the revenue asset and trading stock concessions

1.36 Where interest holders exchange units in a unit trust or shares in a company for shares in an interposed company, an income tax liability may arise under the tax rules for trading stock (as defined in section 70-10) or revenue assets (as defined in section 977-50). Otherwise, it will generally result in an income tax liability as a result of the CGT provisions.

1.37 Currently, the business restructure roll-overs under Subdivisions 124-G and 124-H may apply to allow taxpayers to in effect defer any liability that would otherwise arise. However, these roll-overs will generally only benefit taxpayers who will be subject to CGT on the disposal of the shares or units. The roll-overs are only available for assets held as trading stock or revenue assets if:

- the assets are shares; and
- the relevant transaction occurs as part of a restructure of a consolidated group.

1.38 These amendments allow the taxpayer to potentially access a rollover for all shares or units regardless of the character of the shares or units in the taxpayer's hands (including where it is held as a revenue asset or trading stock). ***[Schedule 1, item 1, Division 615]***

Electing to access the roll-over for assets held as revenue asset and trading stock

1.39 In order for an interest holder to be eligible for the optional trading stock or revenue asset concession, the interest holder must elect for the roll-over to apply in respect of the asset. ***[Schedule 1, item 1, sections 615-5 and 615-45]***

1.40 If the taxpayer meets the requirements for the roll-over and chooses for the roll-over to apply, the choice has effect regardless of the character of the asset. Having the election apply for all purposes is simpler for taxpayers and ensures consistent tax treatment.

1.41 It also ensures that there is no possibility that the deferral of tax in relation to shares or units held as a revenue asset may result in the asset being subject to CGT in that year.

1.42 So that all taxpayers are eligible to make this election, the CGT exemption for trading stock in section 118-25 is disregarded. ***[Schedule 1, item 1, section 615-60]***

1.43 In some cases, the interest holder will be taken to have chosen for the roll-over to apply. In these cases, the interest holder is treated in the same way as if they had made an election. ***[Schedule 1, item 1, subsections 615-5(2) and 615-10(2)]***

How the income tax consequences are deferred — trading stock

1.44 In cases where the shares or units are held as trading stock, the amendments provide that interest holders who exchange their shares or units for shares in a new company as part of the restructure are taken to have received an amount for each of the shares or units they have ceased to hold equal to either:

- the value of the trading stock at the time of the restructure; or
- if the trading stock was held at the start of the income year, the value of the trading stock at the start of the income year plus any subsequent increase in cost.

[Schedule 1, item 1, section 615-50]

1.45 Similarly, the value of the shares an interest holder receives in the restructure is taken be equal to the amount that has been included in their assessable income for the disposal of the old shares or units divided by the number of their new shares that are trading stock.

1.46 The effect of these special valuation rules is to ensure that the value of the old shares or units is taken to be the same as the value of the new shares. As a result, the amount included in the taxpayer's assessable income as a result of the disposal of the units or old shares will be exactly offset by the amount which the taxpayer may deduct from their assessable income as the cost of acquiring the new shares, ensuring no net tax consequence arises at the time of disposal.

1.47 Instead, as the new shares are taken to have the same value as the old shares or units, any unrealised gain or loss in respect of the old shares or units will be subject to tax upon the eventual disposal of the new shares (subject to any subsequent events that may affect this gain or loss).

1.48 To ensure this outcome is achieved, the amendments specifically exclude the application of certain integrity rules that can alter the value of trading stock when sold or acquired by related parties or outside the normal course of business. ***[Schedule 1, item 1, subsection 615-50(3)]***

1.49 Altogether, this ensures that the interest holder's tax position will not change as a result of a restructure to which the provisions apply.

Example 1.1

Coffee is a publicly listed unit trust and restructures for commercial reasons by interposing a new company, Decaf Pty Ltd (Decaf) between itself and its unitholders.

Chai Traders Pty Ltd (Chai) holds 10,000 units in Coffee Unit Trust (Coffee). Chai has held these units as trading stock since the start of the income year and has accounted for these units using the cost method under the trading stock provisions.

As a result of the restructure, all of the units in Coffee are cancelled and as consideration for this cancellation, the former unitholders are issued one share in Decaf for every two units they held in Coffee. Chai therefore is issued 5,000 shares in Decaf.

Chai elects for roll-over relief and the trading stock roll-over provided by these amendments apply.

As Chai has elected the cost method to account for its trading stock, Chai is to include in its assessable income the total cost of the units at the start of the income year plus any cost incurred since the start of that income year. In the case of Chai, this cost is $1 per unit and as it holds 10,000 units in Coffee, Chai includes $10,000 in its assessable income.

For Chai to determine the cost of each share it acquires in Decaf (and subsequently for Chai to determine the income tax deduction it receives as a result of acquiring shares in Decaf), Chai is required to use the formula described in paragraph 1.46.

The cost of each of the shares in Decaf is $2 using the formula. This cost is calculated as follows:

$$\frac{\text{The total amount included in the interest holder's assessable income as a result of subsection } 615-50(1)}{\text{The total number of shares the interest holder acquires that are trading stock}}$$

$$\frac{\$10{,}000}{5{,}000} = \$2$$

As Chai received 5,000 shares in Decaf and the cost of each of the shares in Decaf is $2, Chai is entitled to an income tax deduction of $10,000.

Therefore, by Chai including $10,000 in its assessable income for the realisation of the units in Coffee, and by receiving a $10,000 income tax deduction for acquiring shares in Decaf, this has the net effect of producing a trading stock deferral for Chai.

As the value of Chai's units in Coffee at the start of the income year is the same as the value of its units in Decaf at the end of the income year, Chai is not required to include an amount in its assessable income in respect of these assets under section 70 35.

How the income tax consequences are deferred — revenue assets

1.50 In cases where the taxpayer holds the old shares or units as a revenue asset, the amendments instead provide that the interest holder is taken to have realised the unit for an amount that would result in them not making a profit or loss on the realisation of those shares or units. Generally this will be the price at which the entity acquired the shares or units. ***[Schedule 1, item 1, section 615-55]***

1.51 When calculating any future profit or loss from the realisation of the shares in the interposed entity, the interest holder is assumed to have acquired each share or unit for the total amount they are taken to have received for the shares or units they disposed of in the restructure divided by the total number of new shares or units. ***[Schedule 1, item 1, subsection 615-55(1)]***

1.52 As a result, a restructure to which the roll-over applies will similarly not change the effective net tax position of a taxpayer holding shares or units.

Example 1.2

Continuing on from Example 1.1, Debbie also holds 20,000 units in Coffee. These units are revenue assets for Debbie, as she buys and sells these units for the purposes of earning income.

Debbie elects for roll-over relief.

At the time of the restructure, all of Debbie's units in Coffee are valued at $40,000. In addition, at this time, the total cost of Debbie's units is $30,000.

To ensure Debbie does not make a profit or loss on the realisation of her units in Coffee, using the principle described in paragraph 1.50, Debbie is taken to have received $30,000 for the realisation of her units and not the market value of $40,000.

To determine a profit or loss on the future realisation of Debbie's shares in Decaf, Debbie is taken to have acquired each share for an amount as determined using the method set out as described in paragraph 1.51. This amount is calculated as follows:

$$\frac{\text{The total amount included in the interest holder's income as a result of subsection 61555(1)}}{\text{The total number of shares the interest holder acquires that are revenue assets}}$$

$$\frac{\$30{,}000}{10{,}000} = \$3$$

As Debbie is taken to have received $30,000 on the realisation of her units in Coffee and as she subsequently receives 10,000 shares in Decaf, she is taken to have acquired each share in Decaf for a cost of $3. This puts Debbie in the same income tax position in respect of her shares in Decaf as compared with her position in holding units in Coffee just before the restructure.

Technical amendments

1.53 This Schedule also makes a number of technical amendments to the operation of the business restructure roll-over and other CGT roll-overs.

Correcting the operation of the concession for revenue assets

1.54 As outlined above at paragraph 1.7, prior to these amendments, a taxpayer could elect for a roll-over where the taxpayer disposed of shares in a company in exchange for shares in an interposed company where the shares were held as revenue assets. However, it is not clear that the provisions to give effect to this roll-over gave rise to the intended outcome.

1.55 While interest holders were required to include an amount in their assessable income, the provisions could be interpreted as requiring the inclusion of a fixed amount rather than being whatever amount is necessary to ensure the transaction did not give rise to income tax consequences.

1.56 The amended provisions make clear that shares held as revenue assets are treated as having been realised for the amount that would result in the interest holder not making any profit or loss at the time of the restructure, whatever this amount may be. This ensures the taxpayer will face no net tax consequences in the year of disposal. ***[Schedule 1, item 1, subsection 615-55(1)]***

1.57 The existing provisions that ensure that any unrealised profit or loss is appropriately brought to account in any subsequent disposal or other dealing with the new shares are effective and are not substantively changed by these amendments. ***[Schedule 1, item 1, subsection 615-55(2)]***

Integrity rule for replacement assets

1.58 The amendments also include an additional requirement to access the business restructure roll-over in respect of revenue assets and trading stock (the 'same tax character' rule). As a result of this requirement, the replacement shares acquired must have the same tax character as the original share or unit — that is, the original asset and the replacement asset must both be trading stock or must both be a revenue asset. ***[Schedule 1, item 1, paragraphs 615-45(c) and (d)]***

1.59 The provisions providing for the roll-over operate by modifying the value of the asset for the purposes of the relevant rules both at the time of the restructure and when subsequently subject to tax.

1.60 This symmetrical treatment allows income tax consequences to be deferred from the time of the restructure until the subsequent disposal or other dealing. However, if the replacement asset did not share the same character, the rules to modify the tax treatment of the subsequent disposal or other dealing would not apply. This would mean that any unrealised gain or loss at the time of the restructure would never be appropriately recognised for tax purposes, often resulting in an exemption rather than a deferral of tax.

1.61 The additional requirement included by the amendments about the character of the replacement asset ensures the integrity of the roll-over by ensuring indefinite deferral cannot occur.

Modifications to the CGT roll-overs where a trust transfers an asset to a company or another trust

1.62 A CGT roll-over is available where a trust transfers a CGT asset to a company (Subdivision 124-N) or another trust (Subdivision 126-G). A key condition for both of these roll-overs is that the company or trust receiving the asset must hold no CGT assets other than a small amount of cash or debt (see paragraphs 124-860(4)(b) and 126-225(1)(b)).

1.63 These amendments will modify these conditions, ensuring that the roll-overs will also be available where the entity receiving the asset holds rights under an arrangement that facilitates the transfer of assets to that entity. These rights, when treated collectively, must only be used to facilitate the transfer of assets from the transferring entity to the receiving entity. ***[Schedule 1, items 37 and 38, paragraphs 124-860(4)(b) and 126-225(1)(b)]***

1.64 This requirement would be satisfied where the receiving entity holds any rights that only have a function of facilitating the transfer of assets to that entity, including:

- rights that stipulate that particular assets will be transferred to the receiving entity;
- rights that are required to be held by the receiving entity, to the extent they are required to facilitate the transfer of assets to that entity; and
- ancillary rights arising from other rights, whereby these other rights facilitate the transfer of assets to the receiving entity.

1.65 Where an entity has more than one arrangement with rights that facilitate the transfer of assets to that entity, these amendments will apply separately for each of the arrangements. This ensures that all rights that facilitate the transfer of assets to the receiving entity are ignored for the purposes of determining whether an entity satisfies the CGT roll-over requirements.

Example 1.3: New company under Subdivision 124-N

Green Trust (Green) plans to dispose of its assets to a newly established company, Yellow Pty Ltd (Yellow).

Yellow holds a deed which stipulates that as a result of the restructure the ownership of Green's assets will be transferred to Yellow at a particular point in time.

As all of these rights under the deed facilitate the transfer of assets from Green to Yellow, they are ignored for the purposes of determining whether the roll-over conditions in Subdivision 124-N are satisfied.

Consolidating the business restructure roll-overs

1.66 The amendments repeal Subdivisions 124-G and 124-H and reproduce their effect in a new Division, Division 615. This consolidation eliminates significant duplication and simplifies the law. ***[Schedule 1, item 1, Division 615]***

1.67 Other than in the specific changes detailed elsewhere in this explanatory memorandum, this consolidation results in only one additional change to the operation of the roll-overs (now the roll-over). This change relates to the period for the new interposed company to elect for the roll-over to apply. Under the existing law, the company has 28 days or such further time as the Commissioner of Taxation (Commissioner) may allow to make this choice for a corporate business restructure and two months for a restructure of a trust into a company.

1.68 As a result of the amendments, the new company will always have two months or such further time as the Commissioner may allow to choose for the rollover to apply, unless the restructure involves the replacement of the head company of a consolidated group. For restructures of consolidated groups, the period will remain 28 days or such further time as the Commissioner may allow which is consistent with the period required for reporting under the consolidation tax rules in Division 703. ***[Schedule 1, item 1, section 615-30]***

1.69 The consolidation of Subdivisions 124-G and 124-H has resulted in changes to the structure of the provisions previously contained within those Subdivisions.

1.70 Under the new provisions, there are two sets of circumstances in which the roll-over may be available:

- the disposal of shares or units; and
- the redemption or cancellation of shares or units,

for shares in an interposed company as part of a restructure. ***[Schedule 1, item 1, sections 615-5 and 615-10]***

1.71 The provisions then set out the requirements that must be met to access the roll-over in all cases, organised by the interest to which they apply. ***[Schedule 1, item 1, sections 615-15, 615-20, 615-25, 615-30 and 615-35]***

1.72 Finally, they outline the tax consequences of the roll-over for shares or units held as CGT assets, trading stock and revenue assets. ***[Schedule 1, item 1, sections 615-40, 615-45, 615-50, 615-55 and 615-60]***

1.73 While this is broadly aligned with the current structure of Subdivisions 124-G and 124-H, these Subdivisions separately reproduce some of the requirements after each set of circumstances and have a less structured approach to laying out the general requirements and tax consequences.

1.74 The guide material for the provisions has been revised to better reflect the intended operation of the consolidated Division. ***[Schedule 1, item 1, section 615-1]***

1.75 Finally, the new Division is located in the Part of the Act for general roll-over rules (Part 3-80 — Roll-overs applying to assets generally). This reflects that the business restructure roll-overs will no longer be restricted to applying only to CGT consequences. ***[Schedule 1, item 1, Division 615]***

1.76 In addition to these specific changes a number of consequential amendments have been made to replace existing references to Subdivisions 124-G or 124-H with references to the new Division. ***[Schedule 1, items 2 to 36, note 5 to section 121AS in the Income Tax Assessment Act 1936, paragraph 103-25(3)(a), table items 9, 10, 14D and 14E in section 112-115, subparagraphs 124-20(3)(a)(i) to (ii) and (v) to (vi), Subdivisions 124-G and 124-H, subsection 124-795(3), notes to subsections 124-795(3), 125-70(5) and 703-5(2), Group heading before section 703-65, note to section 703-65, heading to section 703-70, subsections 703-70(1) and (2), notes to subsection 703-70(2) and (3), heading to section 703-75, subsection 703-75(1), note to subsection 703-75(1), subsections 703-75(2) and (3), heading to 703-80, subsection 703-80(1) and note 2 to section 703-80 in the ITAA 1997, subsections 58T(1) and (2) and the note to subsection 58T(2) in the Petroleum Resource Rent Tax Act 1987 and paragraph 45-705(4)(a), subparagraphs 45-705(4)(d)(i) and (ii) and paragraphs 45-705(d) and 45-740(2)(a) in Schedule 1 to the Taxation Administration Act 1953]***

1.77 Further details on the operation of the business restructure roll-over may be found in the explanatory memorandum to the Bills that introduced the original provisions that have now been consolidated. The legislative history in relation to these provisions is summarised at paragraph 1.92.

Application and transitional provisions

Summary of key dates of effect

Amendment	*Announcement date*	*Application date*
Business restructure roll-overs		
Providing revenue asset and trading stock concessions for units in unit trusts	17 November 2011	7.30 pm on 10 May 2011
Resolving technical defects in the revenue asset roll-overs for shares	10 May 2011	7.30 pm on 10 May 2011
Introducing the 'same tax character' integrity rule	8 May 2012	7.30 pm on 8 May 2012
Broadening the revenue asset and trading stock concession for shares	8 May 2012	7.30 pm on 8 May 2012

Amendment	*Announcement date*	*Application date*
Subdivision 124-N		
Removing technical defects in the CGT roll-over where the receiving entity holds facilitation rights	10 May 2011	7.30 pm on 10 May 2011
Subdivision 126-G		
Removing technical defects in the CGT roll-over where the receiving entity holds facilitation rights	10 May 2011	1 November 2008

Business restructure roll-overs

1.78 The amendments to the business restructure roll-over provisions all apply from 7.30 pm (by legal time in the Australian Capital Territory) on 10 May 2011. ***[Schedule 1, subitems 39(1) and (2)]***

1.79 However, transitional provisions modify the operation of the new rules for the period between 7.30 pm on 10 May 2011 and 7.30 pm on 8 May 2012 for shares and units that taxpayers hold as trading stock or revenue assets. ***[Schedule 1, item 41, section 615-5 of the Income Tax (Transitional Provisions) Act 1997]***

1.80 During this period, taxpayers may apply the roll-over in respect of shares and units in unit trusts that are held as trading stock or revenue assets without having to satisfy the 'same tax character' integrity rule. ***[Schedule 1, item 41, sections 615-10, 615-15 and 615-20 of the Income Tax (Transitional Provisions) Act 1997]***

1.81 Further, taxpayers may only access the roll-over in respect of shares held as trading stock or revenue assets if the taxpayer is taken to have chosen to obtain the roll-over because the restructure relates to the head company of a consolidated group. ***[Schedule 1, item 41, sections 615-10, 615-15 and 615-20 of the Income Tax (Transitional Provisions) Act 1997]***

Rationale for application dates

1.82 Broadly, the date of effect for all of these amendments is the date each change was announced by the then Government.

1.83 This protects taxpayers who have acted in accordance with the announcements about how the law will be changed.

Minor technical changes to the CGT restructure roll-over provisions

Subdivision 124-N roll-over

1.84 The amendments to Subdivision 124-N that allow a company to hold rights that facilitate the transfer of assets to that company apply in relation to CGT events happening after 7.30 pm on 10 May 2011.

1.85 This change, which is beneficial for all taxpayers, applies from the time of the announcement in order to ensure the technical defect does not inhibit interest holders from accessing the CGT roll-over. ***[Schedule 1, subitem 39(2)]***

Subdivision 126-G roll-over

1.86 The amendments to Subdivision 126-G that allow a receiving trust to hold rights that facilitate the transfer of assets to that trust apply in relation to CGT events happening on or after 1 November 2008. ***[Schedule 1, subitem 39(3)]***

1.87 This amendment, which is beneficial for interest holders, applies retrospectively to align with the application date of the Subdivision 126-G fixed trust roll-over.

Requirement for trustees to notify beneficiaries of the Subdivision 126-G roll-over being chosen

1.88 If the CGT roll-over under Subdivision 126-G is applied, section 126-260 requires that the trustee of the transferring trust must, within three months after the end of the income year in which the transferring trust transferred the asset to the receiving trust, send written notice to each of the trust's beneficiaries providing them with certain information so they can meet their obligations. Section 126-260 imposes a penalty on the transferring trustee if they do not meet this condition.

1.89 As the amendment to Subdivision 126-G applies from 1 November 2008, some interest holders will not be able to benefit from the amendment by amending prior completed tax returns without the relevant trustee contravening section 126-260. This is because, in some cases, it would not be possible for the trustee to provide each of the trust's beneficiaries with the written documentation within three months after the end of the income year in which the asset transfer occurred, as this time period would have already lapsed.

1.90 Therefore, where the transferring trust transfers an asset to the receiving trust between 1 November 2008 and the income year that ends before these changes obtain Royal Assent, the amendments allow a trustee to provide the relevant beneficiaries with certain documentation within three months of the roll-over being chosen without the trustee breaching subsection 126-260(1). ***[Schedule 1, item 40]***

Amendments to assessments

1.91 This Schedule modifies the application of section 170 in respect of amendments to assessments. Where an assessment has been made prior to the commencement of Schedule 1, amendments may be made for the purpose of giving effect to this Schedule for at least two years after the day this Schedule commences. This ensures that taxpayers are still able to receive the benefit of these changes despite the delay between the announcement and passage of these amendments. ***[Subclause 4(1)]***

Legislative History of Subdivisions 124-G and 124-H

1.92 Subdivisions 124-G and 124-H were added to the ITAA 1997 by the *Tax Law Improvement Act (No. 1) 1998*. They were rewritten versions of the former sections 160ZZPA and 160ZZPB of the *Income Tax Assessment Act 1936*.

1.93 These provisions have been amended by:

Act title	***Act No.***	***Effect of amendments***
Tax Law Improvement Act (No. 1) 1998	46 of 1998	Rewrote the provisions and moved to ITAA 1997.
Taxation Laws Amendment (Company Law Review) Act 1998	63 of 1998	Updated the tax law to ensure that changes made by the *Company Law Review Act 1998* to facilitate capital distributions did not have unintended tax consequences.
A New Tax System (Indirect Tax and Consequential Amendments) Act 1999	176 of 1999	Amendments to reflect new definition of market value.
New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002	117 of 2002	Extended roll-over relief to shares held as revenue assets or trading stock for restructures of corporate groups.
Tax Laws Amendment (2004 Measures No. 2) Act 2004	83 of 2004	Extended the period for the new head company to choose whether or not a restructured consolidated group continues to exist (electing for the group to continue is necessary for the rollover to be available but also has other tax consequences). The extended period is consistent with the general notification period that applies under the tax law for events affecting consolidated groups.

Act title	*Act No.*	*Effect of amendments*
Tax Laws Amendment (2004 Measures No. 7) Act 2004	41 of 2005	Corrected terminology to refer to 'foreign resident' rather than 'not an Australian resident'.
Tax Laws Amendment (2006 Measures No. 2) Act 2006	58 of 2006	Minor correction to the use of asterisking when defining market value.
Tax Laws Amendment (2006 Measures No. 4) Act 2006	168 of 2006	Amendments to restrict the availability of roll-overs for foreign residents to cases where shares or units are taxable Australian property.
Tax Laws Amendment (2011 Measures No. 9) Act 2012	12 of 2012	Updated the provisions to reflect new rules introduced to permit the application of roll-overs to transactions involving foreign residents and share sale facilities.

Finding tables

Old law to new law

1.94 Below is a finding table to assist in locating the provision in the new Division 615 that corresponds with a provision in the old Subdivisions 124-G or 124-H.

Old law	*New law*
124-350;	615-1
124-355	No equivalent provision
124-360	615-5
124-365	615-15,615-20
124-370	615-10
124-375	615-15, 615-20
124-380	615-25, 615-30
124-382	615-35
124-385	615-65
124-390	615-45, 615-50, 615-55

Old law	*New law*
124-435	615-1
124-440	No equivalent provision
124-445	615-5
124-450	615-15, 615-20
124-455	615-10
124-460	615-15, 615-20
124-465	615-25, 615-30
124-470	615-65

New law to old law

1.95 Below is a finding table to assist in locating the provision in the old Subdivisions 124-G or 124-H that corresponds with a provision in the new Division 615.

New law	*Old law*
615-1	124-350; 124-435
615-5	124-360; 124-445
615-10	124-370,124-455
615-15	124-365(1), 124-375(1); 124-450(1), 124-460(1)
615-20	124-365(2) to (4), 124-375(2) to (4); 124-450(2) to (4), 124-460(2) to (4)
615-25	124-380(1) to (3); 124-465(1) to (3)
615-30	124-380(5) to (7)
615-35	124-382

New law	*Old law*
615-40	No equivalent provision
615-45	124-390(1)
615-50	124-390(2) and (3)
615-55	124-390(4) and (5)
615-65	124-385;124-470

STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Removing tax impediments to certain business restructures

1.96 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

1.97 Schedule 1 to this Bill amends the *Income Tax Assessment Act 1997* to extend the circumstances where an interest holder can defer their income tax consequences as a result of a business restructure. In particular, the amendments:

- provide revenue asset and trading stock roll-overs where interest holders exchange their units in a unit trust for shares in a company;
- broaden the existing revenue asset and trading stock roll-overs that apply where interest holders exchange their shares in a company for shares in another company, so that the roll-overs are not limited to ownership arrangements involving consolidated groups;

- provide adequate integrity by ensuring that the revenue asset and trading stock roll-overs are only available where the asset acquired under a restructure is of the same tax character as the asset exchanged under the restructure; and

- resolve technical defects relating to the revenue asset roll-over that applies where interest holders exchange their shares in a company for shares in another company and to certain capital gains tax trust restructure roll-overs.

Human rights implications

1.98 This Schedule does not engage any of the applicable rights or freedoms.

Conclusion

1.99 This Schedule is compatible with human rights as it does not raise any human rights issues.

Chapter 2
Managed investment trust withholding regime for foreign pension funds

Outline of chapter

2.1 Schedule 2 to the Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to ensure that foreign pension funds can access the managed investment trust (MIT) withholding tax regime and the associated lower rate of withholding tax on income from certain Australian investments.

Context of amendments

2.2 The MIT withholding tax regime provides a reduced rate of withholding tax for foreign investors in Australian managed funds for the purposes of attracting and retaining foreign investment in Australia.

2.3 Broadly, the liability for MIT withholding tax is imposed on foreign residents in respect of the fund payments they receive either directly or indirectly from a MIT.

2.4 However, under the current law, the concessional MIT withholding tax regime does not apply in circumstances where an ultimate beneficiary cannot be established. This will occur where fund payments are made to a trust without presently entitled beneficiaries.

2.5 Consequently, a foreign pension fund, as a foreign beneficiary or foreign custodian, will not have access to the MIT withholding tax regime if it receives fund payments as a trustee and does not have beneficiaries that are presently entitled to the payments. Instead, the foreign pension fund may be liable to tax under the general provisions relating to the taxation of trusts in Division 6 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936) and may be taxed at the highest marginal tax rate.

2.6 These amendments will ensure that foreign pension funds can access the MIT withholding tax regime and the associated lower rate of withholding tax on eligible Australian investments. This result is achieved by treating the foreign pension fund as the ultimate beneficiary in respect of fund payments flowing to the fund directly or indirectly from a MIT.

2.7 The amendments will apply to income years commencing on or after 1 July 2008. This application date will ensure that affected foreign pension funds can access the MIT withholding tax regime reflecting current industry practice.

Summary of new law

2.8 Schedule 2 to the Bill amends Division 840 of the ITAA 1997 to ensure that foreign pension funds can access the MIT withholding tax regime. Under the amendments, foreign pension funds will be treated as the final beneficiary of a fund payment and will be liable for MIT withholding tax.

Comparison of key features of new law and current law

New law	*Current law*
Fund payments made to foreign pension funds will be subject to the MIT withholding tax regime.	Fund payments made to foreign pension funds may be subject to the general trust taxation rules in Division 6 of Part III of the ITAA 1936.

Detailed explanation of new law

2.9 The MIT withholding tax regime provides a reduced rate of withholding tax for foreign investors in Australian managed funds for the purposes of attracting and retaining foreign investment in Australia.

2.10 Broadly, the liability for MIT withholding tax is imposed on foreign resident beneficiaries in respect of amounts received that represent, or are reasonably attributable to, the fund payments of a MIT. The jurisdiction in which the beneficiary is a resident will determine the rate of MIT withholding tax that applies.

2.11 These amendments ensure that a foreign pension fund that receives a fund payment as a trustee will be taken to be a beneficiary in its own right and, as a result, will be liable to income tax at the MIT withholding tax rate as determined by the residency of the fund.
[Schedule 2, items 1 and 2, section 840-800 and subsection 840-805(4A)]

2.12 A ***foreign pension fund*** is either:

- an entity that has the principal purpose of funding pensions (including disability and similar benefits) for the citizens or other contributors of a foreign country, provided that:
  - the entity is a fund established by an exempt foreign government agency (as defined in the ITAA 1997); or
  - the entity is established under a foreign law (as defined in the ITAA 1997) for an exempt foreign government agency; or
- a foreign superannuation fund (as defined in the ITAA 1997) which has at least fifty members.

[Schedule 2, items 2 and 3, subsection 840-805(4B) and the definition of 'foreign pension fund' in subsection 995-1(1)]

2.13 As a foreign pension fund will be liable to income tax at the MIT withholding tax rate, the amendments make clear that in the event there exists a beneficiary of the fund that is presently entitled to income of the fund, that beneficiary will not also be liable to MIT withholding tax. ***[Schedule 2, item 2, subsection 840-805(4C)]***

Consequential amendments

2.14 Consequential amendments are made to the Pay As You Go withholding rules in Division 18 of Schedule 1 to the *Taxation Administration Act 1953* to ensure that the withholding tax regime, including the crediting provisions, apply appropriately. ***[Schedule 2, item 4, subsections 18-32(3) and (4)]***

Application and transitional provisions

2.15 The amendments will apply to fund payments made in income years starting on or after 1 July 2008, the date when the MIT withholding tax regime commenced. ***[Schedule 2, item 5]***

2.16 This will ensure that specified foreign pension funds can access the MIT withholding tax regime reflecting current industry practice.

Amendment of assessments

2.17 Generally, the Commissioner of Taxation has the power to amend an assessment of a trust (including where a taxpayer requests an amendment), other than a trust that is a small business entity, within four years from the date of the notice of assessment. As these amendments may apply to income years in respect of which the four-year amendment period has expired, the period for amending assessments will be extended. An assessment can be amended if:

- the assessment was made before the commencement of the amendments (that is, before the day on which the amendments receive Royal Assent);
- the amendment is made within two years after that date; and
- the amendment is made for the purpose of giving effect to these amendments.

[Subclause 4(2)]

STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Managed investment trust withholding regime for foreign pension funds

2.18 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

2.19 This Schedule ensures that foreign pension funds can access the managed investment trust (MIT) withholding tax regime and the associated lower rate of withholding tax on income from certain Australian investments.

Human rights implications

2.20 This Schedule does not engage any of the applicable rights or freedoms.

Conclusion

2.21 This Schedule is compatible with human rights as it does not raise any human rights issues.

Chapter 3
US Force Posture Initiatives

Outline of chapter

3.1 Schedule 3 to this Bill provides an exemption from Australian tax on income derived by certain entities engaged by the Government of the United States of America (US) in connection with Force Posture Initiatives in Australia.

Context of amendments

The US Force Posture Agreement

3.2 The Force Posture Initiatives were first announced in 2011 by the then Prime Minister of Australia and the US President. The Force Posture Initiatives in Australia currently involve annual rotational US Marine Corps deployments and enhanced aircraft cooperation activities with the US Air Force in northern Australia.

3.3 On 12 August 2014, the Government of Australia and the Government of the US signed *The Force Posture Agreement between the Government of Australia and the Government of the United States of America* (the Agreement).

3.4 The Agreement provides a legal, policy and financial framework to govern the Force Posture Initiatives in Australia and contains important protections and assurances for both jurisdictions. It requires, for example, respect for Australian sovereignty and the laws of Australia, and affirms that the Force Posture Initiatives will occur at Australian facilities. It also provides certainty around the conditions for US access to Australian owned facilities as well as the types of activities that US forces will be able to conduct under the Force Posture Initiatives.

3.5 The Agreement also provides an exemption from Australian income tax for Australian source income derived by US contractors in connection with the Force Posture Initiatives. In particular, paragraphs (3) and (4) of Article XVII of the Agreement provides the following:

> *Income derived wholly and exclusively from performance in Australia of any contract with the United States in connection with activities under this Agreement by any person (who is not a national of nor*

ordinarily resident in Australia) or company (other than a company incorporated in Australia) being a United States Contractor, who is in or is carrying on business in Australia solely for the purpose of such performance, shall be deemed not to have been derived in Australia, provided that it is not exempt, and is taxed, under the taxation laws of the United States. Such contractors will not be subject to Australian tax in respect of income derived from sources outside Australia.

Where the legal incidence of any form of taxation in Australia depends upon residence or domicile, periods during which such United States Contractors are in Australia solely in connection with activities under this Agreement shall not be considered as periods of residence therein, or as creating a change of residence or domicile, for the purposes of such taxation.

3.6 A legislative amendment to the *Income Tax Assessment Act 1936* (ITAA 1936) is required to give effect to this aspect of the Agreement.

Overview of the Current Law

3.7 Subsection 23AA(5) of the ITAA 1936 currently provides for an income tax exemption for income derived by US contractors wholly and exclusively from the performance of prescribed contracts in connection with approved projects.

3.8 Under the current law, prescribed contracts relate to contracts with the US Government, and related subcontracts. As such, this explanatory memorandum uses the term 'US contractor' in lieu of the legislative concept of 'foreign contractor'.

3.9 Section 23AA was introduced in 1963 to provide an exemption from Australian tax for services performed in Australia in relation to a contract with the US Government in connection with the establishment, operation or maintenance of the Naval Communication Station at North West Cape. The exemption in section 23AA has been expanded over time to cover further projects.

3.10 Under the existing section 23AA, the exemption from income tax extends to a number of entities in Australia in connection with an approved project, including certain:

- members of the US armed forces;
- civilians accompanying US forces;
- employees of US Government;

- contractors and subcontractors of the US;
- employees of contractors; and
- dependents of the above.

3.11 A condition for the exemption from Australian income tax is that the income is not exempt from income tax in the US (see paragraphs 23AA(5)(b) and (6)(b)).

Summary of new law

3.12 Schedule 3 to this Bill provides that income derived by US contractors wholly and exclusively from the performance of contracts in connection with the Force Posture Initiatives will be deemed to have been derived from sources outside Australia and will be exempt from Australian tax, provided that the income is not exempt from income tax in the US.

3.13 This amendment gives effect to paragraphs (3) and (4) of Article XVII of the Agreement.

3.14 In addition, the exemption will extend to the other entities listed at paragraph 3.10 that are in Australia in connection with the Force Posture Initiatives.

Comparison of key features of new law and current law

New law	*Current law*
Force Posture Initiatives will be added to the list of approved projects. Income derived by US contractors and certain other entities in connection with the Force Posture Initiatives will be deemed to have been derived from sources outside Australia and will be exempt from Australian income tax.	An exemption from income tax applies to a number of entities in Australia in connection with 'approved projects' involving the cooperation between Australia and the armed forces of the US.

Detailed explanation of new law

Exemption from Australian income tax

3.15 Schedule 3 to this Bill amends subsection 23AA(1) of the ITAA 1936 to include the Force Posture Initiatives in the definition of an 'approved project'. ***[Schedule 3, item 1, subsection 23AA(1)]***

3.16 As a result of this amendment, income derived by US contractors and certain other entities in connection with the Force Posture Initiatives will be deemed to have been derived from sources outside Australia and will be exempt from Australian income tax.

3.17 The exemption is subject to the existing framework established in section 23AA, which requires, for example, that the income not be exempt from income tax in the US.

Definition of a Force Posture Initiative

3.18 A Force Posture Initiative has the same meaning as in the Agreement. ***[Schedule 3, item 2, subsection 23AA(1)]***

3.19 The Agreement's exemption from Australian tax is modelled on the provisions contained in Article 6 of the *Agreement between the Government of Australia and the Government of the United States of America relating to the Operation of and Access to an Australian Naval Communication Station at North West Cape in Western Australia* [2011] ATS 36, which entered into force 24 November 2011.

3.20 The Agreement defines 'force posture initiatives' as the initiatives jointly announced by the then Prime Minister of Australia and the US President on 16 November 2011, and other initiatives as mutually agreed.

3.21 Currently, there are two announced Force Posture Initiatives in Australia: one concerns annual rotational US Marine Corps deployments, and the other concerns enhanced aircraft cooperation activities with the US Air Force in northern Australia. Additional initiatives may be covered under the Agreement where both parties mutually agree that they are Force Posture Initiatives.

3.22 Provision for the Agreement and related tax exemptions to apply to future Force Posture Initiatives is consistent with the regime under the *Agreement with the Government of the United States of America concerning the Status of United States Forces in Australia, and Protocol* [1963] ATS 10, which entered into force on 9 May 1963, and

which provides for tax exemptions for certain defined classes of people in connection with agreed activities. The Australian and US governments of the day determine what activities are agreed on and are conducted in Australia pursuant to that agreement.

Consideration by the Joint Standing Committee on Treaties (JSCOT)

3.23 It is current practice that JSCOT be given sufficient time, either 15 or 20 joint Parliamentary sittings, to consider and report on all treaty actions before legislation to give effect to the treaty is introduced into Parliament.

3.24 In exceptional circumstances, where national interest reasons dictate that this is not possible, JSCOT may agree to a request from the relevant Minister that legislation giving effect to the treaty be introduced into Parliament.

3.25 JSCOT has not yet reported on the Agreement. However, on 25 August 2014, JSCOT agreed that Schedule 3 to this Bill could be introduced into Parliament, notwithstanding that it has not yet reported on the Agreement.

3.26 JSCOT concurred with this course of action following advice from the Minister for Defence that the Agreement contains important protections and assurances, and that it was in Australia's national interest for the Agreement to enter into force as soon as is practicable.

Application and transitional provisions

3.27 The amendments in Schedule 3 commence on the day this Bill receives Royal Assent.

3.28 In effect, the application of the income tax exemption is contingent on the Agreement coming into force ***[Schedule 3, item 2, subsection 23AA(1) definition of 'Force Posture Agreement']***. Paragraph 1 of Article XXI generally provides for the entry into force of the Agreement on the date that Australia and the US exchange diplomatic notes confirming that each party has completed its domestic requirements to give effect to the Agreement.

3.29 On entry into force of the Agreement, the amendments in Schedule 3 apply to the 2014-15 income year and later income years. ***[Schedule 3, item 3]***

STATEMENT OF COMPATIBILITY WITH HUMAN RIGHTS

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

US Force Posture Initiatives

3.30 This Schedule is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

3.31 Schedule 3 to this Bill provides an exemption from Australian tax on income derived by certain entities engaged by the Government of the United States of America in connection with the Force Posture Initiatives in Australia.

Human rights implications

3.32 This Schedule does not engage any of the applicable rights or freedoms.

Conclusion

3.33 This Schedule is compatible with human rights as it does not raise any human rights issues.

Chapter 4
Fuel tax credits and grants

Outline of chapter

4.1 Schedules 4 and 5 to this Bill amend the *Fuel Tax Act 2006* and the *Energy Grants (Cleaner Fuels) Scheme Regulations 2004* (Cleaner Fuels Regulations). Schedules 4 and 5 ensure that changes to the amount of excise and excise-equivalent customs duty payable by taxpayers as a result of any tariff proposals tabled in the House of Representatives are taken into account in calculating fuel tax credits and the cleaner fuels grant for biodiesel and renewable diesel. Therefore upon Royal Assent to this Bill, fuel tax credit and grant claimants are able to claim the higher rate of fuel tax credits and grant amounts as a result of the Excise Tariff Proposal (No. 1) 2014 and the Customs Tariff Proposal (No. 1) 2014 tabled in the House of Representatives

4.2 The amendments also make consequential changes to the fuel tax credit attribution rules consistent with the introduction of fuel indexation under the Excise Tariff Proposal (No. 1) 2014 and the Customs Tariff Proposal (No. 1) 2014.

Context of amendments

4.3 The Government tabled the Excise Tariff Proposal (No. 1) 2014 and the Customs Tariff Proposal (No. 1) 2014 in the House of Representatives to:

- increase the rate of excise and excise-equivalent customs duty to apply from 10 November 2014 to fuels to assist in funding investment in road infrastructure following delays in passage of the Excise Tariff Amendment (Fuel Indexation) Bill 2014, Customs Tariff Amendment (Fuel Indexation) Bill 2014, Fuel Indexation (Road Funding) Special Account Bill 2014 and Fuel Indexation (Road Funding) Bill 2014; and

- re-introduce bi-annual fuel indexation.

4.4 Tariff proposals do not amend the excise and customs law but rather give notice of the Government's intention to introduce legislation to Parliament to change the rate of excise or excise-equivalent customs duty. Tariff proposals also allow the Commissioner of Taxation

(Commissioner) and the CEO of the Australian Customs and Border Protection Service to collect duty in accordance with the tariff proposals, pending the legislation to ratify the tariff proposals being enacted. Tariff proposals do not however have a flow on operation to other provisions in the tax law that are linked to the amount of excise and excise-equivalent customs duty paid by taxpayers, for example the fuel tax credit system and grants under the Cleaner Fuels Grants Scheme. Without amendment, this would have an adverse compliance cost impact on business fuel tax users that claim fuel tax credits or have an entitlement to a grant for fuel.

Summary of new law

4.5 Schedules 4 and 5 to this Bill amend the *Fuel Tax Act 2006* and the Cleaner Fuels Regulations. Schedules 4 and 5 ensure that changes to the amount of excise and excise-equivalent customs duty payable by taxpayers as a result of any tariff proposals tabled in the House of Representatives are taken into account in calculating fuel tax credits and the cleaner fuels grant for biodiesel and renewable diesel.

4.6 These amendments also make consequential changes to the fuel tax credit attribution rules consistent with the introduction of fuel indexation under the Excise Tariff Proposal (No. 1) 2014 and the Customs Tariff Proposal (No. 1) 2014 tabled in the House of Representatives.

Comparison of key features of new law and current law

New law	*Current law*
Amount of fuel tax credits: effect of tariff proposals	
The amount of fuel tax credits is based on the rate of fuel tax payable at the relevant time, including the effect of changes to the rate of excise and excise-equivalent customs duty that is required to be collected as a result of a tariff proposal. Where a tariff proposal increases the rate of duty collected, fuel tax credit and grant claimants are able to claim the higher rate of fuel tax credits and grant amounts from the time the tariff proposal was moved.	The amount of fuel tax credits is based on the rate of fuel tax payable at the relevant time, and does not include the effect of changes to the rate of excise and excise-equivalent customs duty that is required to be collected as a result of a tariff proposal.

New law	*Current law*
Calculation of fuel tax credits	
Fuel tax credit claimants who acquire or import fuel calculate their fuel tax credits using the duty rate on the day they acquired or imported the fuel. The same rule applies to registered and unregistered claimants. Fuel tax credit claimants who manufacture fuel and enter it for home consumption calculate their fuel tax credits using the duty rate on the day they enter the fuel for home consumption.	Registered claimants who acquire or import fuel after 30 November 2011 and before 1 July 2015 calculate their fuel tax credits using the duty rate on the day they acquired or imported the fuel. Registered claimants who manufacture the fuel and enter it for home consumption after 30 November 2011 and before 1 July 2015 calculate their fuel tax credits using the duty rate on the day they enter the fuel for home consumption. Registered claimants who acquire, manufacture or import the fuel after 30 June 2015 calculate their fuel tax credits using the rate on the first day of the tax period to which the credit is attributed. Unregistered claimants calculate their fuel tax credits using the rate on the day the Commissioner receives their return.
Cleaner fuels grant amount	
The amount of the grant available for biodiesel and renewable diesel is based on the amount of duty payable on biodiesel at the relevant time. For the purposes of calculating the grant, duty payable is treated as including amounts payable under a tariff proposal.	The amount of grant available for biodiesel and renewable diesel is based on the amount of duty payable on biodiesel at the relevant time. The duty payable does not include amounts payable under a tariff proposal.
Effect of tariff proposal not being ratified	
If a tariff proposal is not ratified by the earlier of the following times: • the close of the session of Parliament in which the tariff proposal was moved; and • the expiration of 12 months after the tariff proposal was moved, then claimants of fuel tax credits and the cleaner fuels grant for biodiesel and renewable diesel must recalculate their entitlements without taking the tariff proposal into account.	Not applicable.

Detailed explanation of new law

Fuel tax credits

Amount of fuel tax credits: effect of tariff proposals

4.7 The *Fuel Tax Act 2006* provides for a single system of fuel tax credits. Fuel tax credits are paid to reduce or remove the incidence of fuel tax levied on taxable fuels, ensuring that generally, fuel tax is effectively only applied to fuel used in private vehicles and for certain other private purposes, and fuel used on-road in light vehicles for business purposes.

4.8 The amount of fuel tax credits that a claimant is entitled to depends on the rate of excise or excise-equivalent customs duty that applies to fuel under the *Excise Act 1901* and the *Excise Tariff Act 1921*, and the *Customs Act 1901* and the *Customs Tariff Act 1995*, respectively.

4.9 Schedule 4 amends the meaning of 'fuel tax' in the *Fuel Tax Act 2006* to include the effect of:

- an Excise Tariff alteration, proposed by a motion moved in the House of Representatives, that relates to duty payable on fuel; or
- a Customs Tariff alteration, proposed by a motion moved in the House of Representatives, that relates to duty payable on fuel;

so that the tariff proposal (also known as a tariff alteration) is treated as amending the *Excise Act 1901* and the *Excise Tariff Act 1921*, or the *Customs Act 1901* and the *Customs Tariff Act 1995*.

[Schedule 4, items 2 and 4, subsections 43-6(1) and 43-6(2), section 110-5 (definition of fuel tax) of the Fuel Tax Act 2006]

4.10 This amendment ensures that the effect of a tariff proposal such as the Excise Tariff Proposal (No. 1) 2014 and the Customs Tariff Proposal (No. 1) 2014, is taken into account in working out the amount of fuel tax credits. A tariff proposal will increase the amount of fuel tax credit entitlements if the tariff proposal authorises the collection of a higher rate of duty on fuel than imposed under the law at the time the proposal is tabled. In contrast, a tariff proposal will reduce the amount of fuel tax credit entitlements if the tariff proposal authorises the collection of a lower rate of duty than imposed under the law at the time the proposal is tabled.

4.11 The effect of Schedule 4 in relation to the Excise Tariff Proposal (No. 1) 2014 and the Customs Tariff Proposal (No. 1) 2014 that were tabled in the House of Representatives is that upon Royal Assent to this

Bill, an increased duty rate for liquid fuel is payable if the liquid fuel is acquired, imported or manufactured and entered for home consumption on or after 10 November 2014.

4.12 In these circumstances eligible fuel users qualify for fuel tax credits at the increased rate of duty less the road user charge (for on-road fuel use) and related grants or subsidies.

4.13 For most claimants, fuel tax credits are claimed through the business activity statement (BAS). The BAS is lodged on a monthly, quarterly or annual basis ('tax period'). The due date for monthly BAS lodgers is the 21st day of the following month.

4.14 Therefore, where Royal Assent to this Bill occurs prior to 21 December 2014, all monthly, quarterly and annual claimants of fuel tax credits on the BAS will be entitled to claim the increased rate of fuel tax credits resulting from the Excise Tariff Proposal (No. 1) 2014 and the Customs Tariff Proposal (No. 1) 2014, when their next BAS for the relevant tax period is due for fuel acquired, manufactured or imported on or after 10 November 2014. Similarly, claimants that are required to lodge fuel tax returns will be entitled to claim the increased rate of fuel tax credits in their next fuel tax return following Royal Assent to this Bill.

Tariff proposals not ratified

4.15 However, if legislation to ratify a tariff proposal does not come into force before the earlier of the following times:

- the close of the session of Parliament in which the tariff proposal was moved; and
- the expiration of 12 months after the tariff proposal was moved by a motion in the House of Representatives,

then the effect of the tariff proposal ceases to be taken to have had the effect of amending the *Excise Act 1901* and the *Excise Tariff Act 1921* or the *Customs Act 1901* and the *Customs Tariff Act 1995*, so as to alter the amount of fuel tax credit entitlement.

[Schedule 4, item 2, subsections 43-6(3) and 43-6(4) of the Fuel Tax Act 2006]

4.16 If this occurs, fuel tax credit claimants will have a 'fuel tax adjustment' under section 44-5 of the *Fuel Tax Act 2006*. The amount of the adjustment will be the difference between the amount of fuel tax credits claimed and the amount that is claimable following the expiration of 12 months after the tariff proposal was moved (or the close of the session of Parliament in which the tariff proposal was moved, if applicable).

Example 4.1: Tariff proposal not ratified by legislation

Customs and Excise Tariff proposals are tabled in Parliament on 20 June 2017 that increase the rate of duty on liquid fuels by one cent a litre on 1 July 2017.

Camille uses fuel in her fixed equipment that she operates at her business premises. She is entitled to claim fuel tax credits taking into account the additional one cent per litre that is collected under the tariff proposals when she lodges her July 2017 monthly BAS for fuel purchased on or after 1 July 2017.

Legislation is not enacted by the expiration of 12 months after the tariff proposals were moved in Parliament. Camille is required to make an adjustment to her fuel tax credit claim in the BAS period following the expiration of 12 months to take account of her increased claim of one cent per litre for the relevant period (that is, 1 July 2017 to 30 June 2018).

Calculation of fuel tax credits: attribution

4.17 Before the amendments in Schedule 4, subsection 43-5(2A) of the *Fuel Tax Act 2006* provided that if a claimant acquired, manufactured or imported fuel after 30 June 2015, they would have used the duty rate on the first day of the tax period to calculate the amount of the fuel tax credits.

4.18 This may have understated the fuel tax credits for claimants because changes to the rate of duty apply part way through a tax period. Claimants may have paid a higher rate of duty, or acquire fuel that has borne the higher rate on or after 10 November 2014, but could only claim fuel tax credits based on the lower duty rate applying on the first day of a tax period starting on 1 November 2014 for monthly tax periods, 1 October 2014 for quarterly tax periods and 1 July 2014 for annual tax periods.

4.19 Schedule 4 amends the law to ensure the rate that is used for determining the amount of fuel tax credits is the same as the excise or excise-equivalent customs rate of duty that was payable on the fuel. In working out their entitlement to fuel tax credits:

- claimants who acquire or import fuel use the rate of duty that applies on the day that they acquired or imported the fuel; and

- claimants who manufacture the fuel and enter it for home consumption use the rate of duty applying on the day they enter the fuel for home consumption.

4.20 These rules also apply in determining the rate of duty used in working out a claimant's fuel tax credit entitlement after deducting the road user charge and any applicable grant for biodiesel or renewable diesel (see paragraphs 4.22 and 4.23 below). ***[Schedule 4, items 1 and 3, subsections 43-5(2A) and 43-10(6) of the Fuel Tax Act 2006]***

4.21 The amendments also remove the special rule for determining the appropriate duty rate for unregistered claimants. Before the amendments in Schedule 4, unregistered claimants used the duty rate applying on the day the Commissioner received their return relating to the fuel to work out their entitlement to fuel tax credits. If this rule was retained after the amendments to the rates of duty, unregistered claimants would be able to gain an advantage by postponing the lodgement of their fuel tax returns. ***[Schedule 4, item 1, subsection 43-5(2A) of the Fuel Tax Act 2006]***

Grant for biodiesel and renewable diesel

4.22 Schedule 5 to this Bill amends the Cleaner Fuels Regulations to ensure that the amount of the grant for cleaner fuels for biodiesel and renewable diesel is calculated using the biodiesel duty rate, including the effect of any tariff proposal on that rate, at the time when the cleaner fuel was entered for home consumption. ***[Schedule 5, items 1 to 5, subregulation 3A(1), Regulations 6 and 7C of the Energy Grants (Cleaner Fuels) Scheme Regulations 2004]***

Tariff proposals not ratified

4.23 However, in the event that legislation to give effect to the operation of a tariff proposal does not come into force before the earlier of:

- the close of the session of Parliament in which the tariff proposal was moved; and
- the expiration of 12 months after the tariff proposal was moved by a motion in the House of Representatives,

then the claimant is treated as:

- never being entitled to an additional amount of the cleaner fuel grant relating to the tariff proposal if the tariff proposal resulted in an additional grant entitlement; or

- always being entitled to the amount of the cleaner fuels grant calculated on the basis of the rate of duty in force under legislation (rather than under the tariff proposal) if the tariff proposal resulted in a reduction in the amount of the grant able to be claimed.

[Schedule 5, item 1, Subregulations 3A(2) and 3A(3) of the Energy Grants (Cleaner Fuels) Scheme Regulations 2004]

Application and transitional provisions

Application provisions

4.24 The amendments to the attribution rules for the calculation of fuel tax credits under the *Fuel Tax Act 2006* apply to a tax period that starts on 1 July 2014, or a fuel tax return period where the return is lodged with the Commissioner on or after 1 July 2014. ***[Schedule 4, item 5]***

4.25 Although this applies retrospectively, taxpayers are not adversely affected as the fuel tax credit rate in the period 1 July 2014 to 9 November 2014 does not change.

4.26 The amendments to the amount of fuel tax credits to give effect to the tariff proposals apply on and after 10 November 2014, to align with the date from which the Excise Tariff Proposal (No. 1) 2014 and the Customs Tariff Proposal (No. 1) 2014 is effective. ***[Subclause 2(1)]***

4.27 The amendments to the *Energy Grants (Cleaner Fuels) Scheme Regulations 2004* concerning the rate of the grant commence on 10 November 2014, to align with the date from which the Excise Tariff Proposal (No. 1) 2014 and the Customs Tariff Proposal (No. 1) 2014 is effective. ***[Subclause 2(1)]***

STATEMENT OF COMPATIBILIY WITH HUMAN RIGHTS

Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*

Schedule 4 — Fuel tax credits

Schedule 5 — Energy Grants (Cleaner Fuels) Scheme

4.28 Schedules 4 and 5 to this Bill are compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

4.29 Schedules 4 and 5 amend the *Fuel Tax Act 2006* and the *Energy Grants (Cleaner Fuels) Scheme Regulations 2004* (Cleaner Fuels Regulations). Schedules 4 and 5 ensure that changes to the amount of excise and excise-equivalent customs duty payable by taxpayers as a result of any tariff proposals tabled in the House of Representatives are taken into account in calculating fuel tax credits and the cleaner fuels grant for biodiesel and renewable diesel.

4.30 The *Fuel Tax Act 2006* provides for a single system of fuel tax credits. Fuel tax credits are paid to reduce or remove the incidence of fuel tax levied on taxable fuels, ensuring that generally, fuel tax is effectively only applied to fuel used in private vehicles and for certain other private purposes, and fuel used on-road in light vehicles for business purposes.

4.31 The amount of fuel tax credits that a claimant is entitled to depends on the rate of excise or excise-equivalent customs duty that applies to fuel under the *Excise Act 1901* and the *Excise Tariff Act 1921*, and the *Customs Act 1901* and the *Customs Tariff Act 1995*, respectively, determined by the meaning of 'fuel tax'.

4.32 The meaning of 'fuel tax' in the *Fuel Tax Act 2006* is amended to include the effect of:

- an Excise Tariff alteration, proposed by a motion moved in the House of Representatives, that relates to duty payable on fuel; or

- a Customs Tariff alteration, proposed by a motion moved in the House of Representatives, that relates to duty payable on fuel,

such that the tariff proposal (also known as a tariff alteration) is treated as amending the *Excise Act 1901* and the *Excise Tariff Act 1921*, or the *Customs Act 1901* and the *Customs Tariff Act 1995*.

4.33 In the event that the tariff proposal is not ratified by legislation, the effect of the alteration to the meaning of fuel tax is taken not to apply, and claimants would be required to ensure that their fuel tax credit entitlement and cleaner fuels grant are adjusted accordingly.

4.34 These changes ensure that tariff proposals do not have an adverse compliance cost impact on business fuel tax users that claim fuel tax credits or claimants of grants for biodiesel or renewable diesel.

4.35 The amendments also make consequential changes to the fuel tax credit attribution rules consistent with the introduction of fuel indexation under the Excise Tariff Proposal (No. 1) 2014 and the Customs Tariff Proposal (No. 1) 2014 tabled in the House of Representatives.

Human rights implications

4.36 Schedules 4 and 5 do not engage any of the applicable rights or freedoms.

Conclusion

4.37 Schedules 4 and 5 are compatible with human rights as they do not raise any human rights issues.

REGULATION IMPACT STATEMENT

CPI Indexation of fuel excise and excise and excise-equivalent customs duty

What is fuel excise?

4.38 Fuel tax (excise or customs duty) is applied to all excisable fuel and petroleum products whether domestically produced or imported.

4.39 The rate applicable to each fuel varies, but the benchmark rate that applies to petroleum and diesel is currently set at 38.143 cents per litre. The tax is applied at the point at which the fuel enters the Australian market. For domestically produced fuels, this is generally at the point of wholesale, while for imported fuels, it is at the point of delivery for home consumption.

4.40 Indexation of fuel tax was introduced in August 1983 in order to maintain the real value of tax collections and to provide more stability for businesses and consumers by removing the need for discretionary changes to tax rates (larger amounts made less frequently). In March 2001, the then Government abolished the six monthly indexation of fuel tax rates, but continued to apply indexation to other excisable goods, such as alcohol and tobacco. This decision was taken following the introduction of the GST on 1 July 2000, as increasing world oil prices at the time gave rise to concerns that fuel prices would be pushed higher. Consequently, the fuel tax on petrol and diesel has remained at 38.143 cents per litre since then.

4.41 The *Australia's Future Tax System* report released in May 2010 recommended that revenue from fuel tax imposed for general government purposes should be replaced over time with revenue from more efficient broad-based taxes.

4.42 The report also recommended that fuel tax should apply to all fuels used in road transport on the basis of energy content, and be indexed to the consumer price index (CPI).

Why is government action needed?

4.43 Since the cessation of fuel tax indexation in March 2001 the real value of fuel tax has declined with inflation, creating significant difficulties for the Government to fund spending commitments, such as new road infrastructure projects. At the time of the indexation freeze, fuel

tax represented 43.4 per cent of the average national petrol price. By March 2014 this proportion had fallen to 25 per cent.

4.44 In the 2014-15 Budget the Government committed to increasing road expenditure, with around $26 billion of Commonwealth spending planned for road infrastructure projects. An increase in the rate of fuel tax would be used to help fund these infrastructure projects. This would create a link between the users of the road infrastructure and the payers of fuel tax whilst ensuring a predictable and growing source of revenue.

4.45 Unlike fuel, rates on alcohol and tobacco are currently indexed. Alcohol (excluding wine) is indexed to the CPI, which changes biannually in February and August every year. As of March 2014, tobacco has changed from CPI indexation to Average Weekly Ordinary Time Earnings (AWOTE) indexation and is now indexed in March and September every year.

What policy options are you considering?

Option 1: Biannual CPI indexation

4.46 Beginning 1 August 2014 the excise and excise-equivalent customs duty on all non-aviation fuels are indexed to the CPI, occurring on 1 February and 1 August each year thereafter based on the sum of the CPI movements in the two quarters prior to the indexation date.

4.47 The duty on gaseous fuels will increase on 1 July 2014 in accordance with their transition into the fuel tax system, and will then have biannual CPI indexation applied to them from 1 August 2014. On 1 July 2015 the duty rate will then rise by an interval such that it maintains a 50 per cent discount on the energy content equivalent rate with the application of indexation.

4.48 For consumers of petrol and diesel, the reintroduction of indexation is expected to result in an initial price increase of around 0.5 cents per litre on 1 August 2014.

4.49 By the end of the forward estimates period in July 2018 the biannual indexation of fuel excise and excise-equivalent customs duty is estimated to result in a total increase in petrol and diesel prices of 4.2 cents per litre, which includes a 0.4 cent per litre increase in GST which is levied on the duty-inclusive price.

Option 2: Quarterly CPI indexation

4.50 Beginning 1 August 2014 the excise and excise-equivalent customs duty on all non-aviation fuels are indexed to the CPI, occurring on 1 February, 1 May, 1 August and 1 November each year thereafter based on the CPI movement in the quarter prior to the indexation date.

4.51 The duty on gaseous fuels will increase on 1 July 2014 in accordance with their transition into the fuel tax system, and will then have quarterly CPI indexation applied to them from 1 August 2014. On 1 July 2015 the duty rate will then rise by an interval such that it maintains a 50 per cent discount on the energy-content equivalent rate with the application of indexation.

4.52 For consumers of petrol and diesel, the reintroduction of indexation is expected to result in a price increase of around 0.5 cents per litre after two indexation periods.

4.53 By the end of the forward estimates period in July 2018, the quarterly indexation of fuel excise and excise-equivalents customs duty will result in a larger increase in petrol and diesel prices than the biannual indexation due to compounding effects.

Option 3: A one-off increase of four cents

4.54 On 1 August 2014 the excise and excise-equivalent customs duty rates on petrol and diesel are increased by 4 cents per litre, with all other non-aviation fuels having pro-rated increases. This would increase the duty rate on petrol and diesel from 38.143 cents per litre to 42.143 cents per litre.

4.55 Gaseous fuels would continue to increase at the same intervals as previously until they reach their full rate on 1 July 2015 and then have an additional 10.5 per cent increase on 1 July 2016, bringing the duty rate on gaseous fuels back in line with 50 per cent of the energy equivalent rate.

What is the likely impact of each option?

Fuel wholesalers and importers

4.56 The Australian Competition and Consumer Commission (ACCC) currently publishes an annual price monitoring report on the

Australian petroleum industry. The most recent was published in December 2013. [1]

4.57 In that report, the ACCC stated that the wholesale market for petroleum is dominated by four major players (BP, Shell, Caltex and Mobil). These four entities accounted for 92 per cent of wholesale petrol sale volumes in 2012-13.

4.58 According to further data provided by the Australian Taxation Office (ATO), there are fewer than 100 remitters of fuel excise (excluding aviation fuel remitters).

4.59 For the options which change the current treatment of fuel tax (all options), the initial compliance cost imposed on wholesale remitters is likely to be felt through the need for an update to their systems to enable changes to the rate they apply when on-selling the fuel.

4.60 As a result, the compliance cost assessment uses the average wage in the IT industry of $47 per hour and assumes an average of five hours to update each of the 97 fuel companies. This creates a total compliance cost for the industry of approximately $22,795 for all of the considered options (a Regulatory Burden and Cost Offset (RBCO) Estimate Table for option 1 is provided at Appendix A).

4.61 However, some of the oil companies may not need the initial update to their systems as they will already have the ability to account for changing duty rates.

4.62 There will also be ongoing compliance costs for the options, as a legislative change to the fuel excise and excise-equivalent customs duty will result in either biannual (Option 1), quarterly (Option 2) or once-off (Option 3) changes to the duty rate that the wholesalers charge purchasers of fuel. Each change with indexation will require the manual inputting of a new duty rate into the company's systems, with reference to the new duty rate announced by the ATO.

4.63 The compliance costs for this action are assumed to be completed by administrative staff paid an average of $27 per hour, taking half an hour to find and change the excise and customs duty rates in the company's system and done either biannually, quarterly or once only, depending upon which option is chosen. This creates a total compliance

1 Australian Competition and Consumer Commission (2013) *Monitoring of the Australian petroleum industry 2013 — Report of the ACCC into the prices, costs and profits of unleaded petrol in Australia*; www.accc.gov.au/publications/monitoring-of-the-australian-petroleum-industry.

cost for the industry of $2,619 for biannual indexation, $5,238 for quarterly indexation or $1,309 for the one-off increase (which would be the same as for an annual indexation option).

4.64 The indexed rates of fuel tax will be calculated by the ATO every indexation period, which will save businesses the need to calculate the new rate themselves by applying CPI to the present duty rate.

4.65 The size of these compliance costs is likely to vary from wholesaler to wholesaler, with smaller remitters of duty likely to face greater compliance cost relative to the four large oil companies.

Households and businesses

4.66 By re-introducing biannual indexation by the consumer price index of excise and excise-equivalent customs duty (Option 1) for all fuels except aviation fuels, the Government would generate $2.2 billion over the forward estimates period.

4.67 The price impact of any increase in fuel excise and excise-equivalent customs duty will fall most heavily on households and owners of light commercial vehicles used on-road. However, there will be no increase in the compliance costs borne by these groups.

4.68 Similarly, the effect on demand of an increase in the fuel tax is expected to be minimal, due to the inelasticity of demand for most fuel products. The *Australia's Future Tax System* consultation paper noted that 'due to limitations in current technology and distribution systems, the demand for transport fuels is relatively unresponsive to price'.[2]

4.69 Fuel used in heavy (that is, more than 4.5 tonnes gross vehicle mass) on-road vehicles and business off-road use will not bear the burden of any fuel excise increases because of their entitlements to fuel tax credits. For off-road activities, this is the full reimbursement of fuel tax while for heavy on-road vehicles this is equivalent to the fuel tax rate minus the road user charge.

4.70 However, businesses with access to fuel tax credits may still face increased compliance costs. Fuel purchase records will need to be categorised before and after the indexation date and variable fuel tax credit entitlements will need to be calculated for standard reporting

2 Australia's Future Tax System (2008) *Consultation Paper*; http://taxreview.treasury.gov.au/content/downloads/consultation_paper/consultation_paper.pdf.

businesses with either quarterly or annual business activity statements (BAS). This will occur under any of the considered options to change the duty rates (all options), but will be an ongoing cost every six- or three-month period under the indexation options (Options 1 and 2).

4.71 The indexation of fuel excise will also further affect those businesses which rely on their own software to calculate their fuel tax credit claims, as they will have to manually enter the new excise rate every indexation period.

4.72 The ongoing compliance costs for these actions depend on which option is chosen and may occur once-off, biannually or quarterly. Assuming that all (approximately 186,000) fuel tax credit claimants are similarly affected by either filing a BAS quarterly or annually or through having to update their own software every month, the compliance costs are estimated at $27 per hour for a single administrative staff member to either sort through the fuel purchase records or change the excise rate in the software within half an hour. This creates a total compliance cost for the industry of $5,037,903 for biannual indexation, $10,075,806 for quarterly indexation or $2,518,952 for the once-off increase.

4.73 Businesses with an entitlement to offsetting fuel tax credits may also face the possibility of increased cash flow issues due to a larger immediate outgoing of fuel tax, as they only receive the credit for fuel tax paid at the end of their tax period when they lodge their BAS.

4.74 As a result of the more frequent indexation periods and the fixed time costs of any rate changes, quarterly indexation (Option 2) would likely involve higher compliance costs than biannual indexation (Option 1).

Alternative fuels

4.75 The gaseous fuels are not yet through their transition into the fuel tax system, which is set to be completed on 1 July 2015. Reintroducing fuel tax indexation will further raise the scheduled increases in their fuel tax.

4.76 The Government announced in the 2014-15 Budget that it will make changes to the tax treatment of ethanol and biodiesel to end their respective industry support grants, the Ethanol Production Grants and the Cleaner Fuels Grants Scheme. This is planned to begin on 1 July 2015 with the immediate cessation of the grants and a simultaneous reduction of the excise rate on domestically produced ethanol and biodiesel from its current rate of 38.143 cents per litre to zero. The customs duty rate on imported ethanol and biodiesel will remain at 38.143 cents per litre. Over the following five years to 2020-21, both products will be phased into the

excise system until they reach 50 per cent of the energy content equivalent excise rate, similar to the expected treatment of gaseous fuels after 1 July 2015.

4.77 At current excise rates, 50 per cent of energy content equivalence would be 12.5 cents per litre for ethanol (increasing in 2.5 cent intervals over the five years) and 19.07 for biodiesel (in 3.814 cent intervals). However, during the transition period, ethanol and biodiesel will be subject to indexation along with other non-aviation fuels, which will further raise the scheduled increases in their excise.

Consultation

4.78 A targeted consultation process on the compliance costs associated with a change to biannual fuel duty indexation was undertaken. The four major fuel manufacturers in the Australian market (BP, Shell, Caltex and Mobil) have been consulted on the estimated costs associated with the reintroduction of fuel duty indexation.

4.79 While the fuel manufacturers are not overly concerned about the costs of updating their systems, they do have concerns about the time between the announcement of the new duty rate each indexation period and its application on 1 August or 1 February as they consider this could lead to disputes over payments from customers.

4.80 These timing concerns are largely driven by the relevant CPI figures only being released in late July and late January for the August and February indexation periods, respectively. This gives the fuel manufacturers approximately one week to be forewarned of the new duty rate by the ATO and Customs. One weeks' notice for the new rate was standard practice in the years between 1983 and 2001, prior to the freezing of indexation for fuel products, and has continued to be standard practise for alcohol and tobacco duty (prior to tobacco moving to AWOTE indexation in March 2014).

4.81 Concerns were also raised about the impact of indexation on tying up working capital, as there is normally a delay between when the manufacturers remit excise and customs duty and when they receive payment from their customers.

4.82 Further, the fuel manufacturers also raised concerns about the costs involved with informing customers of changed prices. However, given the constant price volatility in fuel markets, the additional costs from fuel indexation involved with this are considered to be negligible in the context of the overall compliance costs of $5.1 million.

Conclusion and recommended option

4.83 In view of the Government's commitment to deliver new road infrastructure projects through a predictable, growing source of revenue, it is considered that the reintroduction of some form of indexation of fuel tax (Options 1 or 2) is the preferred option.

4.84 Given that biannual indexation was a standard feature of the fuel tax system prior to 2001 and due to the additional compliance costs expected from quarterly indexation (Option 2), the biannual indexation of fuel excise to the CPI from 1 August 2014 (Option 1), is the preferred option. In addition, in comparison to annual indexation, biannual indexation would also result in a larger source of revenue which would allow the Government to more easily fund spending on new road infrastructure projects.

4.85 To further simplify the compliance burden on businesses, rounding the duty rate of indexed fuels from three decimal places in a cent to one decimal place would also be recommended. On the current rate for petrol, this would have the effect of reducing the excise and excise-equivalent customs duty rate from 38.143 cents per litre to 38.1 cents per litre.

Implementation and review

4.86 The proposed approach is to biannually index non-aviation fuel excise and excise-equivalent customs duty to the CPI from 1 August 2014 by the introduction of legislation into the Parliament.

4.87 The legislation would modify the *Excise Tariff Act 1921* and the *Customs Tariff Act 1995*. These modifications will result in the reintroduction of the indexation to the CPI of excise and excise-equivalent customs duty on fuel products. In addition, the applicable duties will now be applied by rounding to one decimal place for the purpose of remitting excise and the claiming of fuel tax credits.

4.88 To ensure that the fuel tax credit system works effectively, modifications will also be made to the *Fuel Tax Act 2006*. These modifications seek to ensure that the same indexed rate is used for determining the amount of excise or excise-equivalent customs duty payable on the fuel and the amount of the fuel tax credit for the same fuel.

4.89 Further changes to the *Fuel Tax Act 2006* will also ensure that the road user charge is designated to three decimal places after the next determination by the Transport Minister as well as during the transition

period prior to this determination, in order to prevent additional compliance burdens through an early determination.

4.90 A separate Fuel Indexation (Road Funding) Special Account Bill 2014 will establish a special account in order to ensure that all net additional revenue gained from the indexation of fuel duty is used to fund the provision of new road infrastructure projects.

4.91 Consequential amendments will also be made to the Energy Grants (Cleaner Fuels) Scheme Regulations 2004 to ensure that the Cleaner Fuels Grants Scheme continues to fully offset the increased fuel duty applying to biofuels. Further amendments will be made to the *Excise Act 1901* and the *Financial Management and Accountability Act 1997* to ensure the proper functioning of the fuel duty indexation measure.

Appendix A: Regulatory Burden and Cost Offset Estimate Table

Average Annual Compliance Costs (from Business as usual)				
Costs	Business	Community Organisations	Individuals	Total Cost
Total by Sector	$5,063,317.00	$0	$0	$5,063,317.00
Cost offset	Business	Community Organisations	Individuals	Total by Source
Agency	$5,063,317.00	$0	$0	$5,063,317.00
Within portfolio	$0	$0	$0	$0
Outside portfolio	$0	$0	$0	$0
Total by Sector	$5,063,317.00	$0	$0	$5,063,317.00
Proposal is cost neutral? ☑ yes □ no				
Proposal is deregulatory □ yes ☑ no				
Balance of cost offsets (**$132,988,606.10**)				

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Schedule 1: Roll-overs for business restructures

Bill reference	*Paragraph number*
Subclause 4(1)	1.91
Item 1, Division 615	1.38, 1.66, 1.75
Item 1, section 615-1	1.74
Item 1, sections 615-5 and 615-10	1.70
Item 1, sections 615-5 and 615-45	1.39
Item 1, subsections 615-5(2) and 615-10(2)	1.43
Item 1, sections 615-15, 615-20, 615-25, 615-30 and 615-35	1.71
Item 1, section 615-30	1.68
Item 1, sections 615-40, 615-45, 615-50, 615-55 and 615-60	1.72
Item 1, paragraphs 615-45(c) and (d)	1.58
Item 1, section 615-50	1.44
Item 1, subsection 615-50(3)	1.48
Item 1, section 615-55	1.50
Item 1, subsection 615-55(1)	1.51, 1.56
Item 1, subsection 615-55(2)	1.57
Item 1, section 615-60	1.42
Items 2 to 36, note 5 to section 121AS in the *Income Tax Assessment Act 1936*, paragraph 103-25(3)(a), table items 9, 10, 14D and 14E in section 112-115, subparagraphs 124-20(3)(a)(i) to (ii) and (v) to (vi), Subdivisions 124-G and 124-H, subsection 124-795(3), notes to subsections 124-795(3), 125-70(5) and 703-5(2), Group heading before section 703-65, note to section 703-65, heading to section 703-70, subsections 703-70(1) and (2), notes to subsection 703-70(2) and (3), heading to section 703-75, subsection 703-75(1), note to subsection 703-75(1), subsections 703-75(2) and (3), heading to 703-80, subsection 703-80(1) and note 2 to section 703-80 in the ITAA 1997, subsections 58T(1) and (2) and the note to subsection 58T(2) in the *Petroleum Resource Rent Tax Act 1987* and paragraph 45-705(4)(a), subparagraphs 45-705(4)(d)(i) and (ii) and paragraphs 45-705(d) and 45-740(2)(a) in Schedule 1 to the *Taxation Administration Act 1953*	1.76
Items 37 and 38, paragraphs 124-860(4)(b) and 126-225(1)(b)	1.63
Subitems 39(1) and (2)	1.78
Subitem 39(2)	1.85
Subitem 39(3)	1.86

Bill reference	*Paragraph number*
Item 40	1.90
Item 41, section 615-5 of the *Income Tax (Transitional Provisions) Act 1997*	1.79
Item 41, sections 615-10, 615-15 and 615-20 of the *Income Tax (Transitional Provisions) Act 1997*	1.80, 1.81

Schedule 2: MIT withholding regime for foreign pension funds

Bill reference	*Paragraph number*
Subclause 4(2)	2.17
Items 1 and 2, section 840-800 and subsection 840-805(4A)	2.11
Item 2, subsection 840-805(4C)	2.13
Items 2 and 3, subsection 840-805(4B) and the definition of 'foreign pension fund' in subsection 995-1(1)	2.12
Item 4, subsections 18-32(3) and (4)	2.14
Item 5	2.15

Schedule 3: Income tax exemption for Force Posture Initiatives

Bill reference	*Paragraph number*
Item 1, subsection 23AA(1)	3.15
Item 2, subsection 23AA(1)	3.18
Item 2, subsection 23AA(1) definition of 'Force Posture Agreement'	3.28
Item 3	3.29

Schedule 4: Fuel tax credits

Bill reference	*Paragraph number*
Subclause 2(1)	4.26, 4.27
Items 1 and 3, subsections 43-5(2A) and 43-10(6) of the *Fuel Tax Act 2006*	4.20
Item 1, subsection 43-5(2A) of the *Fuel Tax Act 2006*	4.21
Bill reference	***Paragraph number***
Items 2 and 4, subsections 43-6(1) and 43-6(2), section 110-5 (definition of fuel tax) of the *Fuel Tax Act 2006*	4.9
Item 2, subsections 43-6(3) and 43-6(4) of the *Fuel Tax Act 2006*	4.14
Item 5	4.24

Schedule 5: Energy Grants (Cleaner Fuels) Scheme

Bill reference	*Paragraph number*
Item 1, subregulations 3A(2) and 3A(3) of the *Energy Grants (Cleaner Fuels) Scheme Regulations 2004*	4.23
Items 1 to 5, subregulation 3A(1), Regulations 6 and 7C of the *Energy Grants (Cleaner Fuels) Scheme Regulations 2004*	4.22