

EXPLANATORY STATEMENT

Issued by authority of the Assistant Treasurer

A New Tax System (Goods and Services Tax) Act 1999, Superannuation Industry (Supervision) Act 1993

Tax and Superannuation Laws Amendment (2016 Measures No. 1) Regulation 2016

Section 177-15 of the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act) and section 353 of the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) (the Acts) provide that the Governor-General may make regulations prescribing matters required or permitted by the Acts to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Acts.

The *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Regulation 2016* (the Regulation) amends the *A New Tax System (Goods and Services Tax) Regulations 1999* (the GST Regulations) and the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations) to make consequential amendments to account for changes to the tax law made by the *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2016* and the *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Act 2016*.

Schedule 1 to the *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016* amends the GST Act to ensure that supplies made by foreign suppliers would be subject to goods and services tax (GST) in circumstances where equivalent supplies by an Australian supplier are subject to GST.

Consistent with the objectives of ensuring equivalent GST treatment, the same GST concessions are available for supplies made by foreign suppliers as are available for domestic suppliers. However, in some circumstances the current rules for the GST treatment of financial supplies make use of Australian regulatory requirements that foreign financial institutions cannot feasibly satisfy. This would mean that foreign bank accounts and superannuation fund interests would be subject to GST rather than input taxed (input tax supplies are not subject to GST, but the entity making the supply is also not entitled to related input tax credits).

Applying GST on these supplies would be impractical and impose excessive compliance and administrative costs on taxpayers and the Australian Taxation Office.

The Regulation extends the definition of ‘financial supply’ in the GST Regulations so that it would include the supply of bank accounts and superannuation interests by foreign financial institutions in circumstances where an equivalent supply by an Australian entity is an input taxed financial supply.

These amendments apply to tax periods commencing on or after 1 July 2017, but only if Schedule 1 to the *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016* commences.

Similarly, Schedule 1 to the *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2016* amended the income tax law to change the capital gains tax (CGT) treatment of rights to future payments linked to the performance of a business or business assets following the sale of the business.

The amendments broadly treat these payments as being part of the original transaction for the sale of a business rather than relating to a separate asset for the purposes of CGT. This ensures that the tax system does not inappropriately discourage the sale of businesses subject to such rights as a way of facilitating transactions despite different expectations about the future performance of the business.

As the potential future payments can affect the size of the capital gain or loss from the sale, the amendments also broadly allow taxpayers to wait until all such payments have been finalised before accessing some CGT concessions. These CGT concessions include the small business retirement concession that permits taxpayers to place the proceeds of the sale of their business into superannuation despite the normal contribution caps. However, in some circumstances, delaying making contributions may result in taxpayers being unable to make contributions, due to the restrictions in the SIS Regulations on when funds can accept contributions.

The Regulation creates an exception to the contribution restrictions, allowing funds to accept a contribution of an amount of the proceeds of the sale of a business to which the small business retirement concession applies. This is provided the sale involved an earnout right and the contribution would not have been affected by the contribution restrictions had it been made during the financial year in which the business was sold.

These amendments apply in relation to look-through earnout rights created on or after 24 April 2015, consistent with the application of Schedule 1 to the Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2016.

This means that the amendments could potentially apply to transactions entered into prior to the commencement of the Regulation. To the extent that may occur, it is wholly to the benefit of affected taxpayers, allowing potential access to concessions when this would otherwise be unavailable.

Details of the Regulation are set out in the [Attachment](#).

The Regulation is a legislative instrument for the purposes of the *Legislation Act 2003*.

These amendments are both consequential amendments required by changes to principal legislation. The financial and compliance costs impacts of these amendments were included in the estimates provided for the principal amendments, which are detailed in the Explanatory Memoranda to the *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2016* and the *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016* (the Explanatory Memoranda).

Public consultation on the amendments made by Schedules 1 and 2 likewise took place in the context of consultation on the amendments to the principal legislation as detailed in the Explanatory Memoranda.

Schedule 1 to the Regulation commences on the later of the day after the Regulation is registered or the day the *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016* commences. It does not commence at all if that Bill does not commence.

Schedule 2 to the Regulation commences on the day after the Regulation is registered.

Statement of Compatibility with Human Rights

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

Tax and Superannuation Laws Amendment (2016 Measures No. 1) Regulation 2016

This Regulation 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 of the Legislative Instrument

This Regulation makes consequential amendments to account for changes to the tax law made by the *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2016* and the *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016*.

Specifically:

- Schedule 1 to the Regulation extends the definition of ‘financial supply’ in the *A New Tax System (Goods and Services Tax) Regulations 1999* so that it includes the supplies of bank accounts and superannuation interests by foreign financial institutions in circumstances where an equivalent supply by an Australian entity is an input taxed financial supply; and
- Schedule 2 to the Regulation creates an exception to the superannuation contribution restrictions, allowing funds to accept a contribution of an amount of the proceeds of the sale of a business to which the small business retirement concession applies. This is provided the sale involved an earnout right and the contribution would not have been affected by the contribution restrictions had it been made during the financial year in which the business was sold.

These changes address anomalies that would otherwise arise from the operation of the primary legislation.

Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.

While in some circumstances it is possible for the amendments relating to capital gains tax earnout rights and superannuation to have effect in relation to transactions entered into prior to the commencement of the Regulation, the effect will be wholly beneficial, allowing potential access to concessions when this would otherwise be unavailable.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues.

Details of the Tax and Superannuation Laws Amendment (2016 Measures No. 1) Regulation 2016

Section 1 – Name of Regulation

This section provides that the name of the Regulation is the *Tax and Superannuation Laws Amendment (2016 Measures No. 1) Regulation 2016* (the Regulation).

Section 2 – Commencement

This section provides that the Regulation commences on the day following registration.

Schedule 1 to the Regulation commences on the later of the day after the Regulation is registered or the day the Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016 commences. It does not commence at all if that Bill does not commence.

Schedule 2 to the Regulation commences on the day after the Regulation is registered.

Section 3 – Authority

This section provides that the Regulation is made under the *A New Tax System (Goods and Services Tax) Act 1999* and the *Superannuation Industry (Supervision) Act 1993*.

Section 4 – Schedules

This section provides that each instrument that is specified in a Schedule to this instrument is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to this instrument has effect according to its terms.

Schedule 1 – GST and foreign bank accounts and superannuation interests

Schedule 1 to the Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016 proposes amendments to the GST Act to ensure that supplies made by foreign suppliers would be subject to goods and services tax (GST) in circumstances where equivalent supplies by an Australian supplier would be subject to GST.

This extension means that it is now much more likely that GST will apply to supplies made by non-resident entities outside of Australia. Generally, this will operate without any problems. However, a number of concessions operate by reference to the nature of the entity making a particular supply or supplies. Sometimes concessions of this sort define the entity by reference to Australian regulatory requirements or status.

The use of these requirements in GST concessions does not give rise to any issues for entities operating in Australia, as these entities are generally subject to the relevant regulation when making the supply. However, non-resident entities may not be subject to the relevant rules. While none of these requirements are tied to nationality or residence, in practice non-residents rarely seek to comply with the regulatory requirements of jurisdictions in which they do not operate.

For example, the supply of an interest in a bank account is only an input taxed financial supply if, broadly, it is provided by an authorised deposit-taking institution

(ADI). This limit is in place because the supply of a bank account in Australia by an entity other than an ADI or other entity authorised by State and Territory law is illegal. However, a foreign bank may supply a foreign bank account to an Australian resident without this being contrary to any law. A foreign bank may become an ADI, but in practice has little reason to do so if it does not intend to carry on a banking business in Australia.

Generally this policy outcome, under which GST may apply to certain imported services even where similar domestic supplies are generally GST free or receive some other concession, is considered acceptable. The various concessions provided under the GST law have intentionally been linked to the supplier meeting relevant standards – there is no reason to revisit the existing legislative and policy arrangements in relation to GST concessions in the context of these amendments.

However, unlike many other concessions in the GST law, the input taxed treatment of financial supplies is not a result of any policy decision to assist individuals consuming these supplies. Rather, financial supplies are input taxed because there are difficulties in working out the consideration for certain financial supplies in order to apply GST - specifically the value of the use of the capital held by the entity.

In the context of these amendments, this means that even though in theory it would be acceptable if certain supplies by non-residents were to become taxable, the difficulty of determining the consideration makes this impractical.

Most supplies in the current list of financial supplies are not defined by specific Australian regulatory requirements. As a result, no practical issues generally arise for suppliers operating outside Australia. However, there are two types of financial supplies that are defined by reference to specific Australian regulatory concepts:

- the supply of an interest in a bank account, which under the GST law must be supplied by an ADI or an entity licensed to conduct banking business under a State and Territory law; and
- the supply of an interest in a superannuation fund, which under the GST law only includes interests in regulated superannuation funds, approved deposit funds, pooled superannuation trusts and public sector superannuation schemes.

The amendments made to the *A New Tax System (Goods and Services Tax) Regulations 1999* by the Regulation extend the definition of financial supplies to include:

- the supply of an interest in a bank account by a non-resident in the context of its regulated banking business; and
- the supply of an interest in a superannuation fund by a foreign superannuation fund.

As a result of the amendments, the supply of a bank account by a foreign entity carrying on banking business is an input taxed financial supply even if the entity is not an Australian ADI.

Similarly, the supply of an interest in a foreign superannuation fund is likewise input taxed even if the fund has not met the requirements to be a regulated superannuation fund, approved deposit fund or pooled superannuation trust. This ensures there is no

need for suppliers and the Australian Taxation Office to determine the value of the consideration for these supplies.

These amendments apply to working out net amounts for tax periods commencing on or after 1 July 2017, but only if Schedule 1 to the Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016 commences.

Schedule 2 – Superannuation contribution restriction and earnout rights

Schedule 1 to the *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2016* amends the *Income Tax Assessment Act 1997* (ITAA 1997) to change the capital gains tax (CGT) treatment of the sale and purchase of businesses involving certain earnout rights – rights to future payments linked to the performance of an asset or assets after sale.

As a result of these amendments, capital gains and losses arising in respect of look-through earnout rights are disregarded. Instead, payments received under the earnout arrangements affect the capital proceeds and cost base of the underlying asset or assets to which the earnout arrangement relates.

The amendments also make minor changes to the operation of various CGT concessions in order to ensure that these concessions can apply appropriately to the proceeds of the sale of a business, including payments under earnout rights. Broadly, this is achieved by allowing taxpayers to wait until all payments have been received before choosing whether to access the concession.

Among the concessions that have been modified is the CGT small business 15 year exemption in Subdivision 152-B of the ITAA 1997, which permits a company or trust to disregard an amount in determining its taxable income if, amongst other things, the amount is paid to a CGT concessional stakeholder within two years after the relevant CGT event. Further, under section 292-100 of the ITAA 1997, if the taxpayer receives a payment from a trust or company of the sort to which the CGT small business concession 15 year retirement exemption applies, within two years of the relevant CGT event and subsequently contributes this amount to superannuation, the amount of this contribution does not count towards the non-concessional contributions cap.

In developing these amendments it was identified that, despite the changes to the tax law, restrictions on when contributions can be made in the SIS Regulations could still prevent taxpayers from being able to access the concessions in relation to the sale of a business.

Schedule 2 to the Regulation amends the *Superannuation Industry (Supervision) Regulations 1994* to create an exception to the contribution restrictions, allowing funds to accept a contribution of an amount of the proceeds of the sale of a business to which the small business retirement concession applies provided the sale involved an earnout right and the contribution would not have been affected by the contribution restrictions had it been made during the financial year in which the business was sold.

These amendments apply in relation to look-through earnout rights created on or after 24 April 2015, consistent with the application of Schedule 1 to the *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2016*.